

**Joint Center for Housing Studies  
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**Rethinking Rental Housing:  
Expanding the Ability of Rental Housing to Serve  
as a Pathway to Economic and Social Opportunity**

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## **Introduction and Summary**

Access to decent and affordable housing has long been a cornerstone of efforts to expand social and economic opportunity for all Americans. One in three households – 34 million in all – currently rent their primary residence. Even with the dramatic boom in homeownership over the 1990s, the share of households renting their dwelling unit has fallen only slightly. While economic factors, including income, housing prices and access to mortgage financing influence tenure and other housing choices of families and individuals, these choices are also linked to decisions concerning where to live, how to earn a living, make friends, raise a family, or otherwise secure a meaningful life. In this way, housing and tenure choices involve a complex set of economic and legal factors, as well as social, psychological and political factors.

Despite the diversity of family types and factors that influence individual consumer preferences for various types of housing, the vast majority of U.S. housing falls neatly into two categories – owner or renter. Else where – and especially in many Western European nations – there has been strong political support over the years for what is variously described as “social sector housing:” rental housing that offers families the convenience of renting, but retains many of the benefits associated with homeownership. Though limited in scope in the United States, these alternatives – including limited equity cooperative housing, community land trusts, and service enriched housing – demonstrate the possibility of adjusting the current institutional and legal environment to craft new rental housing options that better serve the needs of low-income and low-wealth families and individuals.

The lack of options available on the marketplace today reflects in large measure the tendency for public policy discussions in the United States to frame housing choice as a simple dichotomy – owning versus renting. This dichotomy not only fails to capture the full range of options actually present in the market place today, it can also divert attention away from larger policy goals, including the overarching goal of ensuring that all families and individuals have access to decent and affordable housing in a suitable living environment.

Arguing that homeownership may be a good choice for many but not necessarily the best for all, this paper reassesses public policy in light of what is known about the impact of owning and renting on individual and societal well-being. As is the case with owner occupied housing, good quality and affordable rental housing can be a pathway to social and economic opportunity. Like homeownership, the availability of good quality and affordable rental housing can go

beyond the simple provision of shelter, and also help low-income and low-wealth families and individuals increase their income earning potential, gain access to needed educational and workforce development services, and otherwise enhance their quality of life.

In focusing on the larger policy goal of expanding access to opportunities for owners and renters alike, this paper discusses both supply- and demand-side approaches designed to expand the range of housing options available in the market and to enhance the ability of families to choose wisely from available alternatives. Following this brief introduction and summary, the first section discusses the various factors that influence tenure and other housing choices. Next, the paper examines the current state of rental housing, focusing on the diversity of the families and individuals living in rental housing, the range of housing types they occupy, and the affordability problems they encounter. Then the paper reviews what is known about the potential impact that these tenure and other housing choices have on a wide range of individual and social outcomes and goes on to identify the many conceptual and methodological challenges associated with identifying causal linkages between tenure and other housing choices (including choice of neighborhood, housing structure type and housing quality) and specific economic or social outcomes. The paper concludes with the discussion of a set of choice enhancing policies and principles that will expand the range of housing options available and improve the ability of low-income and low-wealth households to select the housing option that best meets their needs and aspirations.

## **Summary of Findings**

### **The Current State of Rental Housing**

Given the many factors that contribute to the decision to own or to rent, there is little wonder that renters and the housing they occupy are incredibly diverse. Overall, renter households pay nearly \$250 billion dollars annually in rent, while property owners spend approximately \$50 billion each year to maintain and improve the rental housing inventory that is now valued at over \$2.5 trillion. Yet these aggregate statistics mask the diversity of the tens of millions of families and individuals, as well as the millions of property owners, investors, builders, developers and managers of the current rental housing inventory. Moreover, each year millions of families move back and forth between owning and renting, and millions of housing units are owner-occupied one year, and rented out in another. Adding to the complexity of

housing market dynamics is that many households benefit from a wide range of government housing assistance programs and tax incentives, while other market participants are subject to a host of housing market and land use regulations. Given this complexity, diversity and fluidity, it is often difficult to fully capture the important contributions of rental housing to the health of the overall housing market. Even so, there can be little doubt that for the nation's 34 million renter households, access to decent and affordable rental housing is a key determinant of their standard of living.

***Many Factors Influence Tenure and Other Housing Choices.*** While economic factors, including income, housing prices and access to mortgage financing influence tenure and other housing choices, these choices are also linked to decisions concerning where to live, how to earn a living, make friends, raise a family, or otherwise secure a meaningful life. In this way, housing and tenure choices involve a complex set of economic and legal factors, as well as social, psychological and political forces.

***Renters Are a Demographically Diverse Group.*** Renters tend to be younger, have lower incomes, are more likely to be minorities or immigrants, and less likely to be married or have children living with them. Even so, virtually everyone -- by some estimates as many as 95 percent of all individuals -- lives in rental housing at some point over their life course.

***Affordability Problems Especially Severe for Lowest Income Renters.*** Despite the unusually strong income growth in the United States in the 1990s, millions of renters must pay high shares of their incomes to secure decent housing. Overall, one in five renter households pays 50 percent or more of their income for housing, while for renters with incomes falling in the lowest income quintile, the share with such severe cost burdens rises to 6 in 10 households.

***Much Affordable Rental Stock is at Risk of Loss.*** Over the 1990s, losses of subsidized rental units accelerated as more and more property owners "opted out" of federal housing programs. Equally problematic is the rapid deterioration of older, non-subsidized rental housing -- including the inventory of older small multifamily and single-family rental housing.

***Local Regulations Limit the Range of Options Available to Renters:.*** Some families and individuals might prefer to move to a rental apartment in a particular suburban community, but are unable to act on these preferences because the land use and zoning regulations in many suburban jurisdictions limit the construction of more affordable higher-density multifamily rental housing. For lower-income families and individuals, these limitations can prove most harmful in

that they also limit access to neighborhoods offering good quality public services and proximity to good jobs.

### **The Complexity of Homeownership Impact Studies**

Arguing that “good housing makes good people,” and alarmed by the spread of infectious diseases in rapidly growing cities, housing policy deliberations in the United States in the early 20<sup>th</sup> century focused largely on the provision of good quality housing for low-income renters. Troubled by the growing number of “failed” public housing developments and ongoing concentration of extreme poverty, by the 1970s policy analysts were keenly aware that it would take “more than just housing” to improve the well-being of the nation’s poor. In this spirit, housing research examined “neighborhood effects” and policy efforts increasingly focused on programs designed to enable lower-income renters to move to areas with better schools, more job opportunities, or other beneficial social and economic conditions.

More recently, much economic and social science research – as well as policy discussions in the United States – has focused on the potential impact of homeownership on a wide range of outcomes, including household wealth, savings and investment behavior, mobility, labor force participation, urban spatial structure, residential segregation, home maintenance, political and social activities, health, self-esteem, education and other children-related outcomes. Unfortunately, efforts to isolate the impact of homeownership on a diverse set of policy outcomes must confront daunting data and methodological challenges. While researchers typically are aware of these limitations, policy makers often are less than cautious in interpreting the existing literature. By overstating the potential benefits of homeownership, today’s policy makers risk diverting resources away from more effective means of addressing many of the most critical problems that continue to confront low-income and low-wealth households.

***Tenure Decisions Represent a Complex Multi-period Assessment.*** In purchasing a durable asset, simple logic suggests that families and individuals should assess likely trends in house prices and rents, and then value both the current and the future stream of housing costs and benefits linked to homeownership. The financing decision adds another dimension of complexity to the consumer choice problem. Economic models of tenure choice focus on these issues, even though there is growing evidence that these models bear little resemblance to the way that consumers actually make multi-period decisions.

***Measuring Impacts Presents Difficult Methodological Challenges.*** In the complex world of spatially defined housing markets it is difficult, if not impossible, to control for all the factors that contribute to the decision making process and to understand how alternative housing policies contribute to expanding individual opportunity and social well-being. Rather than shine new light on these matters, empirical research is all too often used to “prove” the preconceived belief that homeownership is the most beneficial tenure form.

***Preferences and Behavior Are Malleable Not Fixed.*** Another factor that limits the value of much of the current empirical research is that individual perceptions and preferences themselves are in many ways culturally determined and influenced by the specific contexts in which the choices are made. Today, many low-wealth and low-income families are being “pushed” into homeownership, not necessarily because they fully appreciate the implications of their choices, but because they perceive (or rather hope) that homeownership in and of itself will help them achieve a better life.

### **Choice Enhancing Principles for a New Housing Policy**

Results emerging from the field of behavioral economics not only challenge the validity of many existing tenure and housing choice studies, but raise serious questions about what is actually known about the impact of various housing choices on individual and social well-being. There can be little doubt that more research on housing choices and consumer preferences is needed, but it is also important not to fall into the trap of “policy analysis paralysis,” namely the tendency to defer decision making until better information is available. For now, public decision makers will have to muddle along using the best information currently available.

***Policy Deliberations Should Focus Less on Means and More on End Goals.*** Rather than promoting a limited range of policies and programs, housing policy works best when it expands both available choices and enhances the capacity of families to make informed decisions. Public policy should focus on the larger goals of promoting access to decent and affordable housing, along with expanding social and economic opportunity for all, and in doing so recognize that promoting homeownership is just one of many possible means for achieving these end goals.

