Joint Center for Housing Studies
Harvard University

Landlords at the Margins: Exploring the Dynamics of the One To Four Unit Rental Housing Industry

Alan Mallach

March 2007
RR07-15

Prepared for
Revisiting Rental Housing: A National Policy Summit
November 2006

Abstract

There are 18 million units in one to four unit rental housing properties in the United States, making up half of the nation's rental housing stock, yet this sector of the rental housing industry has been largely neglected both by researchers and by policy-makers. This housing stock is particularly important as a resource for low and moderate income households in cities and older suburbs, and in areas of high immigration, such as northern New Jersey. After an overview of the one to four unit rental inventory nationally, and a closer look at a cluster of New Jersey cities, we examine the characteristics of the owners of this stock, their investment strategies, management and tenant selection decisions, financing options, and their relationships with governmental agencies. We find that there are wide variations within the sector, particularly between three distinct housing subtypes: single family detached, single family attached, and two to four family properties. We then look more closely at the market factors affecting the condition of this stock in low income submarkets, concluding that narrow operating margins and limited tenant incomes place much of the housing in this sector significantly at risk of loss. We conclude with recommendations for public policy and further research. While we find that financing needs for this sector of the rental market appear to be adequately addressed, public policy has tended to foster an adversarial relationship between government and the owners of these units, and needs to be seriously reconsidered. We conclude that there is a need for effective policies that not only recognize the distinct features of this industry, but that explicitly focus on expanding the pool of competent and responsible owners, while providing disincentives for irresponsible and speculative owners, in order to improve both the quality and long-term stability of the stock.

The author acknowledges gratefully the assistance of Erica J. Blake, research associate, and of the many landlords, realtors, lenders and others who offered their time, information and insights to help provide a solid foundation for this paper. The author is also grateful to Eric Belsky and Harold Simon for their helpful comments on the draft paper.

Introduction

There are over 18 million units in one to four unit rental properties in the United States, which make up over half of all of the nation's rental housing. Despite the obvious importance of such a large and distinctive part of the housing stock, it has been given little attention either by those studying or seeking to frame public policy with respect to the nation's housing. Even where studies have recognized it as a distinct sector of the rental housing market (Downs 1983, Goodman, 1999, Apgar 2004), they generally address it in passing, treating it at most as a discreet accompaniment to themes of greater interest to the author. More problematically, other studies of rental housing treat the sector as a largely undifferentiated market, disregarding significant differences between the one to four unit stock and the multifamily stock, differences which have great implications for the framing and execution of future housing policy. Although a small number of studies have looked at specific issues affecting the one to four unit rental stock, or examined its features in a particular geographic area (Newman, 2005), no study has explicitly set out to investigate this sector in the larger framework of the housing market.[1]

The purpose of this paper is to take an initial, preliminary step in that direction. Utilizing a variety of data sources supplemented by interviews with individuals connected to the one to four unit rental housing sector as property owners, financers, brokers or regulators, I have attempted to present a description of this sector, first from a physical and demographic standpoint (where are the units, and who lives in them) nationally and within a cluster of urban areas in the state of New Jersey; second, to sketch a profile of it as a distinct sector within the larger real estate industry, with its own distinctive characteristics, including patterns of ownership and financial, investment and property management strategies; and third, to explore the relationship between the dynamics of this distinctive sector and the features of local housing markets. Although the one to four unit rental housing sector is a diverse one, including suburban and rural housing as well as urban, and expensive as well as affordable units, the principal focus of this paper is on the affordable and largely urban portion of the larger industry.

Based on this description, which is part qualitative, part quantitative, and perhaps part speculative, in the final section I attempt to suggest public policy directions, as well as directions

[1] In contrast to the paucity of serious research on this subject, it is the subject of considerable attention from other sources, particularly local media in rapidly changing urban areas such as Baltimore (Hopkins, 2005). It is also a subject of great interest to what might be called the 'small investor underground,' which has spawned a vast literature of books, articles, videos and web sites aimed at individuals investing in single family rental property.

for further research, with respect to this sector.[2] That further research is needed does not need to be belabored. The one to four unit rental housing sector houses a large share of the nation's low and moderate income households, particularly families with children, and makes up a substantial part of the inventory available for Section 8 voucher holders. The decisions made by its owners and the manner in which it is maintained and preserved are of great significance for national housing policy. Not only are one to four unit rental properties important as a component of the housing stock, but the dynamics of this industry interact in important and not always fully understood ways with other important policy concerns affecting our cities and neighborhoods. As old policies are reconsidered and new ones devised to provide decent, affordable housing and to rebuild our older cities, the role of this sector of the housing market needs to be explicitly and constructively addressed.

Characteristics and Trends in the One To Four Unit Rental Housing Inventory

The distribution of the rental housing stock in the United States in 2000 by property type is presented in Table 1. Roughly 30% of all rental housing is made up of single family houses, mostly detached, with an additional 20% in two to four family properties. The distribution of rental housing by property type varies widely both by geographic division within the United States and by community type. Over 2/3 of all rental housing outside metropolitan areas is in

Table 1: Distribution of Rental Housing Stock by Property Type, 2000

Category	Number of units	Percentage of total
1 unit, detached	8,531,853	23.9%
1 unit, attached	2,087,994	5.9
2 units	3,301,854	9.3
3 to 4 units	4,254,351	11.9
5 to 9 units	4,332,461	12.1
10 to 19 units	3,748,728	10.5
20 to 49 units	3,049,458	8.6
50 or more units	4,798,031	13.5
Mobile home, RV or boat	1,558,858	4.4
TOTAL	35,663,588	100%

Source: US Census, 2000.

[2] In view of the near-total absence of relevant prior studies, a formal survey of the literature as a part of the paper strikes the author as redundant and accomplishing little other than to interrupt the flow of the paper.

one to four family properties, while 2 to 4 unit properties are more common in urban areas. Although rural areas are more heavily dependent on small properties to provide rental housing, they represent only a small part of the overall stock; 80% of the total stock is located in metropolitan areas, roughly evenly divided between central cities and suburbs.

Table 2: Distribution of One To Four Unit Rental Housing Stock by Location

Category	Central cities	Suburbs	Non-metropolitan areas	Total
Single family	25.3%	33.3%	47.1	31.9%
2 to 4 family	23.7	18.0	21.5	21.0
Multifamily	51.0	48.7	31.4	47.1
TOTAL	100%	100%	100%	100%
Single family	34.5	43.7	21.9	100%
2 to 4 family	49.1	35.8	15.1	100%
TOTAL	40.3	40.6	19.2	100%

Source: American Housing Survey, 2003.

Regional variation

While the magnitude of the one to four family rental stock varies little from one part of the country to another, the character of that stock does vary. Two family houses are substantially more prevalent in the Northeast and the mid-western Rust Belt, while single family rentals predominate elsewhere. Predictably, for a region known for its 'triple-deckers', three and four family units make up a far larger part of the rental stock in New England than anywhere else in the United States. While the one to four unit stock is, equally predictably, newer in the southern and western states which have overall a newer housing stock, it is notable that – with the sole exception of New England – single family rental units are consistently, often substantially, older

Table 3(a): Distribution and Age of One To Four Unit Rental Housing Stock By Geographic Division

Category	NE	MA	ENC	WNC	SA	ESC	WSC	MOUN	PAC
Structure types as percentage of total rental stock by division:									
1 family	17.0%	18.3%	28.0%	34.1%	33.2%	37.5%	36.7%	32.1%	32.9%
2 family	17.5	14.4	12.6	8.6	6.8	8.6	6.1	5.5	5.5
3-4 fam	22.6	13.2	12.5	11.3	10.0	11.0	9.1	11.5	11.2
TOTAL	57.1	45.9	53.1	54.0	50.0	57.1	51.9	49.1	49.6
Year built and median age of single family rental housing by division:									
1980-2000	17.7%	13.4%	11.7%	13.2%	26.9%	20.2%	22.3%	28.8%	21.3%
1970-1979	12.6	10.1	11.6	13.1	17.8	17.4	19.9	20.5	18.1
1950-1969	28.0	28.6	32.8	31.4	32.6	36.0	36.1	28.5	35.2
Before 1950	41.6	47.9	43.9	42.3	22.8	26.5	21.7	22.2	25.3
Median	1958	1952	1954	1953	1967	1963	1966	1969	1964
Median all rental housing	1955	1954	1964	1968	1975	1973	1975	1976	1970

Source: US Census 2000.

than the rest of the rental housing stock within their geographic area, with a median age nationally over 50 years. The age of this inventory reflects both that few, if any, single family units are ‘purpose-built’ for rental occupancy, and that rental single family homes are more highly concentrated in central cities (16% of all single family houses, compared to 9% in suburban areas), where the stock is typically the oldest of the state or region. In addition, one can speculate that investors are more likely to buy older and lower-value houses for rental ownership. The age of this particular component of the housing stock has potentially significant implications for preservation issues.

Another noticeable regional difference lies in the proportion of two to four unit properties that are owner-occupied. While nationally only slightly more than 1/3 of all such properties are owner-occupied, the percentage is significantly higher in the Northeast than in the rest of the United States. The regional disparity is, albeit modestly, even more marked with respect to center city properties; while roughly half of 2 to 4 family properties are owner-occupied in Northeastern cities, barely ¼ are owner-occupied elsewhere in the country.

Table 3(b): Percentage of All 2 To 4 Family Properties Owner-Occupied By Region

Category	Northeast	Midwest	South	West
All properties	45.l%	29.5%	29.5%	30.9%
Central city properties	48.0	29.2	24.0	26.4

Source: 2001 Residential Finance Survey.

Demographic Features

Except in the predictable, and important, respect of family size, the occupants of single family rental housing are not markedly different from other renters with respect to their principal demographic characteristics. They have moderately higher incomes (a 2003 median income of \$30,400 compared to a median of \$26,983 for all renters), and are slightly less likely to be people of color (in 2003, 59.8% of single family renters were non-Latino white, compared to 56.5% of all renters). Reflecting the substantially greater size of single family rental units compared to other rental units, the households of single family renters are likely to be larger than other renters, particularly among black and Latino renters – 38.4% of all black single family renter households, and 56.8% of all Latino single family renter households, contained four or more members, compared to only 21.5% of the renter population as a whole, and only 26.7% of white single family renters. Notably, this characteristic does not apply to the renters of 2 to 4 unit properties, whose household size and other demographic characteristics do not differ materially from the renter population as a whole.

Table 4: Distribution of Single Family Renters by Ethnicity and HH Size

Category	Single family renters				All renters
	All renters	White non-Latino renters	Black non-Latino renters	Latino renters	
1 person	22.0%	25.5%	19.7%	9.8%	36.5%
2 person	25.5	28.9	21.2	15.2	26.6
3 person	19.1	18.8	20.6	18.2	15.4
4 person	16.5	15.3	17.6	20.3	11.2
5+ person	16.9	11.4	20.8	36.5	10.2
	100%	100%	100%	100%	100%

Source: US Census 2000.

The household size data illustrates a critical dimension of the one to four family rental market, particularly single family units, and the importance of this sector as a resource for renter families with children. Such families are disproportionately likely to occupy single family units, a pattern likely to increase as new construction of multifamily housing (other than subsidized housing) tends to disproportionately favor small families, single people and empty nesters.

Table 5: Distribution of Renter Households with Children by Structure Type

Category	1 family detached	1 family attached	2-4 family	Multifamily	Total
% of rental inventory	24.1%	7.7%	21.0%	47.2%	100%
% of renters with children in structure type	49.0	41.1	35.8	28.8	
% of total renters with children	32.8	8.8	20.8	37.6	100%

Source: American Housing Survey 2003.

The ethnic disparities noted above reflect an important feature of the single family rental market. As is true of the multifamily market (Goodman, 1999), the single family rental market is far from a homogenous one. While one segment of the market includes large suburban houses renting for $3000 per month in Princeton or Cherry Hill, often occupied by a relocating executive or manager, the other is made up of small row houses rented for one-third of that or less only a few miles away, in Trenton or Camden, often occupied by undocumented immigrants or by a family with a Section 8 voucher. Indeed, the picture presented by the nationwide data fails to reflect the distinctive behavior of the many local geographic sub-markets working in this sector.

This point serves to underscore a particularly important distinction; although the 1 to 4 family rental sector is highly diverse, it represents a disproportionately large share of the *unassisted* rental housing occupied by low income households. As Table 6 illustrates, this sector provides housing for just over 70% of America’s renter households earning less than 50 percent of the median income in their geographic area. As a result, and as will be discussed further below, the preservation of this stock in sound condition carries particular weight with respect to the housing of the nation’s low income population.

Table 6: Distribution of Unassisted Rental Units Occupied by Low Income Households by Property Size

Housing type	% of unassisted low income rental housing
One unit	45.1%
2 to 4 units	25.5%
5 to 19 units	19.4%
20 to 49 units	6.1%
50 or more units	3.9%
TOTAL	100%

Source: Millenial Housing Commission, Finance Task Force, Multifamily Rental Housing Background Paper by Shaun Donovan, 2002. Based on data from the *Annual Housing Survey.*

Trends

Before looking at a representative geographic sub-market, it is appropriate to look at the overall trend line with respect to the one to four family inventory. The three principal components of the inventory – single family detached, single family attached, and two to four family properties – show sharply varying trend lines, reflecting potentially important differences in the workings of their respective markets. The inventory of the largest of the three components, single family detached houses, has been declining steadily in recent years. Between 1995 and 2001, the number of single family detached rental units in the American housing stock declined by slightly over 10%, representing a loss of some 664,000 housing units. Over the same period, the two to four family rental stock showed an even greater loss in relative terms, losing nearly 13% of the 1993 inventory, or 660,000 units. At the same time, however, single family *attached* rentals have increased both in their number and in their share of the total one to four family

Table 7(a): Change in One To Four Family Rental Housing Inventory 1995-2001

Structure Type	1995 Inventory	2001 Inventory	Δ1995-2001	New units added 1995-2001	Δ in pre-1995 inventory	% Δ in pre-1995 inventory
1 family detached	8,569	7,905	- 664	221	- 885	- 10.3%
1 family attached	2,609	3,593	+ 984	360	+ 624	+ 23.9%
2-4 family	7,565	6,905	- 660	294	- 954	- 12.6%

Source: American Housing Survey. All figures in 000.

rental stock, increasing by over a million housing units, and rising from 14% to 20% of this market.[3] Those gains came close to offsetting the losses in the rest of the one to four family rental sector.

The extent to which each of these components is growing or declining is affected by two principal factors: the degree to which newly constructed units become part of the rental inventory, and the extent to which the existing older stock is either moving toward or away from rental occupancy, or depleted through abandonment or demolition. Here as well, each of the components shows a distinct pattern, reflected in Tables 7(b) through (e), showing the change in the inventory by age of the property between 1997 and 2001.

Table 7(b): Units Constructed Between 1995 and 2001 by Tenure

CATEGORY	1 family detached	1 family attached	2 to 4 family
Owner	6,059,000	517,000	50,000
Renter	221,000	360,000	294,000
TOTAL	6,280,000	877,000	344,000
% renter	3.5%	41.0%	85.5%

Source: American Housing Survey 2001.

Table 7(b) shows the distribution of units built since 1995 by tenure. Although there has undoubtedly been some movement between rental and owner-occupancy during this period within this subset of the stock, we would suggest that the 2001 rental share of these units can serve as a proxy for newly constructed units going directly into the rental market. While a small number of newly constructed single family detached units become part of the rental inventory, being bought by absentee landlords rather than homebuyers, it is a very small number of units as well as a minute percentage of total new construction, and offsets only a small part of the loss of existing units from this inventory.

Notably, the rate of loss from the single family detached rental inventory is highest for the more recent units (those built during the 1980's) and lowest for those built prior to World War II. Since the newer units are likely to be more valuable, this suggests that the increase in sales prices relative to rent levels characteristic of recent years may have led a significant number of landlords to sell their properties to homebuyers, in order to cash in on the appreciation

[3] Single family attached structures are those which share a common wall with another structure on one or two sides; i.e., semi-detached (twin) structures and townhouses. Condominium units are classified by the Census and other authorities on the basis of the number of units in the structure, and are not considered attached single family properties.

Table 7(c): Change in Single Family Detached Rental Inventory by Age of Property 1997-2001

Period of construction	1997	Δ97-99	1999	Δ99-01	2001	%Δ97-01
90-99	305	+ 39	344	+ 33	377	+23.6%
80-89	635	- 81	554	- 23	531	- 16.4
70-79	1071	- 19	1052	- 58	994	- 7.2
60-69	1108	- 14	1094	- 76	1018	- 8.1
50-59	1542	- 93	1449	- 21	1428	- 7.4
40-49	1121	- 39	1082	- 59	1013	- 8.7
39 and earlier	2573	- 82	2491	+ 11	2501	- 2.8

Source: American Housing Survey. All figures in 000.

in that market. The relative stability of the pre-1939 inventory, in turn, reflects the extent to which the single family rental market is becoming gradually a slightly more urban market. This also suggests that the age of this inventory, already high compared to other components of the American housing stock, will continue to rise.