***Efforts Must Continue to Eliminate Discriminatory Barriers.*** Though perhaps more subtle today than in previous decades, discrimination in housing and mortgage finance markets

persists. Clearly, efforts to promote expanded homeownership opportunity fall short when people who would benefit from homeownership are denied access. Similarly, it is impossible to realize the full benefit of the existing inventory of good quality and affordable rental housing when racial and ethnic minorities face differential treatment by residential property owners and managers.

***Help Consumers Make Informed Tenure Choices.*** Unable to properly assess the real risks and responsibilities of homeownership, many low-income and low-wealth households become homeowners even if this choice is a risky and potentially costly mistake. When families take on debt that they are unable to repay, homeownership does not build wealth, but rather diverts scarce resources away from meeting other pressing needs. In the worst case scenario, lower-income homeowners may become trapped in declining neighborhoods with little access to employment, good quality schools or social services and equally limited potential for price appreciation. In these situations, all too often the dream of homeownership becomes the nightmare of a financially devastating foreclosure.

***Help Families Identify Good Rental Housing Options.*** Consumer education, counseling and outreach can help low-income and low-wealth families to understand better the many tradeoffs that are part of the housing and tenure choice process and to make more informed choices from among the options available in the market place. Many current programs provide housing search assistance for families receiving Section 8 vouchers. Efforts to expand consumer education and housing search assistance to all low-wealth and low-income renters – whether or not they receive subsidies – would help increase the ability of these families to secure the housing that best meets their needs.

***Help Renters Build Credit.*** Recognizing the importance of credit history in accessing a wide range of financial services, renters would benefit from creation of a national system that helps them translate a good rental payment record into a good credit rating. Today, credit bureaus do not typically have the mechanisms in place to capture that a family or individual may have a steady rent or utility payment record. To help stimulate the collection of needed data, rental properties financed by or otherwise benefiting from public resources could be required to report the rent payment record of its residents to an existing credit bureau.

***Promote New Forms of Housing Tenure.*** There numerous examples of choice enhancing tenure options, but often these struggle to move to scale. Programs to facilitate non-profit or other socially motivated forms of ownership of rental housing, or programs that provide residents with an equity stake in cooperatively owned multifamily developments create housing

that captures some of the benefits of both owning and renting. In order to enhance the choices available to low-income and low-wealth individuals and families, national housing policy should not only explore, but embrace these alternative tenure models.

### **Rental Housing Can Serve as a Pathway to Opportunity**

Today, homeownership is widely viewed as a pathway to economic opportunity. Many now point to homeownership as a means to obtain stable residential occupancy, to build wealth and gain access to the increased social and economic status associated with living in better quality neighborhoods. Lacking good quality and affordable rental housing options many households purchase a home of their own, even though homeownership may not represent a good choice. To fully realize the potential contribution that rental housing can make to improve the well-being of low-income and low-wealth families, an effort must be made to create new forms of rental housing that go beyond the simple provision of shelter, and in addition help disadvantaged households increase their income earning potential, gain access to needed educational and workforce development services, and otherwise enhance their quality of life.

***Confront Barriers to Construction of Affordable Rental Housing.*** To the extent that families seek both good quality rental housing and access to better quality education and public services, efforts must continue to eliminate restrictive land use policies that limit the supply of affordable higher-density multifamily rental housing in tax and resource rich suburban communities. Simply put, land use restrictions not only harm lower-income renters, but they also promote land intensive sprawl development that raises housing prices and imposes costs on all households – rich and poor, owners and renters alike.

***Better Utilize Privately Owned and Managed Units for Voucher Programs.*** Currently some 2 million units of privately owned housing are part of housing voucher and other similar leasing programs. In the vast majority of cases, units are leased one at a time by local or regional entities with rent payments shared by the tenant and the agency. In today's soft market, local governments could build an inventory of good quality housing by purchasing or otherwise securing multi-year leases – especially for units in low-poverty, service rich neighborhoods. These units could then be subleased to housing voucher holders, allowing them to secure good quality housing in attractive neighborhoods, while still preserving the option of individual residents to relocate as their situation dictates.



***Create New Financing Tools for Construction of Affordable Rental Housing.*** Most affordable housing finance is development specific, i.e. the subsidy is made available on a project by project basis. For example, moving beyond project by project financing should prove a beneficial way to meet the capital needs of the growing number of regional housing partnerships. As these housing partnerships grow in scale, and the capital markets continue to centralize, accessing capital on a project by project basis is increasingly inefficient. What is needed are new techniques to aggregate, pool and syndicate capital so that it can be obtained more efficiently and on terms that reflect the higher performance and lower risk associated with funding a more spatially diverse portfolio of developments.

***Preserve the Existing Stock of Affordable Rental Housing.*** Although public attention now focuses on subsidized rental housing, preserving the stock of affordable, privately owned, unsubsidized single-family and small multifamily rental units is equally critical. Lack of suitable financing vehicles is, however, a major obstacle. Once again, there is a need to explore new wholesale approaches to accessing capital for this section. One approach is to perfect “pooled approaches” where a set of individual properties are financed with a single mortgage transaction. On the equity side, current policy discussions would do well to consider how best to create new types of real estate investment trusts capable of combining private capital with federal state and local resources, and in doing so reduce costs associated with obtaining subsidies on a project by project basis.

***Create Additional Service Enriched Rental Housing.*** In creating new affordable rental housing initiatives, careful attention must be made to providing “more than just housing,” by helping residents gain access to needed health and human services, child care, transportation and other work force development initiatives that will enable low-income and low-wealth families to increase their ability to earn a decent income. Moreover, families do best when they are able to avoid the economic and social disruption of frequent moves. To help families maintain longer-term occupancy, it would be useful to create model landlord tenant laws that include clearly articulated and easily enforceable residential leases designed to promote longer-term, more stable occupancy. Further, recognizing that lower-income families may have less than stable incomes, these new leases could incorporate escrow or reserve accounts to help renters better manage their often uneven rent paying ability.

## **Conclusion**

Today, homeownership is widely viewed as the “silver bullet” solution to a range of individual and social problems. Yet there are downsides to excessive focus on promoting homeownership. Notably, homeownership is not the only way to expand access to opportunity, and for some families, owning a home may prove unhelpful or even financially disastrous. Just as through “push-marketing” the mortgage industry can encourage unsuspecting families to obtain high-cost and otherwise inappropriate mortgage products, it is also important for government policy and programs not to push families into bad tenure choice decisions.

Developing basic policy principles is an important first step in any effort to rethink rental housing policy. All too many research studies seem content to simply prove why a single approach is best, rather than probe into how individuals make decisions, and understand how housing of any type can promote economic opportunity and upward mobility. By expanding the range of choices available in the marketplace, and by attempting to endow rental housing with many of the attributes now commonly associated with owner occupied housing, the United States can move beyond the false dichotomy of owning versus renting and develop policies that better utilize the nearly \$160 billion dollars now being spent to help ensure that all families have access to decent and affordable housing.

## **Many Factors Influence Tenure and Other Housing Choices**

Economic factors – including income, housing prices and access to mortgage finance – explain many of the observed patterns in housing and tenure choices. Yet these choices also involve an important but less well understood set of legal and institutional forces, as well social, cultural, psychological and political factors. This section briefly examines each of the various elements that influence one of the most important decisions families and individuals make – the decision whether to own or rent their home.

## **Legal and Economic Factors Distinguish Renting from Owning**

Much of the current academic and policy discussion treats owner occupied housing as totally distinct from renter occupied housing. Yet at any given point in time – and depending on prevailing rents and home prices – a particular home will change tenure.

Indeed, Joint Center research suggests that more than one million dwelling units move from being owned to being rented each year, while another one million units move in the reverse direction.<sup>1</sup> Whether a housing unit of any given characteristics is either owned or rented will have little impact on its ability to provide shelter and other basic housing services, but the unit's tenure status provides families and individuals with a distinctly different set of legal rights and responsibilities.<sup>2</sup> These in turn depend in large measure on the institutions, laws and financial arrangements in effect at the time and place where the tenure choice is being made.

As a renter, tenant/landlord laws and regulations govern the obligation of the property owner to meet certain standards of service provision and process concerning rent setting and eviction, as well as responsibilities of the tenant (including making rent payments in a timely manner). At the same time, tenants retain the option to vacate the property on relatively short notice (subject to whatever notice requirements are present in the rental contract or lease). Perhaps most importantly, rental housing represents an important alternative housing option for those who cannot afford to purchase their own home.

Home owners generally have a more expansive set of rights, but also more responsibilities. Local zoning, building and health codes along with other land use regulations impose responsibilities on owners (e.g., requirements to adhere to applicable fire and safety standards) or otherwise place limitations on the use of an owner occupied property (e.g., limit the ability of an owner to conduct various types of business on the property). These restrictions, however, do little to undermine the general proposition that an owner has the right to deny others access to his/her property and to use the property as he/she believes is suitable. Owners also have a right to stay in their unit until they decide to move, though this right may be undercut by eviction due to mortgage foreclosure or failure to pay applicable property taxes.

Purchasing a home also differs fundamentally from renting due to the transaction costs associated with shopping for and securing the unit. Transaction costs associated with renting a

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<sup>1</sup> Annual estimate based on American Housing Survey data for the two year period 2001 to 2003. These data suggest that approximately 2.5 million units were switched from being renter occupied in 2001 to being owner occupied in 2003, while approximately the same number switched from being owned to being renter. Note that this number does not count individual units that switched from owner to renter back to owner occupied within this two year period.

<sup>2</sup> For a discussion of the "bundle of rights and responsibilities" approach for examining alternative forms of housing tenure see Marja Elsinga (2004), "Affordable and Low-Risk Homeownership: A Marginal but Interesting Phenomenon on the Housing Market" A paper presented at the European Network for Housing Research (ENHR) Conference, University of Cambridge, Cambridge, England. June.

unit including required rental deposits are modest when compared with fees paid to real estate and mortgage brokers associated with the purchase of a home. As a result, simple logic suggests that households with short expected stays will tend to rent, while households expecting to live in a unit longer will tend to purchase, since they can spread these higher transaction costs over a longer period. Moreover, unless the homeowner is able and willing to rent out their home to another household, to move a homeowner incurs costs associated with home sale.<sup>3</sup>

Finally, homeownership also brings with it the risks and rewards associated with potential changes in the value of the unit as a capital asset, a feature that does not enter in the financial calculation of the cost of renting. Upon the sale of the unit, the owner is entitled to any capital gain that has accrued, but also suffers the consequences of any capital loss. Purchasing a unit with mortgage financing further magnifies the risks and rewards of investing in a durable capital asset. The leverage associated with a debt financed acquisition implies that any given percentage increase in property values will generate an even larger percentage increase in the owner's equity in the property. Alternatively, with leverage comes the risk that any decline in property values will generate capital losses that erode or eliminate entirely an owner's equity in the property.

Renters generally do not participate in the capital gains or losses of their home or apartment. Depending on the details of their lease agreement, renters may nevertheless share some portion of the risks and rewards that flow from real estate market fluctuations. For example, to the extent that rent payments can adjust from month to month or year to year, renters bear some portion of the risk of a fluctuating market. Alternatively, to the extent that rents are fixed by long term lease arrangements or by rent control they are shielded from these risks.<sup>4</sup>

The importance of capital gains and losses are further magnified by distinctly different tax regimes governing owners and renters. In the United States, homeowners benefit from their ability to deduct mortgage and property taxes from ordinary income, while at the same time not having to declare the imputed value of housing services (sometimes called owner equivalent

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<sup>3</sup> For a discussion of legal rights and responsibilities of owning and renting see Peter W. Colwell and Joseph W. Trefzger (1994), The Economics of Real Estate Principles, a publication of the University of Illinois Real Estate Center.

<sup>4</sup> Though rent control is only found in a few jurisdictions in the United States, the so called "Social Housing Sector" that constitutes a major segment of the housing inventory in many European nations does provide tenants with varying levels of protection from market driven fluctuations in rents. For discussion see Hugo Priemus and Peter Boelhouwer (1999), "Social Housing Finance in Europe: Trends and Opportunities," Urban Studies, Vol. 36, No. 4, pp. 633-645.

rent) on their income. By lowering their current tax liability, U.S. tax policy also lowers the cost of holding owner-occupied housing as a capital asset. In addition, current tax laws shield homeowners from capital gains taxes. In combination, these two features of the tax code reduce the holding costs and increase the potential investment gains of owning a home.<sup>5</sup>

As recently documented by the Millennial Housing Commission, the federal tax benefits for homeownership dwarf other direct federal expenditures to subsidize or otherwise assist renters. For example, in fiscal year 2001, program outlays for the U.S. Department of Housing and Urban Development totaled \$33.6 billion. In contrast, that same fiscal year federal tax expenditures for housing totaled \$121.2 billion with tax related expenditures for homeowners (including mortgage interest and property tax deductions, and capital gains exclusion) accounting for \$106 billion of that total. Unlike federal expenditures for rental housing that largely benefit low- and moderate-income renter households, federal tax expenditures to support homeownership largely benefit middle- and upper-income households.<sup>6</sup>

The generosity of current federal tax benefits for housing have prompted the creation of new legal and institutional forms of housing tenure that fall somewhere between owner occupied or renter occupied housing. For example, over the past thirty years there has been a rapid growth in owner occupied housing in cooperative and condominium projects, and other “gated” or planned communities in the United States. Collectively labeled “Common-Interest Housing,” they involve specific legal and economic characteristics that build on many aspects of simple homeownership, while still preserving many of the benefits of simple renting.

Over the second half of the 20<sup>th</sup> century, “Common-Interest Housing” grew rapidly. By one account, by 1998 some 750 thousand units were part of a cooperative association, 5 million were part of a condominium development, and 10 million units were part of a “gated” or planned community property association.<sup>7</sup> Now found in most major metropolitan markets, condominium developments typically provide a flexible option for ownership of units in larger multifamily

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<sup>5</sup> For a recent discussion of the tax advantages of homeownership in the United States see Patric H. Hendershott and Michael White (2000), “The Rise and Fall of Housing’s Favored Status,” in *Journal of Housing Research*, Volume 11, pp. 253-275. See also Edward L. Glaeser and Jesse M. Shapiro (2002), “The Benefits of the Home Mortgage Interest Deduction,” Harvard Institute of Economic Research, Discussion Paper Number 1979, October. Note that some states and localities also provide tax incentives that reduce the cost of housing consumption. For example, Massachusetts has a state tax deduction for renters. Alternatively, Washington D.C. has enacted a series of tax incentives to encourage families and individuals to purchase homes in the District.

<sup>6</sup> Millennial Housing Commission (2002), “Federal Housing Assistance, Housing Program Tutorial”, June.

<sup>7</sup> Evan McKenzie (2003), “Common-Interest Housing in the Communities of Tomorrow,” *Housing Policy Debate*, Vol. 14, Issues 1 and 2, pp. 203-234.

structures, while relieving the owner of the responsibility of personally attending to an array of maintenance and management activities that fall squarely on the shoulders of a conventional homeowner.

Planned unit or gated communities involve another mix of legal rights and responsibilities. Though similar in many ways to multifamily condominiums, planned communities differ by providing a wide range of services more typically provided by local governments. These developments may include mixes of housing types (including single-family detached, single-family attached, and small multifamily structures) and are similar to multifamily condominiums in that the purchaser acquires ownership of one of the homes, as well as an interest in the association that owns and maintains the common areas and provides a set of property management and maintenance services. The difference is that in many planned communities the common areas may include private streets, golf courses, parks and swimming pools, while services may include police and fire protection and the provision of water and sewerage treatment. In effect, many planned communities become a privately-owned and controlled local government.

Cooperatives represent a different blend. Here, individuals are shareholders in the entity that owns the building, and have the exclusive right to occupy a particular unit and to participate in decision making concerning property. Yet unlike the condominium form of ownership, cooperative associations often place limits on the ability of an individual to sell his/her unit. For example, limited equity cooperatives and community land trusts seek to expand the supply of perpetually affordable housing by placing limits on the resale price of individual dwelling units. Other cooperatives screen prospective owners before granting them the right to purchase. Though limiting the absolute ownership rights of individuals, the cooperative structure is seen by many as a desirable way for creating a “community” of people working together for a common purpose as much as it is viewed as a desirable legal mechanism for enabling lower-income households to enjoy the tax and economic advantages of homeownership.

There is also a distinct set of alternative tenure arrangements that tilt toward the rental side of the equation. For example, in the United States some 2 million households occupy a home that they do not own in exchange for providing the property owner with various services in lieu of rent payments. These “no cash rent units” include tenant farmers, groundskeepers, caretakers and other household workers, as well as occupants of so-called “in-law apartments”

provided rent free to friends and relatives of the owner. In other instances, a homeowner of a larger single-family home may rent out a single room to a “border” or “lodger,” or create a more or less free standing unit sometimes called an “accessory apartment.”

In addition, more than 3 million of the nation’s owner-occupied manufactured homes are placed on rented or leased land. Obviously, this creates new legal challenges to identify both the rights and responsibilities of the owner of the manufactured home and the owner of the land on which the unit is sited.<sup>8</sup> Once in place, it can be extremely difficult to move a manufactured home to another site, a feature that puts the owner of the unit at an extreme disadvantage should the owner of the land decide to terminate the lease. Recognizing this inherent tension in this mixed tenure form of housing, in 2000 Congress passed legislation mandating that states enact “dispute regulation” procedures designed to clarify the rights and responsibilities of the interested parties in potential conflicts that may arise from this blended tenure form.<sup>9</sup>

As noted throughout, each of these alternative forms of rental housing have their own unique set of federal, state and local laws and regulations governing the rights and responsibilities of the property owners and renters. In addition, at any particular moment the national tax code will provide differing levels of tax benefits to each of these alternative tenure forms. For example, in addition to the substantial tax incentives afforded home owners, federal taxes also provide numerous benefits to rental property owners and investors.

The above discussion draws on the U.S. experience, but examples of mixed tenure forms can be found in countries around the world. Following World War II, pressure to rebuild a war-torn Europe was intense. Though private cooperatives and other municipally operated common-interest housing associations existed in many Western European countries prior to the war, following the war many of these housing associations expanded rapidly and were transformed into a powerful “social housing” sector.<sup>10</sup> Benefiting from substantial public sector subsidies, finance, and regulation, the social housing sector differed from the private rental market and the for sale owner markets that had dominated before the war. And depending on the particulars of

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<sup>8</sup> Joint Center for Housing Studies in collaboration with the Neighborhood Reinvestment Corporation (2002), Manufactured Housing as a Community Building Strategy, a report prepared for the Ford Foundation, September.