The trend line for single family attached houses (row houses and townhouses) is markedly different. Not only are nearly half of all newly constructed units going directly into the rental market, reflecting the fact that many such units are actually part of purpose-built rental developments,[4] but large parts of the inventory in all age ranges are moving from homeowner to renter occupancy, in dramatic contrast to the pattern with respect to both single family detached and 2-4 family structures. The movement of attached houses into the rental inventory, again, is more pronounced on the part of the older units, consistent with data that the urban share of this inventory is also growing.

[4] The definition of single family attached housing for purposes of census and American Housing Survey data singles out units that, while attached to other units by a common wall, are self-contained with respect to egress as well as utility systems. It does not address separate legal ownership or platting on separate lots, thus including 'townhouse style' purpose-built rental developments in which large numbers of units are under single ownership within the totals.

Table 7(d): Change in Single Family Attached Rental Inventory by Age of Property 1997-2001

Period of construction	1997	Δ97-99	1999	Δ99-01	2001	%Δ97-01
90-99	248	+192	440	+119	559	+125.4%
80-89	613	+ 2	615	+ 51	666	+ 8.6
70-79	722	+101	823	- 21	802	+ 11.1
60-69	400	+ 78	478	- 42	436	+ 9.0
50-59	229	+ 54	283	+ 24	307	+ 34.1
40-49	172	+ 92	264	- 42	222	+ 29.1
39 and earlier	425	+138	563	+ 37	600	+ 41.2

Source: American Housing Survey. All figures in 000.

Finally, the trend with respect to two to four family properties varies notably from either of the above trends. While the great majority of newly constructed units are going into rental occupancy – and in most cases absentee ownership – the total volume of new construction is far less than the erosion in the existing stock. In this case, however, the erosion is far greater among

Table 7(e): Change in Two To Four Family Rental Inventory by Age of Property 1997-2001

Period of construction	1997	Δ97-99	1999	Δ99-01	2001	%Δ97-01
90-99	302	+ 91	302	+116	509	+68.5%
80-89	730	+ 80	810	- 53	757	+ 3.7
70-79	1164	- 20	1144	- 3	1141	- 2.0
60-69	792	- 11	781	+ 17	798	+ 0.8
50-59	609	- 131	659	+ 12	671	- 17.2
40-49	742	- 41	701	- 116	585	- 21.2
39 and earlier	2800	- 185	2615	- 171	2444	- 12.7

Source: American Housing Survey. All figures in 000.

the older units in the inventory, those constructed prior to 1960, than the more recent ones. This may reflect the obsolescence of many of these properties, as well as their disproportionate location in areas of relatively weak market performance compared to the single family inventory.

Characteristics and Trends in the New Jersey Urban One to Four Unit Rental Market

In order to look more closely at the characteristics of the one to four family rental sector in a representative cluster of urban areas, we have chosen to focus on the six cities in New Jersey that have historically been considered the state's principal urban centers: Camden, Elizabeth, Jersey City, Newark, Paterson and Trenton.

The Housing Stock

New Jersey differs from its counterparts in the Middle Atlantic States in that the great majority of its one to four unit rental stock is found in two to four unit properties, rather than single family properties, attached or detached. This tendency is reflected in the six cities, where a substantially larger share of the total housing inventory is rental housing. As a result, these cities, although making up roughly 10% of the state's population and housing stock in 2000, contain roughly 25% of the state's inventory of two to four unit rental properties.

Table 8(a): Distribution of Rental Units by Structure Type for New Jersey and Six Major Cities 2000

Category	New Jersey	New Jersey (% of all rental units)	6 Cities	6 cities (% of all rental units)	6 cities as % of NJ total
1 family detached	121,108	11.5%	8,623	3.9%	7.1%
1 family attached	69,181	6.6	18,150	8.1	26.2
2 family	184,778	17.5	43,885	19.6	23.8
3-4 family	155,555	15.8	45,133	20.2	27.1
All 1-4 unit rental	541,622	51.4	115,791	51.8	21.4
ALL UNITS	3,064,645	100%	318,838	100%	10.4%

Source: US Census 2000.

The distribution of units by housing type within the sector varies markedly among the six cities, reflecting a fundamental north/south division in the character of the older housing stock not only in New Jersey, but in the Northeastern United States. In the cities within the New York orbit – Elizabeth, Jersey City, Newark and Paterson – two to four family units predominate, representing 36% to 55% of the total rental stock. In the two cities historically within the larger Philadelphia market – Camden and Trenton – single family attached units represent a far larger share of the rental housing stock.[5] The northern cities, similar to cities in Connecticut and Massachusetts, have an older housing stock typically of frame construction, including large numbers of two and three family buildings. In those cities, single family structures tend to be fewer and more limited to historically upscale residential areas. The older housing stock in the two southern cities, similar to seaboard cities from Philadelphia to the District of Columbia, is typically of brick construction, and largely made of single family attached and semi-detached

[5] Although Trenton is considered to be part of the Northern New Jersey Metropolitan area today, reflecting the far greater economic reach of the New York area, it was historically and culturally part of the Philadelphia area from its colonial origins, when it was founded by Philadelphians, at least through the middle of the last century.

units.[6] These single family houses were the typical housing stock provided for the industrial working class during the principal period of these cities' growth, between 1880 and 1930.

Table 8(b): Distribution of Rental Units by Structure Type for the Six Cities

CATEGORY	Camden	Elizabeth	Jersey City	Newark	Paterson	Trenton
1 family detached	8.1%	4.8%	2.8%	4.1%	5.0%	6.1%
1 family attached	42.9	4.7	3.3	4.9	3.4	28.9
2-4 family	19.7	40.0	36.4	40.6	55.3	29.2
Multifamily	29.3	50.5	57.5	50.4	36.3	35.7
1-4 unit structures as % of all rentals	70.7%	49.5%	42.5%	49.6%	63.7%	64.3%

Source: US Census 2000.

Although the data do not permit us to distinguish in this respect between single family attached and detached properties, it is clear that the share of such properties in these cities' rental housing inventory is growing significantly. Even allowing for a significant margin of error with respect to the Census data on age of structure, a comparison of 1990 and 2000 Census data shows not only that newly constructed single family units are being added to the rental inventory, but that a significant shift from owner-occupancy to absentee ownership is taking place within the existing stock.

Table 9(a): Change in Single Family Rental Inventory 1990-2000

Category	Camden	Elizabeth	Jersey City	Newark	Paterson	Trenton
(A) 1990 single family rental units	6,665	1,192	2,333	3,802	2,013	4,485
(B) Single family rental units constructed 1990-2000	254	195	416	1,194	97	130
(A)+(B)	6,919	1,387	2,749	4.996	2.110	4,615
(C) 2000 single family rental units	6,660	2,693	3,893	6,308	2,573	5,646
(D) Net rental shift in existing single family stock (C) – (B)	- 259	+1,306	+1,144	+1,312	+463	+1,031
(D) as % of 1990 ***owner occupied*** single family units	NA	19.5%	13.0%	15.5%	7.3%	7.0%

Source: US Census 1990 and 2000.

[6] Nearly all of the single family housing in Camden is made up of extended, generally block-long, rows of attached houses. A significant percentage – probably a majority – of the older single family housing in Trenton is semi-detached; that is, a two family house in which the two units are separated by a vertical party wall.

The inventory of single family rental housing grew in five cities; in Camden, although it declined, it did so at a significantly lower rate than the city's occupied housing inventory as a whole, which dropped by 20% between 1990 and 2000. In three cities clustered closely to one another and to New York City – Elizabeth, Jersey City and Newark – newly constructed units alone added more than 10% to the inventory between 1990 and 2000, while the additions to the single family rental inventory from the pre-1990 stock represented more than 10% of the 1990 *owner occupied* single family stock in these cities. While a one-to-one correspondence between increases in the absentee-owned stock and decreases in the owner-occupied stock cannot be claimed, over time there is nonetheless likely to be a reasonably close relationship between the two.[7]

Growth of the Inventory through New Construction

If anything, the rate of increase in the one to four unit rental inventory, and in particular the two family rental stock, in these three cities is likely to have accelerated since 2000, as reflected by building permit data. Over the most recent six year period, from 2000 to 2005, these three cities authorized construction of over 12,000 units in one to four family structures, of which we estimate that roughly 7,500 are likely to be rental units.[8]

This extraordinarily high level of new construction for landlocked cities that were all but fully developed before World War II, which can be projected to increase the two family rental inventory in Elizabeth by 30% and in Newark by over 40% by 2010, results from the conjunction of a number of separate factors. The presence of strong market demand is a threshold condition. The great majority of these units are being constructed without public capital subsidy, although

[7] Many factors can result in changes in one without changes in the other, including occupancy (with or without rehabilitation) of previously vacant units, conversion of non-residential space, conversion of two family units into single family housing, and the like. A further factor that must be recognized is the less than complete reliability of Census data.
[8] The estimate was made by calculating the percentage of rental units of all occupied units by structure type (1 unit, 2 units and 3-4 units) in each city in 2000, and multiplying that percentage by the number of building permits by structure type and city.

Table 9(b): Construction of New One to Four Unit Rental Housing 2000-2005

CATEGORY	Elizabeth	Jersey City	Newark	3 city total
A. Total units authorized by structure type				
One family	246	329	1029	1604
Two family	1958	2364	3848	8170
3-4 family	89	197	2651	2937
B. Estimated number of rental units authorized by structure type				
One family	37	69	319	425
Two family	1147	1333	2224	4704
3-4 family	74	157	2115	2346
C. Percentage increase in rental stock from 2000 represented by new construction by structure type				
One family	1.4%	1.8%	5.1%	3.3%
Two family	19.1	10.5	23.9	16.8
3-4 family	1.4	1.5	11.2	6.8

Source: US Census, New Residential Construction Reports (provided by NJ State Data Center).

Newark's developers receive the benefits of tax abatement and, in some cases, have been able to buy city-owned land for development at below-market or even nominal prices. Equally important is the fact that two and three family structures are a highly efficient product in a market where, notwithstanding the presence of strong demand, there are few players other than relatively small-scale locally-based developers, and assembling large redevelopment sites is difficult.[9]

Construction of two and three family structures is adaptable to lots of almost any size and configuration, requires little sophistication in construction and little investment in expensive equipment, and, since the buildings can be sold individually as each one is completed, requires significantly less long-term capital outlay and debt exposure than more complex multifamily or mixed use development projects. Just as the ownership of two to four family rental structures has historically been a 'mom and pop' matter, the construction of such properties appears to be a similar small-scale industry, in some cases operated by a broker as an adjunct to his real estate business. There appears, however, to be little overlap between ownership and development. In contrast to rehabbers, many of whom fix up properties in order to continue to own and maintain them as investment property, developers of new two and three family structures appear to be largely oriented to selling their product as quickly as possible. Whether they sell to homebuyers or to investors, of course, is likely to be a matter of indifference to them.

[9] The absence of large regional or national development firms from the Newark scene, despite strong market conditions, is likely to have reflected a reluctance to deal with a city administration that, until 2006, was widely seen as both corrupt and dysfunctional.

The construction of two and three family structures is actively facilitated in these cities, particularly in Newark, by supportive but highly questionable public policies. The city of Newark has provided generous tax abatements for the buyers of newly constructed structures, whether homebuyers or investors. These abatements permit developers to sell their buildings for substantially higher prices than the market would otherwise permit, artificially inflating the local market and potentially placing homebuyers at future risk when the abatements expire. Newark has also sold city-owned properties to developers for prices well below market rates (Wang, 2006; Casiano, 2006; O'Flaherty, 2000). There is considerable evidence that, in recent years, land sales as well as discretionary approvals have been more readily available to individuals who were politically favored by the municipal administration (Shearn, 2005). None of these public actions, however questionable, would prompt such levels of housing production were it not for the existence of strong market demand.

The housing market is fueled in urban northern New Jersey by a conjunction of a number of separate factors. These include the pressure of New York City's demand growth on the surrounding areas, which has fueled massive development of upscale housing in those parts of New Jersey closest to Manhattan,[10] and the simultaneous slowdown in new greenfields construction in the New Jersey suburbs, the traditional source of the lion's share of the regional housing supply.[11] While these factors apply to many different cities, they have a particularly strong impact on the three cited above because of their excellent public transportation connections to the region as a whole, and to Manhattan in particular.[12] It is notable that demand and development in Paterson, which has similar geographic and demographic attributes but lacks efficient public transportation connections, have significantly lagged behind the other three cities of generally similar size and demographic character. That may be changing; as one Paterson-based informant commented, "five years ago, someone who owned a vacant lot in a tough

[10] The most extreme case is that of Hoboken, a small city on the Hudson River waterfront with a historic multifamily housing stock and excellent public transit connections to midtown Manhattan. Between 1990 and 2000, this city, with a 1990 population of 33,000 in one square mile, added nearly 5,000 housing units to its inventory. During the same period, the median household income in the city went from 85% of the statewide median to 113% of the statewide median income.
[11] During the 1960's, the annual average number of building permits issued in New Jersey was 50,000. By the 1990's, that figure had dropped to 24,000.
[12] The city of Newark arguably has the best inter-modal transportation network of any city in the United States. The city is served by one of the nation's most important international airports, a major container seaport, the Amtrak northeast corridor line as well as a network of regional rail lines, the PATH subway linking it to Jersey City and New York, and is the hub for the NJ Transit northeastern New Jersey bus network. It also has direct access to Interstate highways 78, 95 and 280.

neighborhood might just give it to you, to not have to pay the taxes. Today, those lots are selling for $30,000 or $40,000."

Demand pressures in northern New Jersey makes it possible for developers to construct new two and three family houses selling for $350,000 to $500,000 depending on neighborhood conditions, more than enough – particularly if combined with low land costs – to provide a high level of return to the developer. Market prices in Trenton and Camden, however, have not reached a level where a developer can anticipate a reasonable return, although there is evidence that the Trenton market may be approaching that point.[13] To the extent that demand pressure from a growing immigrant population is increasing in those cities, albeit substantially more so in Trenton than in Camden, it is being addressed not through new construction but through conversion of single family homes from owner-occupancy to absentee ownership, and to a lesser extent, rehabilitation of vacant properties.

The additional factor, which is particularly relevant to the one to four family rental market, is the effect of immigration on the cities of northern New Jersey. All four cities are major immigrant destinations, more so than either Trenton or Camden to their south. 44% of the population of Elizabeth in 2000 was foreign born; nearly half of those residents had arrived in the United States since 1990. These cities contain distinct areas of particular immigrant concentration. Newark's Ironbound area, the eastern edge of the city, is such an area. In 2000, 64% of all of the residents of the area were foreign-born, over half of whom had arrived in the United States since 1990.[14]

Demographic Features

The Latino population of the cities is disproportionately likely to occupy one to four family rental housing, a pattern that reflects both their larger household sizes and their greater

[13] Average selling prices for houses in Newark and Elizabeth in 2004 were $213,312 and $254,836 respectively, compared to $74,101 in Trenton and $36.043 in Camden (New Jersey Division of Taxation). A survey of Trenton single family house listings, however, on realtor.com by the author in the fall of 2006 found that the median asking price in the four zip codes making up the greater part of the city was nearly $175,000 (accessed Sept. 22, 2006).

[14] Essex County, New Jersey Census tracts 70 through 79

Table 10 Characteristics of the Foreign-Born Population

Category	Camden	Elizabeth	Jersey City	Newark	Paterson	Trenton
Ethnic Characteristics						
Latino	38.6%	49.6%	28.3%	29.4%	50.2%	21.7%
Asian	2.9	2.2	16.3	1.1	1.9	0.7
Other	58.5	48.2	55.4	69.5	47.9	78.4
Origin of foreign-born population						
Europe	2.0	18.1	8.0	25.1	6.1	14.9
Latin America	68.9	75.0	40.6	63.6	83.2	69.5
Asia	26.2	4.8	40.6	3.9	9.6	4.3
% of foreign-born population arrived in United States since 1990 by place of origin						
Latin America	56.3	47.9	43.7	56.5	48.3	60.5
Asia	60.2	52.3	52.5	63.8	54.0	56.8
All foreign-born	56.9	44.9	48.7	51.0	47.4	57.0

Source: US Census 2000.

likelihood to rent rather than own, for both economic and legal reasons. Typically, 45 to 55% of all Latino households in these six cities are dependent on the one to four unit rental housing stock, compared to 35 to 40% of the African-American population, and 25 to 30% of the non-Latino white population

Table 11: Ethnic Distribution of Tenants of One To Four Family Rental Units

CATEGORY		Camden	Elizabeth	Jersey City	Newark	Paterson	Trenton
Percentage of total population of ethnic category occupying each structure type							
1 family	Latino	34.8%	10.9%	6.4%	9.0%	7.3%	33.1%
	Non-Latino white	21.3	3.8	2.6	3.4	4.9	15.1
	African-American	30.3	6.6	6.4	10.3	5.4	25.2
2-4 family	Latino	11.5	35.7	30.1	37.6	45.9	24.9
	Non-Latino white	6.7	22.5	22.8	31.1	26.3	8.9
	African-American	9.5	29.0	27.3	29.1	36.2	15.0
All 1 to 4 family	Latino	46.3	46.6	36.5	46.6	53.2	58.0
	Non-Latino white	28.0	26.3	25.4	34.5	31.2	24.0
	African-American	39.8	35.6	33.7	39.4	41.6	40.2
Average household size of households of ethnic category occupying each structure type							
1 family	Latino	3.97	3.90	3.91	3.79	4.04	4.55
	Non-Latino white	3.66	2.26	2.21	2.49	2.52	2.40
	African-American	3.26	3.49	3.34	3.68	3.30	3.48
2-4 family	Latino	3.28	3.51	3.26	3.31	3.78	3.59
	Non-Latino white	2.22	2.38	1.92	2.52	2.40	1.68
	African-American	2.77	3.09	2.77	2.87	3.35	2.64

Source: US Census 2000.