<sup>9</sup> Manufactured Housing Institute (2000), “106<sup>th</sup> Congress Approves Manufactured Housing Improvement Act,” Manufactured Housing Institute, Arlington, Virginia, December 7.

<sup>10</sup> See for example John I. Gilderbloom and Richard P. Appelbaum (1989), Rethinking Rental Housing, (Philadelphia: Temple University Press), Chapter 8, “European Housing in the Postwar Period: Some Lessons for U.S. Policy,” pp. 150-179. See also Christine M. E. Whitehead (2002), “Response: Housing Tenure and Opportunity,” in Housing Studies, Vol. 17, No. 1, pp. 63-68.

the country involved the social housing sector accounted for anywhere from a quarter to a half or more of all available housing.<sup>11</sup>

The Netherlands represents a good example. In the decades following World War II, ‘social housing’ represented a tenure form that provided good quality and affordable housing in higher density urban environments, yet afforded residents significant protections against evictions and sudden market driven escalation of rents. Even as the Netherlands transitions its housing policy today to include more options for individual ownership, the social sector remains important.<sup>12</sup> Indeed, in Amsterdam the social sector accounts for more than half of all housing, while for the Netherlands as a whole, the social sector still represents more than a third of all housing.<sup>13</sup>

### **Housing and Tenure Choices Have Significant Social and Psychological Implications**

There is a rich literature on the social and psychological significance of housing and tenure choice. In addition to providing shelter from the elements, an individual’s dwelling unit is the locus of many daily activities. It is a gathering place for family activities, a haven that protects people from unwanted intrusions of others, and a symbol of an individual’s place in society.<sup>14</sup> In this sense, the place someone lives (variously described as a dwelling unit or house) becomes more than just a physical space, but instead takes on important social, cultural, political, and psychological meaning as a “home.”<sup>15</sup>

Often the social/psychological aspects of housing are discussed in terms of owner-occupied housing. Yet there is nothing inherent in the concept of “home” that is necessarily linked to homeownership. Writing nearly four decades ago, Lee Rainwater described how decent and affordable rental housing helped create a much desired ‘haven’ that protected lower-class families against intrusion of both human and non-human threats to their well-being. Even

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<sup>11</sup> Hugo Priemus and Peter Boelhouwer (1999), “Social Housing Finance in Europe: Trends and Opportunities,” *Urban Studies*, Vol. 36, No. 4, pp. 633-645.

<sup>12</sup> William G. M. Salet (1999), “Regime Shifts in Dutch Housing Policy,” *Housing Studies*, Vol. 14, No. 4, pp. 547-557.

<sup>13</sup> Manuel B. Aalbers (2004), “Promoting Home Ownership in a Social-Rented City: Policies, Practices, and Pitfalls,” *Housing Studies*, Vol. 19, No. 3, pp. 483-495.

<sup>14</sup> Ade Kearns, Rosemary Hiscock, Anne Ellaway, and Sally MacIntyre (2000), “‘Beyond Four Walls.’ The Psycho-social Benefits of Home: Evidence from West Central Scotland,” in *Housing Studies*, Vol.15, No. 3, pp. 387-410.

<sup>15</sup> For further discussion of the concept of “house and home” see Pauli Tapani Karjalainen (1993), “House, Home, and the Place of Dwelling,” *Scandinavian Housing and Planning Research*, Vol. 10, pp. 65-74, and Amos Rapoport (1995), “A Critical Look at the Concept ‘home’,” in David N. Benjamin, David Shea, David Saile, and Eje Aren, *The Home: Words, Interpretation, Meanings, and Environments* (Aldershot, Ashgate), pp. 25-52.



though these families might remain low-income renters, better housing had significant social implications in that it enabled them to create more satisfying personal relations, to be better parents, and to work cooperatively with others to address common problems.<sup>16</sup>

Two decades later, the National Housing Task Force reaffirmed the social/psychological significance of decent and ‘affordable’ housing for owners and renters of all income levels.<sup>17</sup> To the Task Force, decent rental housing can be a base for hope and self-respect that allows people to take advantage of opportunities in education, health and employment: the means to get ahead in our society.

More recently, Rachel Bratt argued that good housing is “the foundation for family life,” and discussed the significant social/psychological consequences of providing decent and “affordable” rental housing to the lowest income renter families.<sup>18</sup> Among other aspects, Bratt noted that housing is not only linked to attitudes about self worth, but may also have what she described as beneficial aspects of “the human need to feel potent and to fully realize one’s capabilities.” This type of research is consistent with the view that good quality housing not only provides shelter, but also contributes more generally to the well-being of families and individuals.

### **Political Forces also Influence Tenure Choice**

Recognizing that tenure and other choices have a significant and meaningful impact on the well-being of individuals, families and communities, it is understandable that crafting housing policies at all levels of government is an intensely political undertaking. For most of the political history of the United States, there has been a deliberate tilt favoring property owners, often at the expense of renters. Examples include property requirements for voting and holding public office, tax policies that benefit homeowners but not renters, and local land use policies that limited the development of housing suitable for most renters. Some refer to this

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<sup>16</sup> Lee Rainwater (1966), “Fear and House-as-Haven in the Lower Class,” The Journal of the American Institute of Planners, Vol. 32, pp. 23-31. For a collection of other writings from the 1960s and 1970s on the social aspects of housing see Jon Pynoos, Robert Schafer, and Chester W. Hartman (1966), Housing Urban America (Chicago: Aldine Publishing Company).

<sup>17</sup> National Housing Policy Task Force (1988), A Decent Place to Live (Washington DC: National Housing Task Force).

<sup>18</sup> Rachel G. Bratt (2002), “Housing and Family Well-Being,” in Housing Studies, Vol. 17, No. 1, pp. 13-26.

phenomenon as an “ideology of property,” an ideology built on the belief that owners are superior to renters in many ways, and hence more deserving of public policy attention.<sup>19</sup>

While it is tempting to believe that the ‘American Dream’ of homeownership reflects a set of universally held beliefs, the cross-cultural and cross-national studies suggest that this is not the case.<sup>20</sup> Ideologies and beliefs can vary from one society to another. For example, like current day advocates of community land trusts, many Native American societies still adhere to traditional beliefs that no one person should own the land. Rather, land should be held in common trust and managed for the collective benefit of current and future generations. It often matters little whether these judgments are based on any factual assessment of what is best for individuals and society. What matters is whether or not people act on these beliefs. As a result, an ideology based on limited factual evidence may become a deeply and widely held “truth” that dominates the public discourse at all levels of government.

In the United States and other Western democracies, politics generally defines the process to resolve disputes that arise from conflicts over differing ideologies, values and societal needs. In addition to a focus on the value of owning property in the United States, there also exists a widely shared belief in the virtue of promoting equal opportunity, in the limited role of government, and in the role of the private market place in allocating scarce resources. Each of these values can and often do come into conflict. Moreover, these conflicts persist until a new and perhaps broader set of values emerge that can resolve the conflict.

Over the years, considerable political debate in the United States has revolved around the inability of many low-income and/or minority families to gain access to decent housing. There have been important victories in the battle to expand affordable rental housing opportunities for lower-income and minority families, but for most housing advocates these victories seem too few and far between. Undoubtedly, this reflects that over the years forces opposed to expanding redistributive housing policies have been more effective and better organized than the supporters of such programs. For example, studies of the struggle surrounding the passage of the 1949

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<sup>19</sup> Donald A. Krueckeberg (2002), “The Grapes of Rent: A History of Renting in a Country of Owners,” in Housing Policy Debate, Vol. 10, Issue 1, pp. 9-30.

<sup>20</sup> Lynn M Fisher and Austin J. Jaffe (2001), “Determinants of International Homeownership Rates,” Department of Insurance and Real Estate, Pennsylvania State University Working Paper. See also Ade Kearns, Rosemary Hiscock, Anne Ellaway, and Sally MacIntyre (2000), “‘Beyond Four Walls.’ The Psycho-social Benefits of Home: Evidence from West Central Scotland,” in Housing Studies, Volume 15, No. 3, pp. 387-410.

Housing Act have indicated that advocacy groups representing the interests of home builders, realtors, housing finance and labor organizations dominated the lobbying effort, while groups directly representing the interests of low-income families played a limited role because they lacked money and organizational capacity.<sup>21</sup> The result was legislation that established the lofty goal that all Americans are entitled to a “decent home and suitable living environment,” but provided inadequate resources to make that entitlement a reality.

Equally intense have been the political struggles concerning the appropriate role of the private sector in housing provision. As described by Alexander Von Hoffman, many political reformers in the 1930s and 1940s felt that provision of adequate shelter was too important to be left to the whims of the private marketplace.<sup>22</sup> Indeed, early reform proposals called for an extension of public housing to as many as two-thirds of all families – leaving only the relatively affluent to fend for themselves in the private market.<sup>23</sup> Needless to say, the belief of the housing reformers in a large social housing sector clashed head on with equally strong support for the private marketplace. As a result, the visions of the reformers were soundly trumped by a more modest and politically conservative housing agenda, designed in part to ensure that the blight of America’s poor inner city neighborhoods did not spill out and undermine the quality of life in the newly growing middle-income home owning suburbs.