The effect of their heavy reliance on this sector of the housing stock, when coupled with the effects of language barriers and the undocumented status of a substantial part of the Latino immigrant population, creates conditions in which overcrowding and abusive landlord practices, as well as potential inter-communal conflicts, can come into being. Overcrowding, as defined by the Bureau of the Census as >1 resident per room, increased by 44% in New Jersey between 1990 and 2000, while severe overcrowding (>1.5 residents/room) increased by 75%. As Table 12, which most probably significantly understates both the disparity and the magnitude of the problem,[15] shows, overcrowding is a far more serious problem for Latinos in these cities than for others. These issues will be explored further in the following section.

Table 12: Rental Overcrowding By Ethnic Category

(% of households in overcrowded conditions by category)

CATEGORY	Camden	Elizabeth	Jersey City	Newark	Paterson	Trenton
Latino	30.0%	27.6%	22.5%	21.8%	28.0%	29.0%
Non-Latino	14.1	12.4	12.3	12.1	11.1	9.0
TOTAL	20.0	19.6	15.0	14.8	19.0	12.8

Source: US Census 2000.

The Dynamics of the One To Four Family Rental Industry

The preceding sections have tried to provide a framework for the central discussion of this paper, which is an attempt to present a profile of the one to four unit rental industry with respect to its key characteristics. For purposes of this section, we have identified five key features which, in combination, should provide a comprehensive picture of the industry:

- Who are the owners of this sector of the rental housing stock?
- What are their financial and investment strategies?
- How do they access capital for acquisition and rehabilitation?
- How do they manage properties and select tenants?
- How do they interact with government and other key players in their environment?

Each one of these issues will be addressed in this section. The discussion relies on statistical information, principally the 1995 *Property Owners and Managers Survey* (POMS) and the 2001

[15] Households, particularly those containing undocumented immigrants, are less likely to report overcrowded conditions out of concerns that reporting may result in code enforcement action, or, in the case of subsidized housing, eviction. The data does not provide for a further breakdown of overcrowding by ethnicity and structure type. At the same time, it must be recognized that overcrowding, up to a point, within the Latino community may not carry the same weight as it does among non-Latino whites and African-Americans; see Myers, Baer and Choi (1996).

Residential Finance Survey (RFS), combined with qualitative information elicited from a series of interviews conducted during the first half of 2006 with property owners, brokers, lenders and governmental officials in urban areas in New Jersey, as well as from newspaper accounts and other informal sources of information.[16] In view of the limitations of the information relied upon, it must be stressed that this profile is very much a provisional one. The author hopes that it will be refined, and perhaps substantially revised, through further research.

The Owners of One To Four Unit Rental Properties

The ownership of one to four unit rental properties is generally considered to be one of the few remaining economic sectors of any significance in the United States that has resisted rationalization into larger, impersonal corporate entities. This is largely accurate. Nearly half of all owners of single family detached rental properties own only a single property, with another quarter owning two to four properties, while 70% of the owners of two family rental properties own either one or two properties. While only a very small percentage of the one to four unit rental inventory are held in large holdings of 50 or more properties, even that small percentage represents roughly 850,000 to 900,000 properties nationally, suggesting that some degree of aggregation does exist in this industry.[17]

Table 13: Distribution of Property Owners by Number of Properties Owned[18]

CATEGORY	1 family detached	1 family attached	2 family	3-4 family
1 unit only	48.5%	39.0%	NA	NA
2 to 4 units	27.0	20.4	70.1	52.7
5 to 9 units	10.5	15.1	11.6	18.5
10 to 49 units	11.1	14.2	13.7	23.0
50 or more units	2.9	10.7	4.7	5.8

Source: POMS.

The single family attached property inventory is more aggregated than the other components in this sector, and differs markedly from other one to four family properties in that it

[16] This discussion will also make use of the author's personal experience in the housing and real estate industry, particularly his nine years as Director of Housing & Development for the city of Trenton, New Jersey (1990-1999). For the record, the author owned a single family rental property in Philadelphia for over twenty years.
[17] This figure was derived by multiplying the percentages in the POMS data by the total number of units in each category as reported in the 2003 American Housing Survey.
[18] For purposes of clarity, percentages have been calculated on the basis of the total providing usable answers for each question, rather than the total sample. A substantial number of the respondents to the POMS questionnaire, ranging from 5% to 15% depending on the question, failed to provide answers to one or more questions.

has drawn significantly more partnership and corporate investment. Over 14% of all owners of single family attached properties are partnerships, corporations and REITs, entities that are substantially more likely to amass substantial numbers of properties, compared to 5 to 7% of the owners of other components of this sector. The higher level of corporate and partnership investment flowing into these properties reflects the distinct physical characteristics of this

Table 14: Distribution of Property Owners by Type of Ownership Entity

CATEGORY	1 family detached	1 family attached	2 family	3-4 family
Individual or couple	89.0%	79.3%	90.6%	86.6%
Partnership	2.0	7.0	3.3	5.0
Corporation	2.7	6.2	2.3	1.6
REIT	0.1	1.1	0.8	0.4
Nonprofit entity	2.9	2.1	0.2	0.6
Other*	3.2	4.7	2.7	5.8

Source: POMS.
*The largest single Other category was trustees for estates. Other categories included lenders and life insurance companies.

sector, and may also help explain why, as discussed earlier, the overall inventory of single family attached properties is growing at a rapid pace, while the number of single family detached and two to four family rental units is diminishing.

Demographic Characteristics

The POMS data also provides a demographic profile of the owners of one to four family rental properties. As a group, owners are typically substantially older than the average American, with the typical owner in his or her late 50’s. Roughly three-quarters of all owners do some form of work unrelated to property ownership; of the quarter who do not, however, most have retirement or other income, since only a handful earn all of their income from property ownership. Once again, the distinction between single family attached and other properties carries through, in that their owners have substantially higher incomes, and are more likely to hold professional, managerial or technical jobs than the owners of either single family detached or two to four family properties. That, in turn, may reflect the fact that these properties are more likely to be located in suburbs than 2 to 4 family properties, and that the pool of suburban owners is likely to be drawn, if not from the same community, from the same type of community as the property.[19] It also reflects the fact that a substantial percentage of the owners of two to four family rental properties are owner-occupants themselves, and that those owners are more likely

Table 15: Social and Economic Characteristics of Property Owners

CATEGORY	1 family detached	1 family attached	2 family	3-4 family
Non-Latino white	84.6%	83.0%	85.3%	83.8%
African-American	9.1	6.9	9.1	9.6
Asian	3.5	4.8	3.4	3.9
Latino (may be of any race)	6.0%	7.5%	5.1%	6.2%
Foreign-born	7.4	12.2	13.8	15.5
No other work	27.7%	23.6%	24.7%	23.9%
Prof., mgr., tech.	35.2	49.1	33.2	36.2
Sales, admin. Support	11.1	15.4	11.8	12.8
Other*	29.3	16.4	42.9	53.7
Median age	59	53	55	56
Median household income	$40,828	$54,230	$43,830	$48,751

Source: POMS.
*Includes categories of precision crafts or repair, farming/fishing/forestry, and other. Since the last contains the majority of cases in the overall category, it can reasonably be assumed that it subsumes a wide range of blue-collar employment areas. Totals for this tabulation exceed 100% because of multiple entries.

to be urban, blue-collar and less affluent than single family homeowners.[20] The median incomes of the owners of single family detached and two family properties in particular were well below those of the typical American in the same age bracket at the time.[21]

While by definition all owners of rental single family properties are absentee owners, the owners of two to four family properties fall into two distinct categories, owner-occupants who rent the additional unit or units, and absentee owners. As noted earlier, roughly 1/3 of the two to four family inventory is owner-occupied, with those units disproportionately located in the northeastern states. Owner-occupants of two to four family properties tend to be older, less affluent and more likely to be people of color than single family homeowners. Although the data

[19] Information from the interviews, as well as the author's observations, suggest that while suburban investors are often likely to invest in urban properties, and may make up a substantial part of the investor pool in some cities, the opposite is rarely true; urban investors are less likely to invest in suburban properties.
[20] There is only limited data on this point. The American Housing Survey (2003) reports that the median household income of owners of 2 to 4 unit properties was only 84% that of the owners of single family detached properties ($47,395 and $56,376, respectively).
[21] The median household income in 1995 for households headed by an individual aged 45 to 54 was $48,058 (Current Population Survey).

Table 16: Characteristics of Owner-Occupants of Single Family and 2 To 4 Family Properties

Category	Single family owner-occupants	2 to 4 family owner-occupants
Median age	52	58
Median household income (2000)	$48,860	$39,245
% of owners who are African-American	7.5%	10.0%
% of owners who are Latino	7.2%	13.7%

Source: 2001 Residential Finance Survey.

does not permit a similar demographic comparison with absentee owners of two to four family properties, a limited comparison of owner-occupied with absentee-owned *properties* is possible, as shown in Table 17. Although owner-occupants do not necessarily make a longer-term commitment to their properties than absentee owners, they do appear to invest more in their properties.

Table 17: Characteristics of Owner-Occupied and Absentee-Owned 2 to 4 Unit Properties

Category	Owner-occupied	Absentee-owned
Median year property built	1944	1953
Median years owned by current owner	9	10
Median market value	$145,738	$119,022
Median value of capital improvements made per unit	$3,541	$2,414

Source: 2001 Residential Finance Survey.

Although not reflected in national data, comments from interview respondents in New Jersey cities suggest that there are distinct ethnic clusters among landlords. While none identified the presence of formal ethnically-based landlord associations, they noted many informal systems that facilitate communication between landlords within an ethnic community. In one case, a local church serves as the node of contact for a pool of small Latino, largely Puerto Rican, landlords, who typically own 1 to 3 properties each. Another Puerto Rican landlord in the Newark area indicated that there was a 'Puerto Rican niche' in the local market, with considerable informal interaction and sharing of information between landlords. In Trenton, a substantial number of investors are members of an Orthodox Jewish community in nearby Lakewood, who share information through a closely-knit social and religious network.[22]

[22] There are many landlord associations at state and local levels around the United States, although relatively few are specifically organized by and for one to four unit property owners. One notable exception is the Small Property Owners Association of Massachusetts (SPOA), which characterizes its membership as "small landlords, 'mom and

In the final analysis, there is no such thing as a typical owner. Roughly 3.8 million different individuals, couples and partnerships own single family detached rental properties alone – or roughly 1 out of every 30 American households.[23] Interview respondents, or owners described by non-owner informants, included a diverse collection of individuals, including a number of Puerto Rican couples in which the husband was a blue collar worker and the wife a clerical or lower-level administrative employee; an African-American single mother who worked as a bus driver by day and a bartender by night; a prosperous ethnic Italian suburban couple with a husband holding a well-paid information technology position and a stay-at-home wife with three small children, among many others. They are Everyman, and, although more often male than female, Everywoman. We will discuss owner characteristics further in the following section in the context of the divergent holding and investment strategies they pursue.

Alternative Models of Property Ownership

If the normative model of single family rental ownership is an individual or couple owning only a handful of properties, a number of alternative models have emerged in recent years. Two models worth touching upon are nonprofit ownership and investment vehicles as strategies for aggregating single family rental properties. At present, nonprofit entities, corporations and REITs own an estimated 5% of the total one to four family rental inventory, or nearly a million units. Although it would be premature to suggest that either of these models will

Table 18: Corporate, REIT and Nonprofit Holdings of One To Four Family Rental Properties

Category	1 family detached	1 family attached	2 to 4 family	TOTAL
Corporations & REITS	218,000	183,000	174,000	575,000
Nonprofit and church-related entities	231,000	52,000	28,000	311,000
TOTAL	449,000	235,000	202,000	886,000
% of total inventory	5.5%	9.1%	2.9%	5.0%

Source: Estimate by the author based on POMS and 2003 American Housing Survey data.

pop' landlords, families who live in their own two and three family homes, or families that run part-time or full-time rental businesses without hired management." www.spoa.com, accessed July 20, 2006.

[23] This estimate was derived by converting POMS table 102 'total number of units owned' from units to owners by making estimates of the average number of units for each range, and adjusting the total for the total number of units reported in the 2003 American Housing Survey.

necessarily lead to greater aggregation and rationalization of the single family rental industry in the future, they at least suggest that possibility. This prospect is consistent with data drawn from a comparison of 1991 and 2001data from the Residential Finance Survey. Although this data is not comparable in important respects with the POMS data, it suggests that aggregation is significantly increasing within this sector, with the percentage of ownership that is other than individual rising over the course of the decade from 7.5% of all properties to nearly 16%.[24]

A notable example of nonprofit ownership of single family rental properties is the Cleveland Housing Network (CHN), a nonprofit development corporation created in 1981 by a number of Cleveland area community development corporations (CDCs) as a housing production and management vehicle to support the CDCs' neighborhood revitalization mission. Taking advantage of the Low Income Housing Tax Credit (LIHTC) enacted in 1986 by Congress, CHN developed a long-term single family lease-purchase model, which it has been aggressively pursuing since then. Utilizing the LIHTC as its principal source of capital,[25] CHN constructs or rehabilitates single family homes, which it rents to low income tenants with a lease-purchase option. Since the rules of the LIHTC require the ownership entity (a partnership between CHN and the tax credit investors) to hold the property for a minimum of 15 years, the purchase option cannot be exercised until after the end of the holding period. Given normal rental turnover, the tenant who can exercise the option at the end of the holding period is unlikely to be the initial tenant. This is not a concern for CHN, however, since their goal is to provide low-income tenants with homeownership options, not necessarily to provide a specific tenant with that option.

Since 1987, CHN has developed approximately 2,300 single family rental units. The first 100 to become available for purchase were offered to their tenants during 2004. 90% of the tenants exercised their option, and became the owners of their homes. Since the bulk of the initial cost of the units was covered with tax credit investments and public sector grants, with any debt being largely or entirely amortized during the 15 year holding period, CHN can adjust the selling price to reflect the tenant's financial ability, in some cases selling properties for as little as

[24] The data from the 1991 Residential Finance Survey aggregates all 1 to 4 unit properties, so that a breakdown by type is not possible; moreover, the data excludes owner-occupants of 2 to 4 unit properties, which are included in the POMS data. Furthermore, there are certain inconsistencies in the manner in which the data is handled, particularly with respect to allocations for non-response, between the 1991 and 2001 RFS.

[25] The LIHTC provides investors with a substantial credit against Federal tax liabilities for their investments in low income rental housing properties. Under some circumstances, the amount of money that can be raised through this tax credit can be between 80% and 90% of the total development cost of the project.

$15,000. At present, CHN owns and manages a single family rental inventory of approximately 2,100 units, with an additional 210 units in the development pipeline.

From CHN's initial efforts with its lease-purchase model, it has broadened the scope of its operations to include other real estate development activities, including home ownership and multifamily rental housing, energy efficiency programs, homelessness prevention, and a community training center, which offers programs in financial literacy, homeownership and technology. These activities have a strong synergy with the organization's role as a rental property manager, and provide direct benefits to its tenants as well as others in the community.

CHN, which describes itself as "the largest private mission-driven developer and manager of affordable quality homes in the city of Cleveland,"[26] is a powerful model, particularly in its ability to combine the virtues of operating at a citywide scale with strong community linkages through its close ties to neighborhood-based CDCs. Cleveland is highly unusual among American communities with respect to the strength of its network of CDCs as well as its support system of foundations and intermediaries. Being part of that extensive network and support system has been a critical factor in CHN's ability to build and sustain its organization and create its inventory. At the same time, the model is potentially replicable elsewhere, although finding financial resources to enable an organization to get to scale is likely to be a critical consideration.

A radically different model is offered by Redbrick Partners, LP, which describes itself as managing "the only institutional-class funds in the U.S. dedicated to single-family housing – a particularly attractive asset class that ha been largely overlooked by professional investors."[27] Redbrick has raised $30 million in equity through three offerings, which it has leveraged with debt to acquire approximately 1,000 single family properties. It targets its acquisition activities to urban areas which have medium to low property values but significant appreciation potential, based on a proprietary economic model that they have developed. Within each geographic area it attempts to acquire at least 200 properties, in order to be able to support the cost of an on-site office. As of early 2006, Redbrick was strongly invested in five target areas, including Jersey City, Trenton, Philadelphia, Baltimore, and Connecticut.[28]

---

[26] www.chnnet.com/b_real_estate.html accessed June 29, 2006.
[27] www.redbrickpartners.biz accessed April 23, 2006.
[28] In addition to information from the Redbrick web site, this discussion is based on an interview with Thomas Skinner, Managing Partner of Redbrick, April 26, 2006.