As Von Hoffman’s review of the politics surrounding the creation of the initial national public housing program makes clear, rather than pressuring largely redistributive goals, much of housing policy in the United States has instead focused on improving the well-being of the nation’s growing middle class. And key to this were efforts to promote homeownership for all who could afford this housing option. Combining generous tax benefits with the creation of a supportive national housing finance system, the rate of homeownership grew dramatically in the second half of the 20<sup>th</sup> century. Indeed, this focus on homeownership continues to the present.<sup>24</sup>

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<sup>21</sup> For further discussion, see Jon Pynoos, Robert Schafer, and Chester W. Hartman (1973), Housing Urban America, (Chicago: Aldine Publishing Company), especially Chapter 1 “Politics,” pp.1-23.

<sup>22</sup> Alexander Von Hoffman (1996) “High Ambitions: The Past and Future of American Low-Income Housing Policy,” in Housing Policy Debate, Vol. 7, Issue 3, pp. 423 to 468

<sup>23</sup> See for example Edith Elmer Wood (1931), Recent Trends in American Housing (New York: Macmillan).

<sup>24</sup> Kenneth Jackson (1985), Crabgrass Frontier: The Suburbanization of the United States, (New York: Oxford University Press).

## **New Behavioral Research Provides Insights to Consumer Decision Making**

Working under the banner of behavioral economics, a growing number of economists are drawing on the work of social psychologists and others to examine how preferences are formed and how people make decisions in various contexts.<sup>25</sup> Unlike some economists who opine that choices reveal the underlying preferences of individuals, behavioral economists understand that preferences are malleable and shaped by the available options, as well the political and social context in which the decision is made. Not only does this new research enhance understanding of consumer behavior, behavioral economists are also generating new findings that challenge many long held beliefs about how families make housing and tenure choices.

Consider how families obtain and utilize information about the relative costs of owning and renting their home, and how they use this information to make a tenure choice. The simple economic model posits that in deciding whether to own or rent, consumers must identify units that are available to purchase or to rent, compare the relative price of these available options, and then select the option that maximizes their well-being. This comparison is not easy. The consumer must be knowledgeable about available options, but also deal with the fact that the “price” of owning a home is fundamentally different than the “price” of renting. Unlike renters who make monthly rent and utility payments, owners face a more complex payment calculus that combines the opportunity cost of any required down payment, one time payments to cover closing costs, and monthly mortgage interest payments as well as other periodic payments to cover property taxes and ongoing utility and maintenance expenses, offset by whatever tax advantage and capital gains are realized by the owner.

The information required to complete these calculations is substantial – a burden that is made even more difficult by the fact these calculations involve expectations about future trends in housing prices, property tax rates, utilities, and other periodic payments. While there is a substantial literature on how consumers form expectations, these models typically build on naïve assumptions about how consumers extrapolate past trends into forecasts of likely future events. Yet as the debate on whether a “housing bubble” currently exists in selected US housing markets

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<sup>25</sup> For a good summary of the behavioral economics approach see Richard H. Thaler and Cass R Sunstein, (2003), “Behavioral Economics, Public Policy, Paternalism: Libertarian Paternalism,” AEA Papers and Proceedings, May, pp.173-179.

demonstrates, even experts disagree about future trends in house prices.<sup>26</sup> Indeed in recent Congressional testimony, Federal Reserve Board Chairman Allan Greenspan noted “House prices are difficult to measure given the enormous heterogeneity of the U.S. housing stock,” and because existing house price data “are not fully adequate” to track house price trends.<sup>27</sup> Recognizing that experts differ on what to expect, housing and tenure choice models that rely on the ability of consumers to form detailed price expectations are suspect.

Consumers not only have limited ability to forecast likely future house price and other economic trends, survey research suggests that they also have difficulty shopping – that is searching for the information needed to identify what options are actually available in the marketplace. In a national housing survey, the Fannie Mae Foundation reported that while a growing number of lower-income and low-wealth families could obtain a mortgage, many did not in part because they lacked information concerning available choices.<sup>28</sup> Survey data demonstrates that subprime borrowers in particular have limited knowledge about the mortgage process, are less likely to search for the best mortgage rates, and are less likely to be offered choices among alternative mortgage products.<sup>29</sup>

By identifying what is and is not known about consumer decision making, behavioral economists challenge policy analysts, economists and other social science experts to rethink their frameworks and models for assessing housing impacts and to reconsider the advice that they provide decision makers. First, this rethinking will require unlearning some of the all too simple truths of the past. Next, it demands focusing anew on better understanding the sources of information that consumers actually use to identify available options, what influences and pressures shape their evaluation of competing alternatives, and what methods they deploy to make choices among what they perceive to be available options. Among other things, there is need for a critical reassessment of the impact of public policies that stress the “American Dream

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<sup>26</sup> See for example Robert J. Shiller (2000), *Irrational Exuberance*, Princeton New Jersey, Princeton University Press and Edward Learner (2002), “Bubble Trouble – Your Home Has a PE Ratio Too,” Working Paper, UCLA Anderson School of Business. See also rejoinder by Amy Crews Cutts and Frank E. Nothaft (2004), “Bubbles? What Bubbles,” special commentary prepared for the Office of Chief Economist, Freddie Mac, May 6.

<sup>27</sup> New York Times (2004), “Home Prices Hard to Track,” August 24.

<sup>28</sup> Fannie Mae Foundation (2002), National Housing Survey. For a detailed examination of how housing search differs by race, see Harriet Newberger (1995), “Sources of Difference in Information Used by Black and White Housing Seekers: An Exploratory Analysis,” in *Urban Studies*, Volume 32, Number 3, pp. 445-470.

<sup>29</sup> Courchane, Marsha J., Brian J. Surette, and Peter M. Zorn (2004), “Subprime Borrowers: Mortgage Transitions and Outcomes,” *Journal of Real Estate Finance and Economics*, forthcoming. See also AARP (2003), The 2003 Consumer Experience Survey: Insights on Consumer Credit Behavior, Fraud and Financial Planning, October.

of Homeownership,” even for those who are unlikely benefit from becoming an owner. Instead, housing policy deliberations must pay greater attention to helping consumers make informed choices that best expand their access to housing and economic opportunity – independent of tenure choice.

### **The Current State of Rental Housing**

In meeting a basic human need, safe, decent, affordable housing is important for the well-being of families and individuals and key to their ability to function in society or in the work force. As home to a disproportionately large share of the nation’s lowest-income seniors and working families, rental housing is a particularly important element in the nation’s social safety net. Even so, as the housing needs of families and individuals change over time, virtually every one – by some estimates as many as 95 percent of all individuals – lives in rental housing at some point over their life course.<sup>30</sup>

In addition to being valuable for families and individuals, a well functioning rental housing sector helps preserve mixed-income communities and contributes to the social, economic and political health of local communities. At the same, a robust rental housing sector also contributes to the prosperity of national and local economies. The construction and repair of housing, along with housing finance, management, sales and related housing services contributes significantly to jobs, income, and tax revenues.

### **Rental Housing Is Important to National and Local Economies**

Residential investment, housing consumption, and housing related expenditures together account for nearly one-fifth of GDP. Residential investment – including construction of site-built, manufactured, and prefabricated housing for purchase or for rent, along with expenditures for residential improvement, remodeling and repairs, real estate brokers’ commissions on property sales, and purchases of equipment for rental dwellings – makes up about four percent of GDP. Add to this rent payments and the imputed housing benefits generated by owner-occupied properties and the share increases to 12.5 percent. When spending for heat, utilities, home

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<sup>30</sup> Donald R. Haurin, Robert D Dietz, and Bruce A, Weinberg (2003), “The Impact of Neighborhood Homeownership Rates: A Review of the Theoretical and Empirical Literature,” Journal of Housing Research, Vol. 13, 119-151.

operations, appliances, and furnishings is included, the total contribution of the housing sector approaches 20 percent of GDP.<sup>31</sup>

Over the past several years, the strong housing construction sector has helped the nation to limit job losses and to avoid a deeper recession. Despite rapid growth in the demand for owner-occupied housing, nearly 2.7 million new multifamily rental units were built between 1992 and 2001. Although new construction of multifamily rental units is disproportionately concentrated in the top fifth of the rent distribution, building for the 'middle market' (units with rents between the 40<sup>th</sup> and 80<sup>th</sup> percentile) has also been robust.<sup>32</sup> In the 1990s, close to 40 percent of all new construction took place in this middle market and accounted for over ten percent of the middle market rental stock in 2000. Since nearly half of middle market households have incomes between \$20,000 and \$50,000, middle market rental construction is vitally important to moderate-wage working families.

Even though most renters fall into the lower- and moderate-income ranges, absolutely, rental housing is big business. American Housing Survey data suggest that renter households pay nearly \$250 billion dollars annually to rental property owners.<sup>33</sup> Collectively, these rental property owners spend approximately \$50 billion each year to maintain and improve a rental housing inventory that is now valued at over \$2.5 trillion.<sup>34</sup> Moreover, the rental housing sector is important to local economies. According to the National Association of Home Builders (NAHB), over a ten year period, the construction of a typical 100 unit rental apartment building generates 559 jobs (in worker years of employment) \$161.7 million in local income, and \$25.5 million in local taxes.<sup>35</sup>

## **Renters Are a Demographically Diverse Group**

The proportion of households renting their primary dwelling unit varies systematically by age of household head, marital status, income, race, and mobility status. For example, three of

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<sup>31</sup> Joint Center for Housing Studies (2002), The State of the Nations Housing, 2002, Harvard University, Cambridge, Massachusetts.