The Redbrick model represents a vehicle for aggregation that, if successful, could have an effect within the industry far greater than that of nonprofit developer/managers such as CHN, which, in the final analysis, tend to restrict themselves to discrete niches within the industry. Assuming that it is able to generate reliable returns for its investors at levels approaching its expectations (Skinner and Lee, 2003); it should have little difficulty raising the capital needed to expand its activities almost exponentially. Indeed, the principal apparent constraint on its growth would appear to be the difficulty of establishing an effective organizational structure for centralized management and quality control of a fundamentally decentralized product. While difficult, that task would not appear to be beyond the capabilities of sophisticated management and systems design talent.

Financial and Investment Strategies in the One To Four Family Rental Industry

With millions of individual owners of one to four family rental properties, one can anticipate that there will be if not millions, at least a large number of different financial and investment motivations at work among them. While this is certainly the case, it appears that there are a relatively small number of factors driving the great majority of property owners. Critical questions are what motivates property owners in this sector, and whether those motivations are likely to lead to long-term holding or to more rapid turnover, or flipping of properties. Those questions, in turn, have important implications for the stability and quality of the housing stock represented by this sector.

The POMS data, perhaps somewhat counter-intuitively, paints a picture of an industry dominated by long-term holders, with relatively little variation by housing type within the sector as a whole. The typical property owner has held her property for 10 years or more – 12 years in the case of single family properties – and has no plans to sell within the next five years. Six years later, however, in 2001, the Residential Finance Survey indicated that the median length of ownership of single family rental properties had dropped to 9 years, suggesting that the change in housing market conditions that began in the late 1990's may have begun to trigger a trend toward more speculative behavior. This is supported by anecdotal evidence, discussed below. Only 8% to 10% of the POMS respondents had serious plans to sell within the next three years. The large number of 'don't know' responses, we would suggest, supports this point, since owners with short-term plans are more likely to know their intentions than those without such plans.

Table 19: Anticipated Length of Future Ownership

Category	1 family detached	1 family attached	2 to 4 family
<1 year	4.1%	3.8%	4.2%
1-3 years	6.0	4.2	5.3
3-5 years	6.6	5.5	6.1
>5 years	41.7	47.4	45.8
Don't know	41.6	39.0	38.6

Source: POMS.

The reasons POMS respondents offered for buying their properties, as well as for continuing to hold them, reinforce the picture of a body of owners largely committed to long-term holding, with their motivations divided between cash flow and long-term appreciation. Appreciation-related motivations were greatest among the owners of single family attached properties, driving nearly 1/3 of their decisions to purchase those properties, while income, more than appreciation, drives owners of 2 to 4 family buildings to both buy and hold their properties.

Table 20(a): Principal Reason for Acquiring Property

Category	1 family detached	1 family attached	2 to 4 family
As residence	33.5%	25.8%	29.2%
For rental income	24.2	27.1	32.8
For retirement security	11.0	8.1	12.3
For long-term capital gains	7.1	15.0	9.8
For family security	4.8	3.8	4.0
As tax shelter	2.7	4.2	2.5
Other	14.7	16.0	9.4

Source: POMS.

The data illustrate another salient point, that a substantial percentage of the owners of small rental properties are what might be considered 'inadvertent' landlords; as the table shows, 1/4 to 1/3 of these owners initially purchased the unit to serve as their principal residence. While in the case of two to four unit properties, the decision to buy combined the intention of being both a homeowner and a landlord, in the case of single family properties, the choice of becoming a landlord took place presumably at some point subsequent to acquiring the property, with the owner making a decision to vacate, but not to sell, the household's former principal residence. It would appear, by looking at Tables 20(a) and 20(b) in tandem, that at least some of these inadvertent landlords have at least some expectation of reclaiming the property at some future date for their own use.[29]

Table 20(b): Principal Reason for Continuing To Hold Property

Category	1 family detached	1 family attached	2 to 4 family
As present or future residence	17.4%	11.3%	20.6%
For rental income	23.7	24.0	30.7
For retirement security	16.7	13.9	15.0
For long-term capital gains	5.9	13.8	6.2
For family security	8.0	4.8	5.6
Property is for sale	2.6	2.2	2.4
Would like to sell but can't	5.4	7.6	7.8

Source: POMS.

A variation on that pattern, reflected in a number of the interviews, appears to be fairly common in northern New Jersey communities with large stocks of two and three family properties. A striving working class family may buy a two or three family property as their first home, using the rental income from the additional units to offset the carrying cost. Over time, as their income increases, they realize the American dream by purchasing a single family home for themselves while retaining the two or three family property, which now becomes entirely an income property. Some such owners find the role of an absentee landlord congenial and continue to maintain the property, in some cases going on to purchase additional properties, while others decide after a relatively short period to sell.[30]

The majority of the owners of one to four family rental properties, however, have made a deliberate decision to invest in their properties, driven by cash flow, appreciation or, in many cases, a combination of those two factors. The suburban couple mentioned earlier decided to buy three rental properties, one for each daughter, to build a college fund for their three small children. Subsequently, however, the wife discovered an aptitude for rental property

[29] While the percentage holding for their own future use is roughly half of the percentage of those who initially bought the unit as their principal residence, the overlap between the two categories is impossible to determine. Clearly, at least some of those who plan ultimately to move into their properties have never used them as a principal residence.
[30] Two demographically similar interview respondents described this pattern, one of whom has retained the three family property that was the household's first residence, while the other decided to sell after little more than a year. In the latter case, the couple found that the role of landlord was unduly complicated by the husband's prominence as a deacon and lay leader in the neighborhood Catholic parish.

management. They now own five houses, and anticipate buying as many as five more. A Puerto Rican couple, in which the husband currently works as a manager of a garden apartment complex, is buying properties largely for cash flow. Their goal is to reach the point where the husband can leave his job, and be able to earn enough from their properties so that he will be able to work full-time managing them. In both cases, the owners are long-term investors.

An area worth further exploration is that of how owners choose properties, and what criteria they use to make their decisions. Some investors, such as one unusually thoughtful Philadelphia-area owner, do frame explicit decision-making criteria. This respondent began to buy properties in 2002, driven by his observation that despite historically low interest rates, house prices in sound, well-maintained Philadelphia neighborhoods such as Chestnut Hill or East Falls were exceptionally low. His criteria for acquisition were, in addition to neighborhood strength, that the property was (a) within easy walking distance of a railroad station; (b) within walking distance of a park; and (c) that the projected rents exceeded the sum of principal, interest, property taxes and insurance by at least $400. His goal, which has been successful, was to create a portfolio of high-quality properties which would generate both steady cash flow and potentially significant appreciation. He ultimately purchased 23 properties meeting these criteria; selling seven as property values increased over the coming years. He intends to hold the remaining properties for the foreseeable future.

The question remains whether these examples, or the POMS data generally, accurately reflect current investment and holding strategies. There is substantial, although anecdotal, evidence that short-term speculative holding is widespread in this sector of the rental market. The POMS data is ten years old, and predates the run-up in house prices that has so dramatically transformed the American housing market in the past decade. A radically different picture emerges from newspaper and magazine accounts, as well as the proliferation of web sites promoting real estate purchases. As a recent article pointed out:

> This country is obsessed with real estate. The number of chapters of the National Real Estate Investors Association has jumped from 44 in 2002 to 170 today.[31] 86 books on real estate investing were published last year, nearly three times as many as

[31] The executive director of the NREIA estimates that in addition to the clubs affiliated with the NREIA, there are at least another 300 real estate investing clubs nationally. While this is a small number compared to the number of stock market clubs (roughly 20,000), it is growing, while the number of stock market clubs has dropped significantly since 1999 (Shell, 2005)

> in 1998. […] This summer the Learning Channel will air a show about people flipping real estate in San Diego, hosted by a woman who has bought and sold more than 40 properties in the past seven years (David, 2005).

The article portrays what it describes as "the return of speculators" to the single family housing market, describing the "feeding frenzy" associated with home sales in cities such as Las Vegas, Phoenix, Austin or Miami, along with such phenomena as the Real Estate Wealth Expo that drew 46,000 people over two days to the Los Angeles Convention Center. A 2004 survey by the National Association of Realtors found that 36% of resales went to non-owner-occupants (Hopkins, 2005).

While David's speculators are primarily drawn to middle market Sun Belt communities, the same phenomenon has been highlighted in a number of urban areas. The author's Trenton informants agreed that there has been a dramatic increase in investor purchases of one to four family properties since 2001; one realtor commented that she "sees 2 to 3 investors for every homebuyer." The same pattern is visible in Baltimore, where the number of number of arms-length home sales to "non-owner-occupiers" increased from roughly one out of three in 2001 to 67 percent of all sales during the first four months of 2005. Both in Baltimore and Trenton, as well as in other older cities, a substantial, although hard to document, share of investor activity takes the form of short-term resale, or flipping. Nearly 150 houses in Baltimore sold more than once during the first four months of 2005 (Hopkins, 2005).

Flipping is the principal manifestation of short-term, speculative real estate investment, actively promoted by the infrastructure of clubs, videos, books and web sites.[32] While flipping, as such, is not illegal, at a minimum it pushes up the value of properties in ways that are unlikely to bear any relationship to sustainable demand, taking advantage of lack of information, financial illiteracy or distress on the part of many of the individuals in the market. At worst, it is a form of criminal fraud. Although most flippers undoubtedly embark on their activities without overt criminal or unethical intent, the nature of the activity with its pressure for short-term profit – and significant downside risk if the property cannot be successfully flipped within a short time period

[32] A search for 'flipping real estate' on Google resulted in 8,680,000 entries. It is sometimes referred to as 'wholesaling' real estate.

– represents the paradigm of a slippery slope, potentially leading its practitioners to engage in deceptive practices, and ultimately, in some cases, to engage in fraud.[33]

The same pressures affect investors who buy vacant or substandard properties and rehabilitate them for resale, particularly in urban areas, as those who flip properties ‘as is’. The cost to carry out thorough, fully code-compliant rehabilitation of a severely deteriorated property in a distressed urban neighborhood, combined with the cost of acquisition, can easily exceed both the market value of the rehabilitated property as well as the amount that can be carried with the cash flow from the rental income that can be realized from the property.

The reality, as will be addressed further in the discussion of property management below, is that rental cash flow is a highly uncertain route to wealth. The POMS findings show that fewer than 40% of the owners of one to four family rental properties reported that they had made a profit on their property during the preceding year. Given the substantial possibility of a negative cash flow, the pressure to turn over properties, particularly in a rising market, can be substantial.

Table 21: Cash Flow during Preceding Year

Category	1 family detached	1 family attached	2 to 4 family
Made profit	37.0%	39.1%	39.5%
Broke even	17.6	15.8	16.7
Lost money	29.3	27.3	28.7
Don’t know/not sure	16.1	17.8	16.9

Source: POMS.

This is likely to be more significant for those who are holding a substantial inventory and are engaged in real estate investment on a full-time basis, compared to those who see it as a supplement to other work, and who can more comfortably carry a modest negative cash flow in the interest of long term appreciation. Of course, for those who are purely motivated by appreciation, a short-term negative cash flow may not be a significant disincentive, as one of David’s speculators commented:

> [He] estimates that he loses $3,500 a month on them, since he doesn’t bother to rent out all 15. “If I’m negative on a few, that’s okay,” he says,” I’m in it for the appreciation.” (David, 2005)

[33] Illegal and unethical are, of course, very different matters. The ‘get rich quick’ dynamic of flipping, when applied in many inner-city markets, is arguably unethical even when it is not illegal.

Still, in response to the question "would you buy this property again?" only slightly more than 40% of POMS respondents answered in the affirmative.

Access to Capital for One To Four Family Rental Properties

As of 2001, the Residential Finance Survey found that the amount of debt outstanding on all one to four family rental properties was $414 billion. Nearly all of this was in the form of conventional mortgage debt, reflecting the manner in which the majority of such properties are acquired. Investor buyers are somewhat more likely to utilize non-conventional types of mortgages, such as ARMs or balloons, than are homebuyers, which may reflect the effect of the preferences of short-term investors in the former group.[34] Most purchases of one to four family rental properties involve a mortgage, although a significant number of single family purchases were reported both to POMS and the Residential Finance Survey as cash transactions, substantially more than the number of single family homebuyers reporting cash transactions.[35] The financing patterns for owners of two to four family properties are largely similar to those of owner-occupants, reflecting the extent to which a significant percentage of these owners are in

Table 22(a): Mortgage Characteristics of One To Four Family Rental Properties

Category	Single family properties	2 to 4 family properties
Mortgage status:		
With mortgage	43.0%	56.2%
Without mortgage	57.0	43.8
Type of mortgage instrument:		
Fixed rate level payment	70.0%	68.2%
ARM	19.1	22.8
Balloon or other	11.0	9.0
Mortgage source:		
Uninsured conventional mortgage	72.4%	78.1%
Privately insured conventional mortgage	10.9	8.1
Government insured mortgage	16.7	13.8

Source: Residential Finance Survey, 2001.

[34] In 2001, 22% of single family homebuyers had non-conventional mortgages compared to 30% of single family investor owners. The preference of some investor buyers for ARMs may be associated with the particular feature of ARMs that pre-payment of principal, rather than shortening the term of the mortgage, reduces the monthly payment after the next interest rate adjustment, thus potentially benefiting the investor's cash flow; see Thomas (1999), 23-24.
[35] Generally speaking, the responses to this question on the POMS and the RFS were reasonably close. The large percentage of cash transactions report, however, raises questions, and makes one speculate that at least some purchases with funds borrowed from other sources, such as home equity loans, may have been reported as cash transactions. 11% of single family homebuyers reported purchasing their homes entirely with cash.

fact owner-occupants as well as landlords. The great majority of transactions involved a down payment, although the number of zero down payment purchases was not negligible, representing 10% of all two to four family purchases, and 14% of all single family purchases, made between 1995 and 2001.

Whatever may have been the case in earlier years, today prospective investors in one to four family rental properties appear to have no difficulty obtaining financing on reasonable terms. Mortgage brokers offer a variety of packages for investors, most commonly a first mortgage up to 90% of the purchase price, with an interest rate typically 50 to 75 basis points above a comparable mortgage for an owner-occupant. The mortgage can be a fixed-payment,

Table 22(b): Property Acquisition Financing

Category	One family properties	Two to four family properties
Placed new mortgage	65.0%	77.3%
Assumed existing mortgage	5.9	4.3
Assumed mortgage & placed new mortgage	0.4	1.0
Borrowed using other collateral	2.3	3.3
Cash transaction	24.3	12.2
Other	2.0	1.9

Source: Residential Finance Survey, 2001.

balloon or ARM reflecting the borrower's preference.[36] Similar products, with somewhat higher interest rates, are becoming available for investors putting down as little as a 5% down payment.

Somewhat less scrupulous buyers obtain FHA mortgages with only 3% down by claiming that the unit is for their own use; according to one informant, unless the buyer tries to obtain a second FHA mortgage within a short period, there are no effective risks to the buyer associated with this clearly fraudulent practice. Finally, another widely available product, known in the trade as the "80:20 mortgage" allows an unwary investor to acquire properties without a down payment. The broker provides a conventional mortgage for 80% of the purchase price, and a junior mortgage at a substantially higher interest rate and shorter term for the remaining 20%.[37]

It appears that the structure of financial instruments and the availability of capital pose no impediments to investment in one to four unit rental properties at this time; although there is little doubt that the cost of financing has a substantial effect on cash flow. While the process of

[36] In June, 2006, a major mortgage lender was offering such a mortgage at 7.375% fixed for 30 years with 1 point, or 7.625% with no points.
[37] As of June 2006, the customary interest rates on such junior mortgages were 12% or higher.

placing individual mortgages on individual properties may appear to be cumbersome, informants suggested that many investors preferred it to blanket financing or alternative instruments such as home equity credit lines, despite somewhat higher transaction costs, because of their ability to uncouple individual properties from the rest of their holdings, and not place other assets, such as the principal residence, at risk. In the case of larger operators, this becomes particularly important, since many such owners will regularly sell properties in order to raise capital to invest in others. One Trenton investor bought a package of 15 houses, which included a vacant lot zoned to accommodate two new houses. He sold five of the houses to raise the capital to build the two new houses without the need for construction financing, selling them for $239,000 each.

Managing the One To Four Unit Rental Inventory

Property management is the crux of a viable real estate industry, and it encompasses a variety of different issues, ranging from the manner in which owners take responsibility for their properties, the operating and maintenance cost of the properties, and the dynamics of the landlord/tenant relationship. In the ideal situation, an attentive landlord and responsible tenant combine to provide a well-maintained unit at reasonable cost; in the worst, an irresponsible landlord and/or disruptive tenant result in a poorly maintained unit at risk of abandonment.