<sup>32</sup> Joint Center for Housing Studies tabulations of the 2001 American Housing Survey. Here multi-family rental housing is defined as renter occupied housing in structures with 5 or more units. For discussion see Joint Center for Housing Studies (2004), Middle Market Rental: Hiding in Plain Sight, Harvard University, Cambridge, Massachusetts.

<sup>33</sup> Joint Center for Housing Studies tabulations of 2003 American Housing Survey data on contract rents.

<sup>34</sup> Joint Center for Housing Studies (2003), Improving America's Housing 2003: Measuring the Benefits of Remodeling, Harvard University, Cambridge, Massachusetts.

<sup>35</sup> National Association of Home Builders (2004), Housing: 2004 Facts, Figures, and Trends, Washington, DC.

every five households headed by someone under 35 years old rent, while for households headed by someone over the age of 65 the proportion falls to less than one in five. Married couples and families with children are more likely to own than to rent. In contrast, single persons and unrelated individuals are more likely to rent.

Although the middle and upper range of rental housing market includes many working families, rental housing is nevertheless disproportionately home to the nation's poorest families. In 2001, renters accounted for half of the nation's nearly 20 million families in the lowest quintile of the income distribution. Racial and ethnic differences are also pronounced. Half of all minority households are renters, compared to only a quarter of white households. This difference reflects, in part, that minorities are younger, have lower incomes and are less likely to be married – all characteristics associated with a greater tendency to rent. Yet even when accounting for these differences between the two groups, a gap between the share of white and minority households renting their dwelling unit persists. While some of the remaining difference may be due to unobserved factors that correlate with race, including cultural predispositions to rent or to own, the significant racial gaps in homeownership suggest that housing market discrimination may be at work.<sup>36</sup>

Nearly half of all immigrant households also rent, but the diversity of the immigrant communities prevents broad generalizations. Perhaps the most important distinction is between recent arrivals and immigrants who have lived in the United States for several decades. Three quarters of immigrant households arriving in the 1990s rent their dwelling unit, while some 70 percent of immigrants who entered the country before 1980 own. Generally, recent arrivals are younger, have lower incomes, are more likely to be minorities and less likely to be married. However, even controlling for these demographic factors, a higher share of recent immigrants rent than is the case for immigrants who have lived in the country longer.<sup>37</sup>

The share of households renting is higher for households moving from one dwelling unit to another within the United States. Overall, some 58 percent of the more than 23 million

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<sup>36</sup> See for example Susan M. Wachter and Issac F. Megbolugbe (1992), "Racial and Ethnic Disparities in Homeownership," in *Housing Policy Debate*, Vol. 3, Issue 2, pp. 333-370.

<sup>37</sup> For example, in addition to standard demographic factors, Painter, Gabriel and Myers included immigrant status and a rich set of locational variables, yet still could not explain about 10 percentage points of a 25 percentage point gap in the share of minority and white households renting their dwelling unit. See Gary Painter, Stuart A. Gabriel, and Dowell Meyers (2001), "Race, Immigrant Status, and Tenure Choice," *Journal of Urban Economics*, Volume 49, Number 1, pp. 150-167.



households changing residence in 2001 moved into a rental unit. Whether a household opts to own or rent following a move is closely related to the circumstances that prompt a residence change in the first place, as well as their tenure before the move. Both owner and renter households that moved because of a job or marital status change are far more likely to become renters than those that moved for other reasons<sup>38</sup>. Indeed, over half of the owners who move because of a change in marital status move into a rented unit.

### **Housing Affordability Problems Plague Many Households**

Although the vast majority of all Americans are well housed, many Americans – both owners and renters alike – struggle to secure decent and affordable housing. Overall, 14.3 million households – or one in seven are severely cost burdened (spend more than 50 percent of their income on housing) and another 17.3 million are moderately cost burdened (spend 30 to 50 percent of their income on housing). According to the recently released State of the Nation's Housing Report, despite the unusually strong income growth in the 1990s, in 2001 some 95 million Americans had housing cost burdens or lived in crowded or inadequate housing<sup>39</sup>. Indeed, more than twice as many people in this country now face housing problems as lack health insurance. And, on any given night, at least 850,000 people are homeless, while over the course of a year, the number of Americans experiencing some period of homelessness – many of them children—is in the range of 2.5 – 3.5 million.

Not surprisingly, housing challenges are most severe among those at the bottom of the income distribution, the more than 21 million households with incomes falling into the bottom fifth of the income distribution. Overall, three-quarters of severely cost burdened households (or 10.6 million) have incomes in the bottom fifth of the distribution. Each day they must confront difficult choices concerning how best to allocate their meager incomes to secure housing, food and meet other essential needs. Note that a family with an annual income of just \$10,000 – the median income of households falling into the lowest income quintile – can allot just \$250 per month for housing under the 30-percent-of-income standard. While \$250 per month is

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<sup>38</sup> Recent AHS data suggest that moves triggered by a “disaster loss” are most likely to result in a move into a rental unit, but unlike moves linked to changes in job or marital status, these moves are relatively uncommon.

<sup>39</sup> Joint Center for Housing Studies (2004), The State of the Nation's Housing, 2004, Harvard University, Cambridge, Massachusetts.

insufficient to secure a decent home in most market areas, even an expenditure of this magnitude leaves a household with \$10,000 annual income only \$583 a month to cover all other expenses.

Though high housing cost burdens plague both owners and renters, renters in the lowest-income quartile are more likely to have severe rent burdens than homeowners. Today, approximately 9 million units have annual gross rents of \$5,000 or more (an amount that represents nearly half of the average income of the lowest-income renters). In addition to competing with one another, the 10.8 million lowest-income renter households must also compete with higher-income households for these low-cost units. Little wonder that nearly 8.6 million lowest-income renters pay more than 30 percent of income for rent, and of these almost 6.0 million pay more than 50 percent.

### **The Continuing Shortage of Affordable Rental Housing**

The combination of structurally low wages and persistently high housing costs provide ample reason to believe that the current affordability problems that plague so many households are likely to continue unabated for years ahead. Moreover, the continued loss of affordable rental housing from the inventory, combined with the difficulty associated with efforts to construct new affordable replacement housing, suggest that the current housing squeeze could intensify in the future. Of course, the ability of more moderate- and middle-income households to make the transition to homeownership has eased the pressure on rents in some market segments. Even so, most current renters are unlikely to qualify for a mortgage that they can reliably repay, and hence will remain stuck competing for a largely inadequate supply of rental housing.

### **Much Rental Stock at Risk of Loss**

The deterioration of the older rental stock is troubling, especially for communities facing a shortage of affordable rental housing. Over the 1990s, losses of subsidized rental units accelerated as more and more property owners chose to “opt out” of federal housing assistance programs or prepay their government-insured mortgages. While growing preservation efforts have stemmed these losses, lack of adequate funding still makes it difficult to maintain, no less expand, the subsidized housing inventory.

Equally problematic is the rapid deterioration and loss of the older, non-subsidized rental housing, including the inventory of older small multifamily and single-family rental housing. Almost 19 million of the nearly 27 million privately owned, unsubsidized rental units are in single-family and small (2 to 9-unit) multifamily structures. Although most of this inventory is in good repair, the American Housing Survey estimates indicate that roughly 2.1 million (11.3 percent) of these units have moderate or severe structural deficiencies. Over half of this structurally inadequate single-family and small multifamily rental housing consists of older units built before 1950, units that are risk of loss from the housing inventory due to disinvestment and disrepair.<sup>40</sup>

Of particular concern is that many owners of the small multifamily and single-family rental inventory are themselves ill-equipped to manage and maintain their units. For many property owners, operating rental housing is a part time business. According to a U.S. Department of Housing and Urban Development survey completed in the mid-1990s, nearly 1.1 million rental units were located in two-to four-unit structures with a resident owner. Another 7.9 million apartment units were controlled by absentee landlords owning fewer than 10 rental units.<sup>41</sup>

Operating such properties is a challenging business, especially when tenants have limited rent-paying ability. For many owners of smaller multifamily rentals, it makes economic sense to abandon structurally unsound units if the property does not generate enough rent to cover basic operating expenses, or the property would not sell for enough to cover outstanding debt. In addition, subsidizing smaller multifamily property owners is difficult because the administrative complexity and costs may be just as great for a property owner with a ten unit building as for an owner with a 100-unit building. Consequently, today's major supply side programs – including the low-income housing tax credit – typically provide subsidies to larger properties, even though most renters needing assistance live in smaller properties.

Further adding to the economic problems facing the smaller multifamily rentals is the general lack of financing alternatives available to the owners of these units. Here some definitions of the term “multifamily” are in order. For purposes of mortgage finance, the Federal

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<sup>40</sup> For further discussion see Joint Center for Housing Studies Joint Center for Housing Studies (2002), The State of the Nation's Housing, 2002, Harvard University, Cambridge, Massachusetts.

<sup>41</sup> U.S. Department of Housing and Urban Development (1996), “The Property Owners and Managers Survey (POMS).”

Housing Administration (FHA) has defined “multifamily” to include structures with five or more units, while the term “single-family” lumps single-family detached homes together with two, three, and four unit buildings. While these definitions may have made sense in these 1930s when many of the two to four family dwelling units were owned by a resident landlord who rented out the other units, the concept is increasingly anachronistic today when increasing shares of this inventory is absentee owned. Unfortunately, the five unit plus definition of multifamily has carried over into the rules and regulations that govern the operation of the Government Sponsored Enterprises and are now deeply embedded in the functioning of the secondary market. As a result, even though the government-backed mortgage insurance programs and secondary market activities greatly expanded access to capital for individual home buyers, they have done little to expand access to capital for those investors seeking to purchase or otherwise refinance a two to four unit property.

Even the mortgage market for apartment buildings with five or more units has become bifurcated into small property financing (generally defined as financing for apartments with 5 to 50 units) dominated by portfolio lenders and large property financing (greater than 50 units) dominated by secondary market activity.<sup>42</sup> During the 1990s, options for permanent financing of large properties expanded rapidly as secondary markets developed. The secondary market for loans for the acquisition or refinancing of five to fifty unit buildings has been slow to develop, in large measure because these loans often lack standardized features important to the securitization process.<sup>43</sup> Unlike loans for larger properties, loans for smaller investment properties tend to be more expensive and have less favorable terms. The higher costs of financing, along with the lack of project-based subsidies prevent owners from either investing in capital improvements or selling their properties to more capable owners.

### **Local Regulations Limit the Construction of Affordable Rental Housing:**

Some families and individuals might prefer to move to a rental apartment in a particular suburban community, but are unable to act on these preferences because local land use and zoning regulations in many suburban jurisdictions limit the construction of affordable higher-

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<sup>42</sup> Shekar Narasimhan (2001), “Why Do Small Multi-Family Properties Bedevil Us?” *Capital Xchange*, (November). See also William Segal, “Segmentation in the Multi-Family Mortgage Market: Evidence from the Residential Finance Survey,” *Journal of Housing Research* Volume 13, Issue 2, pp. 175-198.

<sup>43</sup> See Christopher Herbert (2001), “An Assessment of the Availability and Cost of Financing for Small Multifamily Properties,” a paper prepared for the U.S. Department of Housing and Urban Development.

density multifamily rental units. Similarly, various building codes limit the minimum size and quality of new homes and apartment units. Moreover, in an effort to add to local revenue streams, many communities impose other fees and exactions that often exceed the local government's costs of providing infrastructure or other development related services.

In the United States, most development regulations are promulgated by states and localities, but in recent years the federal government has added to the cost of housing production, particularly through environmental protection regulations. In a paper prepared for the Millennial Housing Commission, Michael Schill documented the many development regulations that add to costs.<sup>44</sup> These include land use and zoning, subdivision regulations and exactions, impact fees, growth controls and urban growth boundaries, historic landmark laws, environmental approvals, and building codes and standards. These increase housing construction costs in a variety of ways. First and foremost, they combine to reduce the available supply of developable land and in doing so raise its price. Moreover, payments for legal and other professional services needed to comply with local regulations further adds to the overall cost of development, as do any delays associated with obtaining needed approvals.

There can be little doubt that the price of newly constructed housing has increased substantially in recent years, even in inflation adjusted terms. In part, these increases reflect higher housing quality standards, greater amenities, and the larger size of newly constructed homes. Even so, there is ample evidence that land cost increases dominate. The Joint Center for Housing Studies estimated that a newly constructed home valued at \$200,000 in 1990 would have appreciated 8.2 percent in inflation adjusted terms by 2000.<sup>45</sup> At the same time, best available data suggest that over this same period the inflation adjusted cost of constructing an identical house (less the land cost) increased by 2.9 percent, while the land costs associated with this representative unit increased by 23.9 percent. The relatively slow growth in inflation-adjusted home prices over the decade reflects that improved efficiency in construction techniques helps offset rising labor or building material costs. In contrast, there is limited ability to avoid the impact that zoning and other land use restrictions have on the land price component of new

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<sup>44</sup> For a detailed catalogue of restrictive zoning and land use practices see Michael H. Schill (2002), "Regulatory Barriers to Housing Development in the United States," a paper presented to the Millennial Housing Commission, Washington DC. June 2002.

<sup>45</sup> This example is derived by calculations that first appeared in the Joint Center's report entitled Manufactured Housing as a Community Building Strategy, September.

housing construction, especially when local zoning severely limits the ability of developers to reduce land costs by building at higher density.

These national calculations are consistent with best available research on local housing market dynamics. For example, economist Richard Green observed that “Land use regulation limits the supply of a commodity, and therefore increases its prices.”<sup>46</sup> Empirical work on single-family home prices by Green and Stephen Malpezzi confirmed this linkage.<sup>47</sup> In one innovative paper, Edward Glaeser and Joseph Gyourko used a metropolitan area measure of zoning tightness to examine variation in single-family home prices and concluded that zoning and land use controls are key contributors to the observed price differentials.<sup>48</sup>

Land use restrictions undoubtedly also add to the development cost (and the rents) of new multifamily apartments. Michael Schill noted that restrictions on the land supply available for higher-density multifamily development are typically even greater than for single-family housing. Green observed that the negative impact of land use regulation tends to fall most heavily on lower-income households. Both findings are consistent with the exclusionary nature of many land use restrictions that serve to limit low-income access to affordable rental housing in many jurisdictions. For lower-income families and individuals, these limitations can prove most harmful because they not only raise the costs of rental housing, they also limit access to neighborhoods offering good quality schools and proximity to good jobs.<sup>49</sup>

### **Many Renters Still Unable to Access the Capital Needed to Purchase a Home**

Expanded lending to lower-income borrowers, along with lending to borrowers with less than perfect credit, helped support strong growth in homeownership in the 1990s. Introduction of credit scoring and automated underwriting enabled lenders to extend mortgage credit to credit worthy, lower-income borrowers. Under the current system of ‘risk-based’ pricing, even credit

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<sup>46</sup> Richard K. Green (1999), “Land Use Regulation and the Price of Housing in a Suburban Wisconsin County,” in Journal of Housing Economics, Volume 8, Number 2, pp. 144-59.

<sup>47</sup> Stephen Malpezzi (1996), “Housing prices, Externalities, and Regulation in the U.S. Metropolitan Areas,” Journal of Housing Research, Volume 7, Number 2, pp. 209-241. See also Stephen Malpezzi and Richard K. Green (1996), “What Has Happened to the Bottom of the U.S. Housing Market?” in Urban Studies, Volume 33, Number 10, pp. 1897-20.

<sup>48</sup> Edward L. Glaeser and Joseph Gyourko (2003), “The Impact of Building Restriction on Housing Affordability,” Federal Reserve Bank of New York Economic Policy Review, June.

<sup>49</sup> For discussion of the impact of exclusionary land use practices presented a decade earlier see Advisory Commission on Regulatory Barriers to Affordable Housing (1991), Not in My Backyard: Removing Barriers to Affordable Housing, Washington DC, U.S. Department of Housing and Urban Development.

impaired potential borrowers can now get a loan by making a higher down payment and/or by paying higher mortgage interest rates sufficient to compensate the lender for assuming higher default or foreclosure related risks.

The advent of automated underwriting and low-downpayment mortgages and other changes in the mortgage market have substantially expanded the range of households able to access the capital needed to purchase a home. Consistent with expanded access to mortgage finance, the 2001 Fannie Mae National Housing Survey found the share of renters stating that they were “constrained” from becoming homeowners has declined over the past decade, while the number of “renters by choice” has risen to 41 percent.<sup>50</sup>

Even so, borrowing constraints have not been totally eliminated.<sup>51</sup> The new mortgage finance system presents new challenges to low-income and low-wealth renters seeking to purchase a first home, as well as low-income and low-wealth owners seeking to hold onto the home they already occupy. In most instances, the new mortgage delivery system has expanded access to prime mortgages on favorable terms, yet all too often low-income and minority communities are served by a distinctly different set of financial institutions offering a distinctly different mix of products. As a result of this dual market structure, many lower-income households suffer at the hands of a broker-led “push-marketing” system that encourages some unsuspecting borrowers to take on mortgage debt they cannot afford. In addition, some borrowers are pushed into accepting a “higher-cost” subprime mortgage, even though they have a credit history, income or other factors that would enable them to qualify for a “lower-cost” prime loan.<sup>52</sup>

The rapid growth in high-cost and otherwise abusive lending appears to be linked to the recent surge in foreclosures in many low-income and minority communities. Though hardly in

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<sup>50</sup> Fannie Mae (2001), Fannie Mae National Housing Survey 2001: Examining the Credit-Impaired Borrower. In explaining why some choose to rent, the survey noted that renters tend to place a higher premium on convenience, mobility, low risk investments, flexibility/liquidity of assets, and proximity to work, family, friends and activities.