The greater part of one to four family rental properties are managed, for better or for worse, by their owners. 84% of the owners of single family detached, as well as two to four family, properties manage their own properties; notably, although a majority of the owners of single family attached properties or townhouses manage their own properties, only 64% do so, with 36% managed on their behalf by third party firms. Despite this, the great majority of owners reported to the POMS that they spend little time on managing the property that was the subject of the interview. Since many owners own more than one property, the total amount of time spent on management – which was not addressed in the POMS – by many owners may be substantial. It is notable that the owners of 2 to 4 family properties spent significantly more time on management

Table 23(a): Time Spent By Owner Managing Property

Category	1 family detached	1 family attached	2 to 4 family
None	23.9%	17.2%	12.0%
< 1 hour/week	40.0	38.3	21.5
1 to 8 hours/week	29.3	36.4	48.2
9 to 24 hours/week	4.4	5.8	12.4
25+ hours/week	2.4	2.3	6.0
Median	< 1 hour/week	< 1 hour/week	3.9 hours/week

Source: POMS.

than the owners of single family properties. This data, however, is hard to reconcile with the responses to another question on the POMS, which suggests a somewhat higher level of engagement by owners. Here, too, the greater level of involvement on the part of owners of two to four family properties is notable, as is the presence of a significant percentage of single family owners who clearly pay little attention to their properties. Not all of these cases reflect irresponsibility. The more than 40% who visit their properties less often than monthly includes a substantial percentage (although less than half) who have placed their properties in the hands of an outside manager. In other cases, the property may have a long-term, responsible tenant, or in others it may be located at a substantial distance from the owner's residence. One experienced property manager interviewed commented regarding single family rentals that "the condition of a property varies inversely with its distance from the owner's home."

Table 23(b): Frequency of Visits by Owner to Property during Past Year

Category	1 family detached	1 family attached	2 to 4 family
Owner lives in building	NA	NA	25.0
> 1 visit/week	14.2%	15.0%	22.7%
1 visit/1-2 weeks	25.0	21.1	25.6
1 visit/month	20.2	16.8	11.2
Less than 1 visit/month	24.7	27.2	8.9
Never or almost never	16.0	19.8	6.5

Source: POMS.

Much of the promotional literature understates the amount of time involved in managing even a small inventory; one writer states that "each property…will involve an average of two or three hours per month including time spent driving and doing paperwork."[38] The owners we interviewed all devoted a good deal of time to property management, although in an

[38] Thomas, *op.cit.*, 11

unsystematic fashion. The husband of the Puerto Rican couple mentioned earlier drives every weekend to Reading, Pennsylvania from Trenton, New Jersey to do maintenance and repair work on the three properties they own in that city, a trip of two hours each way. Properties in good condition, with stable tenants, however, do not necessarily require a great deal of time. The owner of a five-family property noted that her husband "goes two times a week to take out the garbage, once a month to collect the rent. Not much time at all." This does not include, however, repairs, which are done by the husband except for major work, and bookkeeping, which is done by the wife of the couple.

A critical issue, of course, is how well or consistently maintenance of the one to four family rental inventory is handled. While the greater part of POMS respondents claimed to be highly responsible about maintenance, a significant minority admitted to substantial deferred maintenance, including as many as a quarter of the owners of detached single family houses.

Table 24(a): Maintenance Practices of Owners

Category	1 family detached	1 family attached	2 to 4 family
Most maintenance postponed	10.0%	4.4%	5.7%
Minor maintenance postponed	14.3	6.1	13.5
No maintenance postponed; preventive maintenance practiced	75.6	89.5	80.8

Source: POMS.

This is not unusual in this industry, as one highly knowledgeable author has described it:

> Small owners…do their own management and repairs and often delay costly capital improvement as long as they can. They will nurse along a leaky roof and old plumbing just to squeeze out a few more years of life before doing big-buck capital replacements (Schloming and Schloming, 1999)

While not all maintenance needs to be done immediately, the data nonetheless suggests that perhaps millions of units may be at risk from inadequate or deferred maintenance. A similar concern is raised by the POMS data on the percentage of rental income spent on maintenance, which found that over half of all single family owners, and 40% of two to for family owners, spend 10% or less of their rental income on maintenance. If one applies the median monthly rents from the 2003 American Housing Survey to these percentages, it appears that the typical property owner spends between $70 and $90 per month on the average for maintenance.

Table 24(b): Percentage of Rental Income Spent On Maintenance

Category	1 family detached	1 family attached	2 to 4 family
None	18.1%	5.0%	4.8%
< 10%	36.9	45.2	35.8
10-19%	23.1	24.2	32.6
20-29%	9.1	9.9	13.5
30-49%	5.8	7.6	6.2
50%+	7.0	8.1	7.2
Median	< 10%	10%	13%
2005 median rent	$769	$906	$660
Median monthly amount spent on maintenance	$69	$91	$86

Source: POMS; 2005 American Housing Survey.

The extent to which property condition and maintenance are disproportionately a problem with respect to the one to four family rental sector is unclear. American Housing Survey data do not support such a conclusion; the incidence of severe physical problems reported there is *lower* for all categories of one to four family rental units than for multifamily housing, although the incidence of moderate physical problems is somewhat higher. The data are not available to evaluate whether this may be a particular problem in lower-income urban areas, as suggested by Newman (2005) in her research on Baltimore's low-end housing market and by the author's observations.

A closely related issue is that of the competence of small property owners, and whether they in fact have the skills to maintain properties cost-effectively, as well as handle the other responsibilities of property ownership, particularly within the tight financial structure that appears to be inherent in the industry. This has not been studied extensively,[39] although there is considerable anecdotal evidence in support of the proposition that many indeed lack important skills, as a result of which a number of local jurisdictions, most notably New York City, have established a variety of training and mentoring programs (Mallach, 2006). Given the extent to which so many owners of one to four family properties have little or no training or personal background in any of the salient aspects of real estate operation, this observation appears highly plausible, and raises further issues about the long-term viability of much of this inventory.

Economies do not necessarily reflect poor maintenance, and the low figures shown above also reflect the extent to which much of the true cost of maintenance is not accounted for by the

[39] Newman (2005) cites a 1972 book by Michael Stegman, *Housing Investment in the Inner City: The Dynamics of Decay* Cambridge: MIT Press, in support of this proposition.

owners. Few owners actually collect a salary for their work, and it is likely that the majority make little or no attempt to account for their time spent on property management and maintenance. If the above-mentioned owner who travels each weekend to Reading, devoting the equivalent of one day every week to his properties there, were to account fully for his time, it would represent a cost of roughly $120 per unit per month.[40] Similarly, by spreading out capital replacement over longer period, and by carrying out repairs in more economical fashion, substantial further economies can be obtained without necessarily impairing the livability of the unit. An amusing illustration comes from a former contractor who now tours the real estate investment lecture circuit:

> As I travel around the country giving seminars and training classes, I often get asked if I have a favorite repair technique. The first thing that comes to mind is "Bondo." Yes, the same Bondo body filler that mechanics use to repair dents on wrecked cars.[41]

He then illustrates how he was able to repair a rotted area on a bay window for $10 after the owner had received quotations of $2000 and more from contractors who maintained that the window had to be replaced. It is not clear, of course, how long such a repair will last, or whether it would be considered code-compliant by the local jurisdiction.

In the final analysis, a low ratio of maintenance and management expenses to rental income is a threshold condition of the viability of the one to four family rental industry. The ratio between mortgage payments and income is such that the residual income is simply not adequate to provide for management and maintenance at a level considered 'normal' by professional

Table 25: Median Costs by Category as a Percentage of Rental Income

Category	1 family	2 to 4 family
Mortgage payments	77%	64%
Property taxes	12	13
Vacancy loss	1	2
Maintenance	9	13
Not allocated (net cash flow)	1	8

Source: All data except for maintenance from Residential Finance Survey; maintenance from POMS.

[40] He and his wife own three buildings in Reading with a total of 9 units. Assuming 8 hours per week at an hourly rate of $20/hour, along with travel costs of $80 per trip, one arrives at a total cost of $1080/month, or $120/unit/month.

[41] "Inexpensive repairs with Pete Youngs," on www.reiclub/articles/inexpensive-repairs-with-bondo, accessed June 20, 2006.

managers of large rental properties, whether Low Income Tax Credit or upscale downtown apartment buildings.[42] 30% of single family owners reported on the Residential Finance Survey that their mortgage payments *alone* exceeded their monthly rent receipts. The squeeze on property owners is even greater in the northeastern states, where the median percentage of rental income devoted to property taxes is 18% for single family and 17% for two to four family properties (Residential Finance Survey, 2001); although some of this additional cost may be offset by the additional tax deduction it offers the owners. Under these circumstances it is not surprising that many owners report a negative cash flow on their properties.

With margins as narrow as those shown above, the ability of the landlord to find reliable tenants who will pay rent on time and maintain the property in good condition becomes critical. The POMS data provides a snapshot of the tenantry of one to four family rental properties, albeit from the landlord's perspective. Strangely, it paints a picture of a body of tenants that are more problematic, and more likely to be the subject of eviction proceedings, in single family attached than in single family detached properties, and in two to four family than in all single family properties. It is likely that eviction proceedings are higher in the last category because it includes a significant number of owner-occupants, for whom problematic behavior by a tenant may be harder to overlook or tolerate. What is notable, and may reflect a variety of factors including the legal obstacles to eviction in some states, is the low number of eviction proceedings reported by comparison to the levels of rent delinquency and disruptive behavior cited by the owners.

[42] Median monthly operating costs exclusive of property taxes for various multifamily housing types in 2004 ranged from a low of $213 for low rise buildings containing 25+ units to a high of $390 for high-rise buildings (Institute of Real Estate Management, 2005). From the author's experience, monthly operating costs in Low Income Tax Credit rental projects typically range from $300 to $500.

Table 26: Tenant Problem Conditions

Category	1 family detached	1 family attached	2 to 4 family
Has a tenant been delinquent in the rent during past two years?			
Yes	28.5%	28.3%	30.6%
No	71.5	71.7	69.4
Have any tenants engaged in disruptive behavior during the past two years?			
Yes	42.2%	47.5%	55.7%
No	57.8	52.5	44.3
Have any tenants engaged in the following types of disruptive behavior during the past two years?			
Violence	5.8%	11.5%	14.3%
Drug use	5.6	13.4	13.4
Have you brought eviction proceedings against one or more tenants during the past two years?			
No	92.0%	87.9%	79.6%
Once	5.2	4.2	12.4
Twice or more	2.8	7.9	8.0

Source: POMS.

Finding and then holding good tenants is a matter of constant concern to small landlords, for whom a disruptive individual or high turnover can have far greater negative consequences than is the case in larger buildings. Typically, landlords will use a variety of simultaneous means to find tenants, including word of mouth, ‘for rent’ signs and newspaper advertisements. Interestingly, the owners of single family attached properties appear to be far more aggressive not only in using multiple strategies, but also in using tools such as property guides and MLS listings than other owners. This may reflect some of the differences in ownership of this part of the one to four unit inventory, such as the larger share of corporate and REIT ownership; it may also reflect the fact that single family attached properties are often a part of a larger townhouse or condominium development, encouraging co-operative or other shared marketing strategies.

Table 27: Methods of Finding Tenants

(% of those currently seeking tenants)

Category	1 family detached	1 family attached	2-4 family
Word of mouth	69.5%	84.3%	61.5
Newspaper ads	51.8	60.2	60.0
‘For rent’ sign	36.2	75.9	50.7
Multiple Listing Service	7.5	13.0	9.8
Property guides	4.9	35.1	10.3
Radio/TV	1.4	7.6	1.5

Source: POMS.

Reliance on word of mouth is a commonplace in the one to four unit property sector, but it has its downside; at least two owner informants felt that it was a bad idea, one commenting “we don’t like word of mouth. When it was word of mouth it was always a family member or a friend of a tenant….Family doesn’t work. Strangers are the best.” For all the purported advantages of renting to family or friends, it actually reduces the effective control of the landlord over the property, putting her in a position where it may be difficult to deal with rent delinquency or problem behavior. Interestingly, those informants who had a larger inventory tended to rely more heavily on word of mouth than those with only a single building. A thoughtful informant, the head of a nonprofit entity that owns 25 houses and manages a number of houses for other owners, relies entirely on word of mouth to find tenants.

As a corollary to the effort to find good tenants, a significant number of landlords actively work to hold onto those that they have. Roughly half of all landlords responding to the POMS questions indicated that they take specific steps to hold good tenants, most often by offering improved services, redecorating, or carrying out other improvements to the units. One not uncommon practice is to hold out an upgrade, such as new carpeting or a new refrigerator as a reward for good behavior, to be provided after the tenant has been in the unit a year, remained current in the rent, and refrained from problem behavior. While rent concessions are less common, some landlords may offer discounts for early payment, or as one describe it, “set the rent 10 percent above what you really need, and if the tenant has paid regularly and kept the apartment in good shape, waive the December rent.”

How a landlord will behave will depend in part on the landlord, her values and ownership goals, and in part on the nature and conditions of the market in the area. The diversity of small landlords, their backgrounds and motivations, means that landlord behavior in this sector is likely to be far less predictable and consistent than that of large apartment buildings, which are typically professionally managed, following a limited number of business models. One Latino woman, who works for the Habitat chapter in her home community as well as owning a number of small buildings with her husband, clearly sees being a landlord as a social mission. She keeps her rents to levels that are 75% or less of the market rent in the area, and helps her tenants figure out how to become homeowners. In contrast, other landlords in similar high-immigration areas specifically target undocumented immigrants. The nonprofit owner cited above commented that many of his fellow landlords will tell him, “it’s easier to rent to illegals – they pay their rent, and they know they don’t have any protections.” Knowing that their tenants are unlikely to complain, many such landlords charge excessive rents leading families to double or triple up, or fail to provide adequate services, facilities or maintenance.

Government and the One To Four Unit Rental Housing Industry

Although one to four unit rental properties may be all but invisible to government at the policy level, there is nonetheless considerable interaction between government and this sector of the rental housing industry on a day-to-day basis. Most often, contact with government occurs through the workings of the elaborate but erratic systems that exist in most of the United States to regulate the physical condition and the operation of rental property. The regulatory system affects every landlord to some extent, while a much smaller but not insignificant number of landlords also derive benefit from governmental intervention, most often in the form of access to government funding through their tenants' Section 8 (Housing Choice) vouchers.

Government as Regulator

For most small landlords, government is a problematic, even punitive force. The legal system in many states is seen as insensitive to the realities of the low-margin business in which small landlords are engaged, as summarized by one Massachusetts commentator:

> The management style of small owners…puts the housing at risk in the face of several difficult state laws: the state sanitary code, rent withholding, and the warranty of habitability. These laws require code-perfect apartments – and allow tenants in code-imperfect apartments to withhold their rent. (Schloming and Schloming, 1999)

To landlords, regulations can be onerous in two respects: first, in the proliferation of the number of different regulations that may be problematic in themselves, and second, in the manner in which they are administered, and the burden they place on the landlord. The sheer number of regulatory regimes that POMS respondents claimed made it difficult for them to operate is an extensive one, as Table 28 suggests.[43] While any single requirement arising from any one of these single regulatory regimes may not be unreasonable,[44] many landlords would argue that their cumulative effect, to which one must add state and local code standards, landlord licensing

[43] This was a 'forced choice' question, and the categories shown in the table were the categories from which the respondent was required to select.
[44] Many landlords would argue, however, that the lead paint removal requirements in many jurisdictions are inherently unreasonable to the extent that they require the physical removal of the paint, rather than permitting it to be covered in different ways.

and registration requirements, tenant protections and restrictions on evictions, and so forth, can be overwhelming, especially for a part-time landlord who, as the Schlomings put it, is "usually just one step or two above their tenants on the income scale," and lacks the expertise to deal with complex regulations or the funds to hire expensive consultants or attorneys to help them do so.

Table 28: Regulations or Restrictions Affecting Rental Unit Operations

Category	1 family detached	1 family attached	2-4 family
Percentage responding that regulations or restrictions make it difficult to operate the rental unit:			
	22.5%	29.2%	47.5%
Which restrictions or regulations (% of those responding affirmatively above)?			
High property taxes	73.1	62.2%	50.3%
Lead-based paint	17.3	25.8	13.3
Waste disposal	15.5	15.0	10.4
Asbestos	15.0	14.6	8.2
Parking restrictions	12.0	29.0	18.8
Americans with Disabilities Act	11.7	14.8	6.1
Zoning/use of property	11.2	11.2	8.2
Water quality	9.2	8.5	4.9
Radon	8.2	10.3	3.8
Rent control	6.8	13.2	7.7
Utility hookup limits	6.7	9.3	5.6
Historic preservation	2.8	9.5	4.6

Source: POMS.

While there is no doubt that many landlords consider themselves overburdened by regulation, the POMS data, however, suggests that most appear to fly under local inspectors' radar screens, at least with respect to property inspection. Only 19% of the owners of single family detached, and 23% of single family attached properties reported that their property had been subject to an inspection during the preceding two years. The percentage was somewhat higher, 35%, for two to four family properties, which may be the subject of more complaints, as well as scheduled inspections in those jurisdictions that maintain regular inspection cycles.[45] If this is representative, it would suggest that single family properties are likely to be inspected on the average only once very 9 to 10 years, and two to four family properties once every 6 years.

Where regulations are enforced, however, the question arises whether that process may trigger negative consequences that arguably outweigh the benefits of the regulations. This issue is

[45] Under New Jersey law, the state Department of Community Affairs inspects all buildings containing 3 or more dwelling units on a five year cycle, while local inspectors can (and do) respond to complaints about those buildings between inspections. Most local jurisdictions do not maintain regular inspection cycles, but inspect on the basis of complaints, or as part of intermittent 'sweeps.'

raised most often in the context of code enforcement; specifically, whether under the adverse economic conditions that exists in many urban areas, overly stringent code enforcement can render it economically unfeasible to continue operating a rental unit, and lead to the unit being abandoned, a patently negative societal outcome. As a hypothesis, it appears highly plausible in light of the narrow margins associated with the one to four family rental industry, but it remains unproven. Although it has been explored in the literature (Ross, 1996, Schloming and Schloming, 1999), it has not been tested in rigorous fashion. Conversely, one can argue that the failure to enforce applicable regulations as a result of inefficiency, lack of adequate staff, or the forbearance of the regulators, all of which appear to be widespread, are a *sine qua non* for the continued viability of the many small rental properties, particularly in lower end markets. That, in turn, could have the negative consequence of allowing truly dangerous conditions to remain unchecked.

If the proliferation of regulations is in itself a problem, it is compounded by what is widely seen as the manner in which government carries out its responsibilities. *Every* landlord respondent made at least one unprompted comment about government officials, of which one, an African immigrant in the Newark area, was typical:

> They don't conduct business like people who are trying to make a profit. They're slow, and lax about paperwork. They're in total control. They know you need them and they don't need you.

Most of the municipalities in which respondents own property do not have regularly scheduled or otherwise explicitly targeted code enforcement programs, but conduct inspections largely or entirely in response to complaints, or in some cases, when the occupancy of a unit turns over. A complaint-driven process can easily lead to irrational and unpredictable enforcement, placing an uneven burden on landlords without contributing materially to the creation of a generally sound or livable rental housing stock. Similarly, in a jurisdiction where an inspection was required after each turnover, one landlord complained that it sometimes took the inspector as much as three weeks to arrive after being called. Failure to enforce even facially reasonable regulations in a fair and timely fashion undermines the credibility of the entire regulatory regime, providing fair game for the cynicism of one commentator, who concludes a discussion of regulation by writing:

> Mark Twain once said that there are only two constants – death and taxes. Perhaps there is a third. Government regulators will always increase regulations, which will always lower your profits (Weiss and Baldwin, 2003)

These issues will be addressed further in the discussion of policy directions that concludes this paper.

Government as a Source of Financial Opportunity

The principal means in which government provides financial opportunities to small landlords is the Section 8 Housing Choice Voucher program. Under the Section 8 program, low-income tenants rent a unit of their choice, for which they then pay 30% of their gross income toward the rent, with federal funds provided by the U.S. Department of Housing & Urban Development (HUD) paying the balance.[46] The unit must rent for an 'affordable rent;' that is, the rent must be below certain maximum levels known as Fair Market Rents established by HUD, as well as meet minimum quality standards.

While the Section 8 program is a large one by the standards of housing subsidy programs, it affects only a relatively small percentage of the nation's rental housing stock. In 2003, 1.6% of all rental units in the nation's 50 largest MSAs, and 6.2% of all units in the affordable price range, were occupied by households with Section 8 vouchers. Generally speaking, the share of Section 8 units was higher in central cities; in five cities, Oakland, San Antonio, Hartford, Buffalo and Atlanta, 10% or more of the affordable units were occupied by voucher holders (Devine et als, 2003). Unfortunately for our purposes, the published data do not provide a breakdown by structure type. According to the POMS data, which dates from 1995 when the pool of Section 8 vouchers was smaller, 4.7% of single family detached units, 7.5% of single family attached, and 5.8% of two to four family units, received Section 8 vouchers.[47]

At that time, a significant percentage of owners indicated that they would not take Section 8 tenants, including 53.2% of the owners of single family attached, 50.9% of single family detached, and 43.9% of two to four family properties. Their reasons tended to combine

---

[46] The funds are generally provided by HUD to local public housing authorities (PHAs), which administer the program in their area, issuing the vouchers and inspecting the units. There are exceptions; e.g., in New Jersey the state government administers the program in roughly 1/3 of the state's jurisdictions.

[47] These figures may be inflated, in that the manner in which the question was asked could lead to the inclusion of some subsidized housing projects, as well as those units where the tenant was receiving assistance to live in conventional privately-owned housing.

suspicion of Section 8 tenants with a reluctance to engage with what they perceived as excessive regulations, paperwork or bureaucracy. Although more recent statistical data is not available, interview responses suggested that landlords, at least in urban areas, are substantially more accepting of Section 8 vouchers today than they were ten years ago, a finding corroborated by a major landlord-oriented web site, which boldly proclaims "doing business with Section 8 is just good business."[48] There appear to be two principal reasons for this change. The first is a widespread perception that the program is administered more effectively than it was ten years earlier, including both more careful selection and screening of voucher holders as well as a more efficient management process.[49]

The second reason underlying the changed landlord attitudes toward Section 8 reflects the extent to which landlords in inner-city neighborhoods have learned how to game the system, by taking advantage of the process by which HUD sets Fair Market Rents. The FMR is defined as the 40th percentile rent; i.e., the dollar amount below which 40 percent of the standard-quality rental housing units are rented, excluding public housing and units less than two years old, as determined for each metropolitan area. Rents in inner-city areas are typically lower, however, and often considerably lower, than the average for the metropolitan area. As a result, landlords in those inner-city areas where vacancy rates were relatively low for units of minimally acceptable standard and where a substantial number of Section 8 vouchers were circulating came to realize that they could increase their rent up to the FMR level, often representing a significant increase over the realistically obtainable market rent in the particular neighborhood or community in which the unit was located.[50] For many landlords in low income submarkets, as will be discussed below, the market rent may well have been inadequate to support the long-term viability of the property, so that the ability to increase the rent to the FMR level was not merely a matter of profiteering, but one of survival. This pattern, which informants independently described as taking place in a number of New Jersey cities as well as Philadelphia, creates significant market distortions, but carries little downside risk for the landlord. What it does, however, is place those lower income households seeking rentals who do *not* have vouchers – the great majority of

[48] www.landlordassociation.org/section8.html, accessed July 20, 2006.
[49] A number of states, including New Jersey, have also passed laws that bar landlords from discriminating against prospective tenants on the basis of their source of income; i.e., their voucher.
[50] Certain programs, particularly the Hope VI program, in which large numbers of vouchers were issued in conjunction with the demolition of large public housing projects, tend to create a spike in the number of vouchers circulating in a community over a relatively short period.

households – in severe hardship, since they will be forced to pay a rent well out of proportion to their means. It may also increase speculative buying in these areas, because of the significant increase in potential cash flow available through the voucher.

Utilization of other governmental benefits by the owners of one to four family rental properties (other than atypical owners such as the Cleveland Housing Network) is rare. Other than rental subsidies, which presumably mean Section 8 vouchers or similar state-level programs, only about 2 percent of the units benefit from tax relief or from government grants, loans or tax credits.

Table 29: Units Receiving Property Benefits

Category	One family	Two to four family
Rental subsidy	1.7%	4.3%
Tax relief or tax abatement	1.0	0.8
Grants, loans, or other	0.8	1.5
No benefits	96.5	93.4

Source: Residential Finance Survey, 2001.

This is hardly surprising. Most small landlords are not sophisticated about government programs and are reluctant to engage with the local bureaucracy, while the ready availability of relatively affordable financing from private lenders has reduced their potential need for governmental assistance. Of equal importance is the fact that most local housing or community development agencies target few resources toward the owners of small rental properties. Most tend to target discretionary resources to income-qualified owner-occupants; where funds are made available for rental housing, they tend to go to large-scale owners or developers; one owner respondent mentioned that he had called the city to enquire about financial assistance to rehabilitate a building, and was told that the program was "out of his league."

Assistance programs for small landlords lack both the feel-good qualities of programs that help low income homeowners, particularly those who are elderly or disabled, or the visibility of programs that target larger buildings or new construction. They can be, moreover, politically unpopular. When the author was head of a city economic and community development agency, he proposed to use a modest amount of Community Development Block Grant funds for a pilot program of improvements to small rental properties; the idea was denounced by a vocal city council member as "rewarding slumlords," and shelved by the council.

Local Market Conditions and the One To Four Family Rental Industry

As noted earlier, the 1 to 4 family rental housing stock is highly diverse, and distributed among areas of markedly different market character. In order to place this diversity in a coherent framework and distinguish between areas of significantly different character, the author has developed a simplified rental housing demand model, shown in schematic form in Table 30.[51] Submarkets are defined in the model by the strength of demand for rental housing by households defined by their income range. Thus, in a C submarket, as shown in the table, the demand for rental housing is strong among low-income households, but weak among moderate, middle or upper income households. This market condition is typical of many inner city neighborhoods throughout the urban United States. In an A submarket, demand is strong across all income categories, from low income to upper income. Such submarkets are common in affluent suburbs as well as in prime urban locations such as in Manhattan and its satellites, Hoboken and the Jersey City waterfront.

Table 30: Simplified Rental Housing Demand Model

INCOME CATEGORY	SUBMARKET RENTAL HOUSING DEMAND BY INCOME CATEGORY D	C	B	A
LOW INCOME	LOW DEMAND	HIGH DEMAND	HIGH DEMAND	HIGH DEMAND
MODERATE INCOME	LOW DEMAND	LOW DEMAND	HIGH DEMAND	HIGH DEMAND
MIDDLE/UPPER INCOME	LOW DEMAND	LOW DEMAND	LOW DEMAND	HIGH DEMAND

The income levels of the potential tenant pool are the central variable, because they largely determine the amount of rent that landlords are able to obtain from their unit, at least in the absence of market distortions such as those created by the Section 8 program. That, in turn, largely determines not only the cash flow and potential appreciation of the existing units, but also the extent to which – and the conditions under which – individuals will invest in rental housing in the area, either maintaining and improving existing rental buildings or purchasing existing properties for purposes of operating rental housing. A critical secondary variable, however, is the extent to which the market perceives potential for significant appreciation in the area, not from its internal market but by drawing a different market into the area, as in gentrification. This is a

[51] This model was initially developed for a paper commissioned by the New Jersey Housing & Mortgage Finance Agency, Preserving *New Jersey's Affordable Private Rental Housing Stock: A Preliminary Assessment* (2004). Although unpublished, the paper is available from the National Housing Institute.

particularly important factor with respect to investor behavior in C submarkets, as will be discussed below. The most common investment or disinvestment patterns associated with the different submarkets – and particularly those of predominately lower income character – are discussed below, and summarized in Table 31 on the following page.

D submarkets, in which there is little or no sustained demand for rental housing by *any* income group, are the most constrained and distressed of all housing market subareas. Typically, an area does not reach this level until after it has already undergone substantial abandonment, and then only if a pool of available rental housing at roughly comparable rent levels is available in other neighborhoods that are perceived as being at least marginally better.[52] A D submarket is, with the possible exception of subsidized housing investment, largely by CDCs, in a state of almost total landlord disinvestment. It is typically a candidate for large-scale redevelopment rather than other neighborhood improvement strategies. While it is doubtful that any such submarkets exist at this point in the northern New Jersey cities discussed earlier, many areas in weak market cities such as Buffalo, Detroit or St. Louis may fit this description.

[52] One of the reasons that D submarkets come into being is that although landlords will increase their rents readily if they believe the area is attracting a more affluent market, the tend not to reduce their rents as readily if they perceive that the neighborhood's market is weakening. Part of this is attributable to the economic phenomenon known as the 'price ratchet', but it also reflects the fact that a landlord will rarely, if ever, consciously offer units for a rent at which she knows she will lose money, except as an occasional short-term expedient. As a result, rents in D submarkets are not likely to be substantially lower than those in more desirable areas, certainly not to the degree that would theoretically be expected on the basis of their relative market weakness.

Table 31: Demand and Investment Characteristics by Submarket

CATEGORY	DEMAND CHARACTERISTICS	INVESTMENT OR DISINVESTMENT IN EXISTING 1 TO 4 FAMILY RENTAL HOUSING
D SUBMARKETS	Effective absence of sustained housing demand from any sector of population. High vacancy rates at all rent levels.	Widespread disinvestment and abandonment of rental properties. Few buyers for 1 to 4 family rental properties, other than speculators or poorly informed, naïve, investors.
C SUBMARKETS	Demand limited to low-income population. Rent levels constrained by lack of demand at higher income levels unless artificially supported by Section 8 vouchers.	Deferred maintenance and repair are common, linked to the inability to recapture investment through rent increases, while abandonment is associated with outcomes of unsuccessful speculation and flipping, or inability to carry debt and maintain positive cash flow. Buyers of 1 to 4 family rental properties are more likely to be speculative investors looking for short-term returns than long-term investors. Where low-income demand is particularly strong, overcrowding is widespread, both as a consumer response and a landlord strategy to maximize cash flow. Investment decisions in these submarkets in relatively strong market regions are strongly influenced by anticipated future market change and appreciation.
B SUBMARKETS	Rental demand is present from both low and moderate income populations. Moderate rate of increase in rent levels, but maximum rent levels still below replacement cost.	Rental housing stock is generally well maintained. Buyers include some speculators but more long-term investors, largely small-scale local owners and developers, as well as owner-occupants of 2 and 3 family properties. To the extent limited abandonment takes place, it is associated with need for major systems repair, which cannot be sustained by cash flow, or transactional abandonment.
A SUBMARKETS	Rental demand from all sectors including middle/upper income households. Strong rate of increase in rent levels unless constrained by rent control, with maximum rent levels equal to or greater than replacement cost.	Multifamily rental housing stock is generally well maintained, often in corporate or REIT ownership and professionally managed, 1 to 4 unit stock is more likely to be speculatively owned, often by investors seeking appreciation rather than cash flow.

An absence of sustained investment in the rental inventory is characteristic of these areas. To the extent that any investment takes place, it is likely to be either highly speculative – and often linked to fraudulent practices such as flipping based on inflated appraisals – or the product of ignorance and naiveté, as reflected in an example from a severely distressed Baltimore neighborhood. A suburban systems engineer turned real estate investor purchased three vacant houses for $15,000, putting $10,000 to $15,000 into each for renovations. After trying to sell them for $40,000 each without success, he rented them out. Subsequently, he was cited both for illegally dumping debris and for numerous code violations, including a furnace that “appears to be patched together with tape and insulation in an unworkmanlike manner.” The engineer signed a consent order requiring him to properly rehabilitate the properties; it is more likely, however, that they will be vacated, and added to the thousands of vacant shells already common in Baltimore’s poorer neighborhoods (Siegel, 2006).

The most significant submarkets for purposes of this analysis are **C submarkets,** in which there is relatively strong demand for rental housing by low income households earning 50% or less of the area median income, but little or no demand by households earning more than that amount. These areas can be seen as representing the classic inner city rental market pattern, and contain a disproportionate share of the 1 to 4 family rental housing occupied by low income tenants. While landlords offering units meeting minimum standards have no difficulty finding tenants, landlords’ ability to increase rent levels is severely constrained by their tenants’ limited ability to pay. This is not a function of altruism on the landlord’s part, but one of realism. A landlord who charges too much in a C submarket will not only find it harder to find tenants, but will experience higher turnover and greater difficulty collecting rent, all of which materially affect her bottom line. A responsible landlord will recognize the negative effects of excessive rent increases, and will moderate her rent demands accordingly. This pattern, however, can be significantly distorted by the effects of Section 8 vouchers, as discussed previously.

Within C submarkets where low-income demand is particularly strong, such as the immigrant neighborhoods of northern New Jersey, large-scale overcrowding is a nearly inevitable product of the demand pattern. Although the demand for rental housing is strong enough to promote the conversion of owner-occupied housing to rental housing, it is too price-constrained to trigger private market production of new rental housing to meet the demand, even if suitable sites subject to reasonable land use regulations are available.[53] Overcrowding is both a rational consumer response to high housing costs, by spreading the cost of housing over more

[53] Most subsidized rental housing, with the exception of housing restricted to senior citizens, is constructed in C submarkets. Buildings and sites may often be obtained at modest cost, many CDCs are active in such areas, and political obstacles to subsidized rental housing are generally less pronounced than in other areas. This construction activity can have beneficial effects, in that it improves the quality of the housing available to the low-income tenants in the area. At the same time, it may have the effect of exacerbating the already excessive concentration of low-income households not only in urban centers, but in particular neighborhoods within those centers, as well as undermining the viability of comparably-priced private rental housing. Carefully planned and designed – particularly if combined with other improvements – low income rental housing can enhance neighborhood quality. If not well planned, it can work against efforts to foster revitalization efforts and increase economic diversity in the neighborhood.

payers, as well as a rational – at least in the short-term – landlord response, by expanding the pool of tenants capable of paying the rent that the landlord needs to carry her investment and make a profit. Given the inability of the market to support significantly higher rents, the excess of demand over supply does not result in expansion of the supply as much as it results in the diminution of housing quality, in the form of overcrowding, and in many cases subsequent deterioration in the physical conditions of the housing unit.

The relationship between increased poverty, rent levels and property values in these submarkets has been established in a recent paper which has established that "marginal increases in poverty when neighborhood poverty rates are in the range of 10 to 20 percent results in dramatic declines in value and rent." (Galster et als, 2006).[54] In essence, rather than the relationship between income and rent levels being linear, at some point within that range a threshold is reached, leading to a negative transformation in the character of the housing market in the area, a crash analogous to the concept known in physics as a phase transition (Ball, 2004).

The price-constrained character of the rental market in C submarkets has significant implications for investment and disinvestment. As Galster points out:

> Past some percentage of poverty, the owner will switch to an undermaintenance mode where net depreciation will occur. I call this point the owner's "disinvestment threshold." Subsequent increases in neighborhood poverty rates will trigger even more radical disinvestment choices, eventually including abandonment (Galster et als, 2006).

Leaving aside the extreme cases, which in our model would be characterized as a transition from a C to a D submarket, the owner of a rental property may be able to obtain a reasonable long-term return from the property, but only under nearly optimal circumstances. For that to happen, the owner must have a modest debt load, be able to manage her maintenance costs carefully, and have no need to make major repairs, which typically cannot be supported by cash flow. Needless to say, those conditions are difficult if not impossible to sustain over time, and many buildings in C submarkets suffer from deferred maintenance and from inadequate repairs to major systems, as landlords attempt to keep buildings occupied without either the ability or the will to improve the property. Moreover, the landlord must be fortunate enough to avoid destructive tenants, and be able to maintain a low vacancy and collection loss over time, something difficult to sustain in

[54] As a general rule, C submarket areas typically have poverty rates above 10 percent.

view of the higher turnover and collection difficulties associated with the limited incomes of the households in the tenant pool.

Still further problems often arise from the limited capacity or know-how of many small landlords, particularly those for whom property ownership is a part-time supplement to an unrelated full-time job. As a result, although a stable market exists for rental units in the area and rental vacancy rates may be low, the economic viability of many buildings is marginal. That, in turn may lead many landlords to abandon any pretense of a long-term holding strategy, and seek to maximize short-term gains through overcrowding and reduced investment.[55] Abandonment of rental housing properties can be an ongoing phenomenon in many C submarkets, which, if not addressed, can trigger a spiral of further abandonment and deterioration. The existence of such trends is supported by the findings of a recent Joint Center publication, which documented the disproportionate loss of one to four family properties in distressed neighborhoods from the rental inventory (Joint Center for Housing Studies, 2006).

The marginal economics of rental housing in C submarkets suggest that many individuals purchasing rental property tend to be speculative purchasers looking for fast returns, rather than individuals looking for long-term stable investments. An individual seeking to buy older properties and upgrade them to good quality housing is likely to find that the rents she is able to obtain may not support carrying both the acquisition cost and an adequate level of improvement, leaving the field largely to speculators who are likely to lack a long-term commitment to the properties. Some exceptions to this pattern, however, may be found in immigrant communities, where emerging real estate entrepreneurs use a combination of informal financing methods and unpaid labor of family and friends in order to overcome the otherwise problematic economics of these submarkets.

These are the areas in which the greatest shifts from owner-occupancy to absentee ownership are taking place. Many C submarkets, particularly those characterized by large numbers of single family structures, also have large numbers of elderly homeowners and weak homeowner

[55] This is confirmed in general terms by Bogdon and Ling (1998). Their study, which analyzed data from the 1996 Property Owners and Managers Survey (POMS), found that properties in competition with subsidized housing as well as properties occupied by lower income tenants were significantly less profitable than those competing only with other market housing and with fewer lower income tenants. While this may seem somewhat obvious, it is important to restate in light of intermittent assertions that inner-city absentee ownership is exceptionally lucrative. This study found that small buildings, particularly those with 5 to 9 units, are consistently less profitable than larger multifamily buildings. It is important to stress that, given the limitations of the POMS data, Bogdan and Ling's findings are more suggestive than definitive.

resale markets. The number of single family or two family properties likely to appear on the market may substantially exceed the limited demand by prospective homebuyers. This dynamic is tailor-made for speculative buyers, who are often able – by offering fast cash closings without contingencies – to buy houses at substantially less than the owners' asking price.[56]

While immigrant-driven demand pressures and the availability of Section 8 vouchers clearly affect landlord behavior in C submarkets, perhaps the most significant factor driving investment decisions in such areas is the perception of potential appreciation resulting from exogenous market factors. Sophisticated investors in single family rental properties such as Redbrick Partners, described earlier, explicitly target those lower priced areas – typically C submarkets – where their assessment of larger citywide and regional trends leads them to anticipate significant appreciation. Small, less sophisticated investors also track wider market trends, although their assessment of the effect of those trends on a particular neighborhood or city block and their targeting of particular properties may be less accurate or well-grounded.[57] The anticipation of future appreciation, however, can result in widely divergent behavior. In some cases, landlords may adopt long-term holding strategies, accepting even some negative cash flow while maintaining their properties. In others, the landlords may adopt a different sort of long-term holding strategy, allowing the property to become physically abandoned while continuing to pay taxes on the property, in anticipation of being bought out for the value of the land, rather than the building.

The other two submarkets will be discussed more briefly. **B submarkets** are areas in which there is sustained rental market demand from both low income households as well as from moderate income households earning up to 80 or 100 percent of the area median income, but not from upper income households. Such submarkets were substantially more common in urban areas through the 1970's than they are today. They have diminished partly because of suburbanization, and partly because of the increase in homeownership opportunities both for racial and ethnic minorities and for 'nontraditional' households such as single individuals, single

[56] The author observed this pattern in Trenton's Chambersburg neighborhood in the 1990's. Many of the houses that were bought as a result were then used by their owners as quasi-dormitories, renting them by the room – or by the mattress – to single men, generally recent Latin American immigrants.

[57] Such investors may erroneously assume that the presence of significant regional or citywide appreciation means that every property or every neighborhood within the city will show similar appreciation, and be highly unselective in their purchasing, as with the suburban systems engineer mentioned above. The reality is that certain areas, in particularly D submarket areas, may be too deeply disinvested to benefit from citywide or regional market change; a rising tide, as someone has pointed out, does not lift boats with leaking hulls.

parents and gay couples. Prior to the 1970's, such households often formed a substantial core of moderate and middle income renters in many urban neighborhoods. Where such areas continue to exist, they are more likely to be found in smaller cities or first ring suburbs, particularly areas that retain strong ethnic identity.[58]

The higher rents that landlords can charge in B submarkets provide for a more stable rental market, in which a higher level of maintenance, replacement and repair, including debt incurred for improvements, can be supported under normal conditions from project cash flows. Where such areas contain an inventory of two and three family properties, their relative stability encourages their purchase by owner-occupants as much as by absentee investors. As a result, the pool of property buyers includes a substantial number of both owner-occupants and individuals seeking longer-term investments as well as short-term speculative buyers. Abandonment in B submarkets is rare, and is associated more with crisis situations such as a major system failure in a poorly managed building, the effects of predatory lending – affecting homeowners more than landlords – or 'transactional' abandonment – abandonment that takes place despite the underlying economic viability of the property, for reasons associated with property transactions, bankruptcies or estate issues.

The pool of buyers is concentrated among small-scale investors and owners, many of whom may be present or former residents of the area, or share an ethnic identity with the present residents of the area, and includes few large corporate investors and owners. While many of these owners have a commitment to their properties or to the neighborhood, the ability of some operators to maintain their properties on a long-term basis is constrained by limited financial capacity or inadequate technical or managerial skills. Since B submarkets typically have relatively healthy homeownership markets as well as rental markets, they are likely to exhibit less movement of existing housing from owner-occupancy to rental occupancy. As a result, the 1 to 4 unit rental stock in these areas is much less volatile than in C submarkets; while it is unlikely to shrink through mismanagement or abandonment, it is also unlikely to grow beyond its present level.

A submarkets are those in which there is sustained demand for rental housing from households at all income levels, although lower income households are often effectively

---

[58] New Jersey contains many such communities, largely located in close proximity to the urban centers of North-eastern New Jersey, such as Clifton, Bayonne, Bloomfield, Nutley, Linden, Roselle, and others. While they tend to have higher homeownership rates than nearly cities, they nonetheless contain substantial numbers of rental housing units, many of which are in owner-occupied two and three family homes. Similar clusters of small cities and inner ring suburbs are found in proximity to other major northeastern cities.

excluded from these areas by high rent levels.[59] Such areas are typically found in the downtowns of urban centers, not only major centers such as Chicago or New York but also smaller cities such as Baltimore or Cleveland and in affluent suburban communities.[60] With respect to 1 to 4 family properties, A submarkets are typically suburban, made up of a mix of postwar single family houses as well as townhouses in upscale new developments.

In today's market conditions, after the spectacular run-up in house prices in areas of strong demand during the late 1990's and early 2000's, the value of most single family houses in A submarkets for sale to owner-occupants usually exceeds, often by a substantial margin, the capitalized value of the potential rental income they can command. As a result, most investors who purchase such properties do so for appreciation rather than cash flow, even accepting a short-term negative cash flow as a cost of doing business. If the market significantly cools over the coming years, a process that appears already to have begun in many parts of the United States, the number of such investors buying single family houses in upscale areas, particularly in newly constructed developments, may decline sharply.[61]

Directions for Future Policy and Research

The picture that has been presented in the preceding pages, a mixture of quantitative data and qualitative commentary, is rich with implications for public policy and for future research. Indeed, as we stated at the beginning of the paper, it is rare that an area of such manifest significance in terms of the nation's housing has been elicited so little public policy interest, or been the focus of so little substantive investigation. This section is designed not to formulate a public policy or research agenda with respect to the one to four family rental stock, but to initiate a discussion on what such agendas might contain.

[59] A significant exception to the exclusion of lower income renters from A submarkets is found where a particular area has made a transition from a lower income to an upper income market, and a substantial pool of subsidized housing built in earlier years continues to house lower income renters. An example is Hoboken, New Jersey, which made a drastic market transition between the 1970's and 1990's. Although it is now an upscale rental market, over 20% of its housing stock is made up of subsidized housing, which today represents virtually the only housing in the community affordable to low income households.

[60] Many cities, however, contain upscale single family residential neighborhoods, which although largely owner-occupied, contain single family rental units that command substantial rents, such as Chestnut Hill in Philadelphia or Georgetown in Washington DC.

[61] This, in turn, could have a significant effect on the course of any future housing market decline. To the extent that significant speculative buying of new homes fuelled the unprecedented increase in house prices between 1998 and 2005, the withdrawal of short-term investors from the new home market could further exacerbate any decline.

As with the paper as a whole, the following discussion of policy and research issues primarily addresses that part of the stock, largely located in urban areas and first ring suburbs, which serves as a major source of housing supply for America's low and moderate income households. It is doubtful that the purchase of single family houses by investors or speculators in affluent suburbs or new upscale developments has any problematic housing policy consequences; however one may feel about the spectacle of the speculative feeding frenzies that have been taking place. That process creates a source of additional, albeit expensive, rental housing; often in areas which are often chronically short of an adequate rental supply, while the nature of the market tends to ensure a relatively high level of maintenance. Moreover, it is likely that most of these units end up, sooner or later, in the owner-occupied stock. It is the less expensive, more largely urban, one to four family rental stock that raises the most important questions and which demands a coherent policy response.

Framing a Public Policy Response

To the extent that this sector is addressed in public policy, the manner in which it does so could be characterized as a form of malign neglect, in which unevenly burdensome regulations are coupled with sanctions for failure to comply with those regulations. Regulations, as a rule, apply to all rental properties and do not single out one to four unit buildings for particular scrutiny. From a policy standpoint, however, the imposition of a single standard on all properties, where their economic and other characteristics are significantly different, will inevitably tend to pose greater burdens on some and lighter ones on others. A code standard that is strict about cosmetic matters is far more onerous when applied to small, older properties than when imposed on newly constructed apartment buildings. Moreover, to the extent that offsetting incentives or benefits are offered, they tend to be limited to home owners or to larger rental properties; even if nominally available to small rental properties, they are unlikely by virtue of their structure and ground rules to be realistically available.

To explore the reasons for this in detail would be beyond the scope of this paper, but a few observations are appropriate. Rental housing generally is widely seen in the United States as second class housing (Krueckeberg, 1999), and landlords have also been widely seen in a negative light, particularly by those active in framing much of American housing policy since the 1930's. Until quite recently, moreover, housing policy has tended to focus far more on the production of housing than on its preservation. Even now, when preservation has become the focus of greater policy attention, the lion's share of that attention is directed to the preservation of subsidized housing developments of the 1970's and 1980's which are at risk of removal from the affordable housing stock through expiration of use restrictions, rather than the older housing stock in general. This reflects the continued bias in rental housing policy toward large-scale multifamily development, reflected both in the financial and legal structure of programs such as the Low Income Housing Tax Credit, as well as in the policy decisions of many public agencies.[62]

Framing sound public policy toward private landlords is a difficult proposition. While many landlords are not responsible owners, whether with respect to their maintenance of their properties or their treatment of their tenants, housing advocates have learned through often painful experience that non-profit or CDC management of rental properties is not in itself a panacea (Bratt et als, 1998). Conversely, many landlords, both for-profit and non-profit, are clearly responsible and conscientious owners and managers. Public policies, however, make no such distinctions, painting them all with the same largely negative brush.

In terms of framing a rational housing policy toward the one to four unit rental housing stock, we would suggest that it is important to begin with the premise that the preservation of this stock, *under continued dispersed private ownership,* is a sound, even essential objective. While it may be appealing to contemplate the conversion of this stock to social housing, we would argue that the likelihood of that taking place in any systematic fashion is too remote to be a credible alternative to a more conservative preservation strategy, even though there are undoubtedly some local circumstances where that could be both feasible and desirable.[63] Of the 18 million units in this inventory, roughly 300,000 are currently in non-profit ownership. Were that to double over the coming decade, it would represent a shift of less than 2 percent in the ownership of the inventory. A comparable or greater shift toward large-scale corporate or REIT ownership is

[62] During the 1990's, the New Jersey Department of Community Affairs had a strong although unwritten policy against funding projects made up of individual rental units or small buildings on scattered sites, rather than distinct multifamily housing developments.

[63] Such circumstances might include communities with particularly powerful speculative pressures and rising rent levels, but where a strong CDC or non-profit entity with the resources and capability to have a major impact on the market was present. As a general proposition, however, we would argue that the cost of converting large numbers of small rental properties to social ownership, which would entail both the cost of acquisition from their owners at fair market value with associated transaction costs, as well as subsequent repair or rehabilitation costs, is likely to be disproportionate relative to the benefits it provides to the tenant population. Moreover, most parts of the United States have few if any credible non-profit entities with either the capability or will to engage in large-scale property management of scattered-site rental housing.

perhaps somewhat more likely, but not to the degree that it will materially change the fundamental ownership pattern of this stock within the foreseeable future. Moreover, there is no particular reason to believe that a shift toward corporate or REIT ownership of one to four family rental properties would necessarily be beneficial from a public policy perspective.

Accepting that premise, it follows that the central public policy goals with respect to the one to four unit rental housing stock should be twofold. First, to preserve – and perhaps even expand – the stock of one to four unit rental housing, while maintaining reasonable levels of quality and affordability; and second, to provide incentives for ‘good’ landlord behavior while continuing to punish ‘bad’ behavior. We would argue that ‘good’ behavior is that which preserves both the quality and affordability of the housing unit, while contributing to – or at least not undermining – the stability of the neighborhood or community in which it is located. Ultimately, public policy should seek to create a regime of incentives and disincentives that is powerful enough to multiply the presence of ‘good’ actors, driving the incompetent and irresponsible actors out of business. While this is a highly ambitious goal, any steps that would result in even partial movement in that direction would be positive ones.

The central conundrum, which has been alluded to previously, is the question of housing quality, and what represents a ‘reasonable’ level of quality. If, as our analysis strongly suggests, the economic viability of the affordable one to four unit rental sector depends on levels of maintenance and repair that fall short of full code standards under the law in many jurisdictions, can this be reconciled with societal standards not only for housing quality, but for social equity?[64] Challenging the necessity of housing code provisions or suggesting that there be differential standards for people at different economic levels, are steps fraught with difficulty, yet if our inference is correct that large numbers of affordable units retain their economic viability only because of conscious failure to enforce the codes, then a differential standard already exists *de facto* if not *de jure.*

A proposal has been put forward for what its authors call a ‘multi-tiered’ code, which

[64] The equity issue is a slippery one, which hinges on the distinction between what is an acceptable minimum standard for housing and what are arguably discretionary, or luxury features. While few people would argue that it is acceptable for people of limited means to live in housing that is substandard, by a reasonable definition, few more would argue that their housing needs to include features that are clearly not essential to decent living conditions. The question, of course, is where the line is drawn, and how the distinction between necessary minimums and discretionary options is made.

would (1) give priority to serious structural/safety conditions, allowing a realistic amount of time to get funding and do well-planned work; and (2) 'grandfather' older housing, allowing it to stay 'as is' as long as feasible. (Schloming and Schloming, 1999). In conjunction with such a code, the Schlomings further suggest that greater flexibility be permitted to allow property owners – rather than solely licensed contracts – to do many repairs, and that technical assistance be provided to owners "emphasizing long-term building maintenance over cosmetics, preservation rather than gut rehab." This policy area needs further exploration. Ideally, rather than being based on polemics, it could take place in conjunction with further research that would establish far more clearly the actual nature of the multifaceted relationship between code enforcement, property maintenance, affordability and economic viability in one to four unit rental properties.

In that light, it is worth investigating whether it would be appropriate not only to provide the regulatory flexibility to enable owners to make essential improvements in a cost-effective manner, but also to provide them with financial assistance that would make it possible for them to do so without impairing the financial viability of their properties. While it would be difficult for a public agency to make such assistance available directly – and indeed many landlords would be wary of dealing with public agencies offering such assistance – it is an area where public funds could be provided to intermediaries, who could blend them with funds obtained from private sources, such as banks or foundations. A model of how such a blended program could operate has been developed by the Federal Reserve Banks of New York and Philadelphia (Federal Reserve, 2000).

Regulatory flexibility and financial assistance can and should be linked to training and technical assistance. The Community Investment Corporation, a non-profit rental property lender in Chicago, offers a property management training program to its borrowers and other landlords, covering subjects from marketing and fair housing to real estate tax issues, maintenance and budgeting.[65] CIC also provides a property management manual which can be downloaded without charge from its web site.[66] New York City, in addition to offering training through its Housing Education Program, offers small group and one on one technical assistance and mentoring to landlords through its Owner Service Program (Mallach, 2006). Although these

[65] The CIC was established in 1974 by a number of lenders as a lending pool for rental housing in Chicago's lower income neighborhoods. Although it concentrated on one to four family properties for its first ten years of operation, it has redirected its efforts toward multifamily housing since 1984.
[66] www.cicchicago.com/htdocs/training/pmmanual.html

programs are principally aimed at the owners of multifamily properties, they are as relevant, if not more so, to the owners of one to four unit properties.

An interesting approach is being developed by the Borough of Rochdale, an industrial city of about 200,000 in northwestern England. The borough has established a Landlords' Accreditation Scheme, under which landlords who adhere to a code of standards obtain preferential treatment from the municipality with respect to a variety of services and resources, including access to a program under which the borough guarantees security for tenants who lack the means to put down a security deposit.[67] A key object of the scheme is to build a cooperative rather than the traditionally adversarial relationship between the municipality and its rental property owners. In such a climate, the ability of the municipality – or appropriate third parties – to provide technical assistance to landlords, and the receptivity of the landlords to that assistance, is likely to be substantially enhanced, with potentially significant benefits for landlords and tenants alike.

In this light, other forms of financial incentive should be investigated. For example, cities which levy a registration fee on landlords – a widespread and growing practice – could offer to waive a year's fee if the owner took a property management course such as that offered by CIC; more ambitiously, cities could offer landlords a rebate of a small part of their property tax bill if they consistently adhered to a body of standards – such as that in Rochdale's code – over a number of years, or could use compliance with those standards as a condition for preferential access to other financial incentives. Tax incentives, such as structuring depreciation schedules or capital gains to reward long-term holding could also be considered, as should ways of restructuring the Section 8 voucher program to foster greater long-term stability in the affordable housing stock (Apgar, 2004). Given landlords' narrow financial margins; it is quite likely that relatively modest financial incentives would be effective ways of motivating desired landlord behavior.

While government has no direct control over who enters the rental housing industry as a property owner, or how long they hold onto their property, there are important areas where such private decisions intersect with the public sector, and where policies can be crafted to discourage entry by unqualified or inappropriate actors, and to discourage short-term speculative holding. Rapid turnovers of property, especially where they result neither in solid improvement to the property nor a stable outcome, would appear to act as a destabilizing factor in stressed

[67] www.rochdale.gov.uk/Living/Housing.asp?URL=lasscheme, accessed July 20, 2006.

neighborhoods, increasing the likelihood that the property will be abandoned and reducing the value of adjacent properties. Various measures have been suggested to discourage speculation, such as an anti-speculation tax, in which the transfer of properties held for a short period is taxed at a higher rate than those held for longer periods (Zarembka, 1990).[68] Still other measures could be devised to address property flipping, including disclosure requirements, strict enforcement of codes of habitability through inspections at the time a property is conveyed, targeted code enforcement, and greater oversight of appraisal practices by state licensing boards.

Many inappropriate actors enter the rental industry by purchasing properties from public entities. Typically, property sales by government, including tax foreclosures and tax lien sales as well as property auctions, are 'all-comers' procedures, where the only criterion is the amount of money proffered by the bidder. Governmental property sale practices tend overwhelmingly to favor short-term financial return to the governmental unit over long-term preservation of the housing stock and neighborhood stabilization, as a result of which they have the *de facto* effect of favoring the more irresponsible bidder and fostering practices that are ultimately destabilizing to the property and the neighborhood (Mallach, 2006). Such sales should take place under tighter controls, including requiring approval of bidders' qualifications and explicit contractual standards for the rehabilitation and use of the property to ensure reasonable outcomes with respect to the properties being sold.

Similarly, where governmental incentives, such as tax abatements or sale of public land at below-market prices, are being used to encourage construction of two or three family properties, the municipality could require that the units be sold to owner-occupants, with provisions for recapture of the benefits of the incentive if the owner failed to remain in the unit for some appropriate number of years.[69] Generally speaking, public policy incentives to further owner-occupancy rather than absentee ownership of two and three family properties are most probably desirable; although the benefits of owner-occupancy would appear to be intuitively clear, further investigation is needed to establish them more unequivocally.

[68] The only anti-speculation statute in the United States of which the author is aware is a Vermont statute that taxes the gain on sale of land on a sliding scale based on a combination of the length of time the property is held and the size of the gain as a percentage of the basis; 32 Vt. Stat. Ann. § 10001-10011. The voters of the city of Burlington Vermont approved an anti-speculation tax in a referendum, but the city was unable to obtain the necessary state legislative approval for it to go into effect.
[69] Such requirements, as well as some of the other recommendations, would undoubtedly call for far better ongoing monitoring of outcomes over a number of years than most local governments are able or willing to perform at present.

One of the most compelling arguments for preservation of the privately owned one to four family rental sector, and the provision of support to its property owners, is the fact that it is a sector which is largely, and for the most part adequately, financed through private capital markets, formal and informal. Alternative strategies to house America's lower income household, that would be required if this sector were to continue to erode, such as constructing large numbers of replacement units or acquiring large numbers of existing units on behalf of the social or non-profit sector would require the dedication of billions in public capital, well beyond the resources likely to be available for the purpose, not to mention the billions that would be required in operating subsidies, dictated at least in part by the radically different operating cost structure of large-scale non-profit owners. By contrast, by shifting the financial incentives driving the behavior of the millions of separate property owners, strategies involving only modest public financial outlay may potentially have a significant impact on the preservation of this sector and the neighborhoods in which it is located.

Directions for Future Research

If nothing else, this paper has demonstrated how little is known about many aspects of the one to four unit rental housing industry. The most difficult question is to know where to begin. Given the sheer magnitude and diversity of the industry, which ranges from decrepit row houses in inner-city Baltimore to expensive homes in affluent suburbs, the cost and difficulty of mounting a global survey focusing on this industry would be considerable, and its value uncertain. Instead, the most important research areas to pursue are elsewhere, in the form of investigations focusing on two distinct themes: first, the way in which the sector functions under different market conditions, and second, specific issues or questions that have direct relevance to housing policy concerns. These issues, we would suggest, are most compelling with respect to that portion of the industry, largely located in urban and older suburban areas, which represents a significant part of the housing of America's low and moderate income households. In the meantime, perhaps the Bureau of the Census and the Department of Housing & Urban Development might consider conducting an updated, expanded version of the POMS study. That study yielded valuable results, but is now eleven years old.

Dramatic changes in the real estate market during the past decade have resulted in considerable market variation among historically lower income urban housing markets. Some urban markets have seen dramatic price increases, associated with large-scale immigration (Saiz, 2001), as in northern New Jersey, or other factors, as in Washington DC. At the same time, other markets, particularly Rust Belt areas such as upstate New York, Ohio and Michigan, have seen far less appreciation, both overall and with particular respect to urban areas. Market conditions often vary significantly by neighborhood within the same city, as in Baltimore and Philadelphia.

Market change is likely to influence a wide range of decisions by present and prospective owners, including when to buy and hold properties, when to sell, how much rent to charge and under what conditions to increase or reduce rents, the level of maintenance provided, and much more. It is likely to have a major impact on the quality and availability of housing for the large number of lower income households who rely on the one to four unit rental sector for shelter. Research that focuses on how different dimensions of market change, including the rate of change and the demographic or other factors driving change, affect owner behavior, and in turn affect the housing conditions of either or both existing lower income residents or lower income immigrants, would be particularly valuable.[70]

Within the context of specific market environments, there are a host of specific research questions worth pursuing through a series of carefully-designed investigations. The following represent some suggested areas for investigation, rather than an attempt at an exhaustive list. Many of these areas are closely related to one another.

(1) The tenure life cycle of one to four family buildings. Under different market conditions, how buildings move back and forth from owner-occupancy to rental, and what factors most strongly affect the change of tenure within the overall housing stock.

(2) Closely related to the above, the elasticity of the supply of one to four family rental housing, and what factors – market conditions, regulatory constraints or incentives, etc. – most strongly affect elasticity.

(3) Again, closely related to the above, the way in which property owners respond to changing market conditions in terms of rents charged, decisions to sell/hold, additional investment in property, etc., the relationship of rental prices in this sector to purchase costs, and the effect of these owner decisions on tenants. These questions are particularly important in

[70] One wonders, for example, whether there is a difference n the effect on the existing population of the demand pressures created by an influx of lower income immigrants, as in Paterson NJ, compared to those created by in-migration of affluent households, as in the District of Columbia.

framing public policies to either assist lower income households, or preserve affordable housing, in appreciating neighborhoods.

(4) Specifically, the difference in the landlord behavior of owner-occupants compared to absentee owners of two to four family structures.

(5) Effects of changes in the one to four unit housing stock from ownership to rental occupancy on their neighborhoods and on adjacent properties under different market conditions.

(6) The actual costs of operating, maintaining and upgrading one to four unit rental housing within the private market.

(7) Closely related to the above, the financial performance and the financial outcomes for different models of investment in small rental properties, differentiated by market and neighborhood conditions, property types and conditions, duration properties are held, etc.

(8) The incidence and cost of governmental regulations on the one to four unit rental property market, not only code enforcement, but such other areas as lead paint, asbestos abatement or ADA compliance.

(9) Closely related to the above, the impact of government regulation on decisions by property owners under different market conditions, including the decision to sell or abandon a property.

(10) The effect of tax policy on the behavior of property owners

(11) The interaction between the Section 8 voucher program and the availability and cost of affordable rental housing in the private market.

(12) Barriers to the utilization of public sector initiatives and other assistance by small property owners.

The nature of these questions is such that most of the investigations would have to take the form of in-depth studies of properties and their owners within carefully defined geographic areas, utilizing a combination of mining of unpublished data (such as municipal building records), field observation, and interviews with property owners and others linked to the rental industry. The information obtained would not only be valuable in itself, but would provide policymakers with a sound basis for modeling alternative public sector programs and incentives, and for framing larger strategies for preservation of the housing stock at risk of loss, whether through disinvestment and abandonment, or through gentrification and market appreciation.

Any and all of these questions, or many others, could form the basis for a research agenda focusing on the one to four unit rental housing sector that could occupy many investigators for many years to come. All of these questions, moreover, have the ability to inform American housing policy in ways that could potentially lead to significantly enhancing both the supply and quality of a sector of the housing stock that is not only a particularly important resource for the nation's low and moderate income households, but is at risk in many parts of the country. It would be time and money well spent.

Bibliography

Apgar, William. *Rethinking Rental Housing: Expanding the Ability of Rental Housing to Serve as a Pathway to Economic and Social Opportunity*. Cambridge MA: Joint Center for Housing Studies (2004).

Ball, Phillip. *Critical Mass.* London: William Heinemann (2004).

Bogdon, Amy S. and Ling, David C., *"The Effects of Property, Owner, Location, and Tenant Characteristics on Multifamily Profitability"* Journal of Housing Research 9(2) (1998).

Bratt, Rachel G., Vidal, Avis C., Schwartz, Alex and Keyes, Langley C. "The Status of Nonprofit-Owned Affordable Housing: Short-Term Successes and Long-Term Challenges" *Journal of the American Planning Association* 64:1 (1998).

Casiano, Jonathan. "Council halts 13 land deals in Newark" *Newark Star-Ledger,* June 8, 2006.

David, Grainger. "Riding the Boom" *Fortune,* May 30, 2005.

Devine, Deborah J., Gray, Robert W., Rubin, Lester and Taghavi, Lydia B. *Housing Choice Voucher Location Patterns: Implications for Participants and Neighborhood Welfare*. Washington, DC: U.S. Department of Housing & Urban Development (2003).

Downs, Anthony. *Rental Housing in the 1980's.* Washington DC: The Brookings Institution (1983).

Federal Reserve Banks of New York and Philadelphia, *Preserving Multifamily Rental Housing: Improving Financing Options in New Jersey* (2000).

Galster, George C., Cutsinger, Jackie M., and Malega, Ron. "The Social Costs of Concentrated Poverty: Externalities to Neighboring Households and Property Owners and the Dynamics of Decline." Paper prepared for the Revisiting Rental Housing conference, November 2006.

Goodman, Jack. "The Changing Demography of Multifamily Rental Housing" *Housing Policy Debate* 10:1 (1999).

Hopkins, Jamie Smith. "Investors Heat Up Housing Market: City Trend Could Hurt Values In Future" *Baltimore Sun,* July 3, 2005.

Institute of Real Estate Management, *Conventional Apartments: Income/Expense Analysis.* Chicago: IREM (2005).

Joint Center for Housing Studies, *America's Rental Housing – Homes for a Diverse Nation* (2006).

Krueckeberg, Donald. "The Grapes of Rent: A History of Renting in a Country of Owners." *Housing Policy Debate* 10:1 (1999).

Mallach, Alan. *Bringing Buildings Back: From Abandoned Properties to Community Assets* Montclair: National Housing Institute (2006).

Myers, Dowell, Baer, William C., and Choi, Seong-Youn, "The Changing Problem of Overcrowded Housing," *Journal of the American Planning Association* 62, no.1 (Winter 1996), 66-84.

Newman, Sandra. *Low End Rental Housing: The Forgotten Story in Baltimore's Housing Boom.* Washington DC: The Urban Institute (2005).

O'Flaherty, Daniel. "Newark's Non-Renaissance and Beyond", Unpublished paper (2000).

Ross, H. Laurence. "Housing Code Enforcement and Urban Decline" *Journal of Affordable Housing* 6, no.1 (1996).

Saiz, Albert. *Room in the Kitchen for the Melting Pot: Immigration and Rental Prices.* Cambridge MA: Joint Center for Housing Studies (2001).

Schloming, Lenore and Schloming, Skip. *The Road Home: Working With Small Property Owners to Preserve and Create Affordable Rental Housing.* Boston: The Pioneer Institute (1999).

Shearn, Ian T. "In city's housing boom, a select few cash in", *Newark Star-Ledger,* December 4, 2005.

Shell, Adam. "Real Estate Investment Clubs Build Up" *USA Today,* May 24, 2005.

Siegel, Eric. "A Neighborhood Abandoned" *Baltimore Sun,* June 25, 2006.

Skinner, Thomas and Lee, Jonas. "Single-family housing: a new alternative asset class?" www.redbrickpartners.biz/images/sfh_as_an_asset_class.pdf.

Thomas, Suzanne P. *Rental Houses for the Successful Small Investor,* Boulder CO: Gemstone House (1999).

Wang, Katie. "Booker wins fight on city land sales," *Newark Star-Ledger*, June 21, 2006

Weiss, Mark B. and Baldwin, Dan. *Streetwise Landlording and Property Management.* Avon, MA: F+W Publications (2003).

Zarembka, Arlene. *The Urban Housing Crisis.* New York: Greenwood Press (1990.)