<sup>51</sup> For a recent study of the extent of continuing “borrower constraint” see David Listokin, Elvin K. Wyly, Brian Schmitt, and Ioan Voicuc (2002), “The Potential and Limitations of Mortgage Innovation in Fostering Homeownership in the United States,” a report prepared for the Fannie Mae Foundation. See for example Donald R. Haurin, Patric H. Hendershott, and Susan M. Wachter (1997), “Borrowing Constraints and the Tenure Choice of Young Households,” in *Journal of Housing Research*, Vol. 8, Issue 2, pp. 137-154. Using data for the 1985-1990 period, this study estimated that the higher incidence of mortgage constraints may reduce the probability of homeownership for young households by 10 to 20 percentage points relative to older households. See also Fannie Mae (2002), Fannie Mae National Housing Survey 2002: The Growing Demand for Housing.

<sup>52</sup> Joint Center for Housing Studies, Harvard University (2004), “Credit, Capital and Communities,” A report prepared for the Ford Foundation, March.

evidence a decade ago, subprime loans are now the most default-prone segment of the national mortgage loan market. For example, researchers at Freddie Mac estimated that as of mid-2002, the serious delinquency rate for conventional prime loans was 0.55 percent.<sup>53</sup> In contrast, subprime loans had a serious delinquency rate of 10.44 percent, nearly 20 times higher than conventional prime mortgages and twice as high as the 4.45 percent serious delinquency rate for loans insured by the Federal Housing Administration.

This rise in subprime foreclosures can have a devastating impact on the families who lose their homes and an equally severe impact on distressed neighborhoods.<sup>54</sup> Indeed, the rising default and foreclosure rates have led many to question whether the recent increase in low-income homeownership – built in part on the rapid growth of subprime lending – is sustainable or desirable. While homeownership can help low-income families build assets, Federal Reserve Board Governor Edward M. Gramlich recently noted that for every ten who got more net worth, there’s one person who loses everything.<sup>55</sup> Moreover, if providing additional public funding to promote homeownership drains resources away from assisting the lowest-income renter families, these policies could further weaken the already tattered social safety net. According to Sheila Crowley, President of the National Low Income Housing Coalition, “The housing affordability problems of very-low income renters remains the most acute housing issue today, but the emerging problems of low-income homeowners show that ‘homeownership above all else’ is an imperfect and incomplete public policy, however politically popular it is.”<sup>56</sup>

### **The History of Housing Impact Studies**

For over a century, social reformers have pushed for greater public support of housing, arguing that “good housing makes good people.” In the late 19<sup>th</sup> and early 20<sup>th</sup> centuries, research and policy deliberations in the United States focused on the provision of good quality housing for low-income renters. More recently, economic and social science research – as well as policy discussions in the United States – have focused on the presumed positive impact of homeownership in a wide range of outcomes, including household wealth, savings and

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<sup>53</sup> Amy Crews Cutts and Robert A. Van Order (2003), “On the Economics of Subprime Lending,” Freddie Mac working paper dated March 2003. Here serious delinquencies include both loans that are already in foreclosure and loans with payments that are more than 90 days late.

<sup>54</sup> For a recent discussion of the rise in foreclosures see Neighborhood Housing Services of Chicago (2004), Preserving Homeownership: The Community-Development Implications of the New Mortgage Market, March.

<sup>55</sup> As quoted in an article by Julie Kosterlitz (2004), “Housing—Home Sweet Home?” in National Journal, March 6.

<sup>56</sup> Sheila Crowley (2004), Memo to Members National Low Income Housing Coalition, January 23.



investment behavior, mobility, labor force participation, urban spatial structure, residential segregation, home maintenance, political and social activities, health, self-esteem, education and other child outcomes. This section briefly describes the history of housing impact studies

### **Early Studies Focused on the Negative Consequences of Slum Housing**

Much of the early literature on the impacts of improved housing conditions involved the effects of poor housing on individual health and welfare. Armed with shocking descriptions, illustrations and pictures of wretched slum conditions, Jacob Riis and other 19<sup>th</sup> century photo journalists raised public awareness of the social and health consequences of inadequate housing.<sup>57</sup> Reinforced by rudimentary statistical analyses and early scientific knowledge about the spread of disease, numerous studies documented how unsanitary and unsafe housing caused respiratory illness, fires, accidents and other health and social ills.<sup>58</sup> The combination of increased public awareness and growing empirical evidence enabled social reformers to secure passage of model housing and health codes designed to eliminate the worst aspects of slum housing.

In the late 19<sup>th</sup> and early 20<sup>th</sup> centuries, what Alexander von Hoffman describes as idealistic philanthropists and reformers argued more expansively that slum housing undermined the work ethic and the moral character of slum dwellers.<sup>59</sup> With little regard for identifying the specific mechanisms that linked “better housing” to these desirable outcomes, reformers of the day constructed dozens of model tenements and industrial villages. As von Hoffman notes, their biggest accomplishment was the broad dissemination of the view that housing reform was necessary to solve social problems related to urban poverty. This belief subsequently helped win passage of significant national housing legislation in the 1930s, and the enactment in 1949 of the national goal of “a decent home and suitable living environment for all.”

Despite the wide spread appeal of this early form of environmental determinism, there were surprisingly few attempts to assess empirically the implications of the provision of good quality rental housing. By the 1960s, there was clear evidence that good housing alone was not

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<sup>57</sup> Jacob Riis (1890), How the Other Half Lives: Studies Among the Tenements of New York (New York: Charles Scribner’s Sons).

<sup>58</sup> For a summary of early studies on the impact of improving general housing conditions see Alvin Scorer (1966), Slums and Social Insecurity, (Washington, DC: Government Printing Office).

<sup>59</sup> Alexander von Hoffman (1996), “High Ambitions: The Past and Future of American Low-Income Housing Policy.” Housing Policy Debate, Vol. 7, Issue 3, pp. 423-446.

sufficient to uplift the poor. In a widely referenced study, David Wilner and his associates examined the situation of two samples of families: one group moved from slum rental housing into a better quality public housing and a second (or control) group remained in slum housing.<sup>60</sup> The group that moved into better housing experienced several health and safety related gains. Yet the change in housing had no demonstrable impact on children's performance on school achievement tests and other expected social outcomes.

Of course, the Wilner study examined what in hindsight seems to be a modest change. Though families that moved into public housing improved their physical housing conditions, the public housing program made no attempt to improve other dimensions of housing – such as social environment, status and location – that are also important to expanding economic and social opportunity. Indeed, by the 1970s the social deterioration of many public housing developments provided policy analysts with ample evidence that public housing developments often lacked the social support, protection, and informal mechanisms of social control more commonly present in slum neighborhoods.<sup>61</sup>

### **Recent Studies Focus on the Role of Housing in Expanding Access to Opportunity**

The mounting concern about the rapid physical deterioration of the nation's subsidized housing inventory sparked a comprehensive review of the nation's housing policy. Completed in 1974, the National Housing Policy Review helped to guide passage of the Housing and Community Development Act of 1974.<sup>62</sup> In addition to creating the Section 8 Project-Based Subsidy Program, which provided incentives for the construction and substantial rehabilitation of privately owned, but publicly subsidized housing, the act also launched the Section 8 Housing Allowance Program, an effort to provide cash to lower-income renters to enable them to secure good quality rental housing on the open market.

To help chart the progress of the newly created tenant subsidy program, Congress also funded the National Housing Allowance Experiment, a research and data collection effort that

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<sup>60</sup> David Wilner (1962), The Housing Environment and Family Life, (Baltimore: Johns Hopkins Press)

<sup>61</sup> L. Harry Spence, (1993), "Rethinking the Social Role of Public Housing," in Housing Policy Debate, Vol. 4, Issue 3, pp. 355-369.

<sup>62</sup> US Department of Housing and Urban Development (1974), Housing in the Seventies, A Report of the National Housing Policy Review<sub>2</sub> (Washington DC).

prompted numerous studies on the potential benefits of relocating low-income families to areas with better schools, more job opportunities, or other beneficial social and economic conditions.<sup>63</sup> For example, as mandated by a court decree designed to remedy years of discrimination by the Chicago Housing Authority, the Gautreaux Program enabled public housing residents to use their Section 8 vouchers to move out of their current public housing units into better quality city and suburban neighborhoods. Overall, research on the families that participated in the Gautreaux Program shows that moving to resource rich neighborhoods improved the lives of adults and their children. The economic and educational results of moving to the suburbs included increases in adult employment, children's educational attainment, and youth employment.<sup>64</sup>

Critics have highlighted several problems with the Gautreaux research studies, including: selection bias (participants chose to participate), very small sample size, and inadequate data gathering. In response, the US Department of Housing and Urban Development designed a similar program called the Moving to Opportunity Program (MTO). Through an intense application and screening process, the participants were randomly divided into three groups: the experimental group received Section 8 vouchers and had to move to a neighborhood with less than 10 percent poverty; the Section 8 group was given housing vouchers and were allowed to move to any neighborhood; and a control group where participants had to stay in public housing. Information gathering began at the beginning of the program and will continue over a 10 year period. This study design will allow researchers to compare the experience of those families receiving housing assistance with an otherwise similar control group and thus identify the impact that moving to a resource rich neighborhood has on the ability of program participants to secure better jobs, gain access to improved social services or realize other desirable outcomes.<sup>65</sup>

While it is still too early in the MTO experiment to determine the long-term benefits of mobility on participants, preliminary results are promising. For example, relocation to lower-

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<sup>63</sup> US Department of Housing and Urban Development (2000), Section 8 Tenant-Based Assistance: A Look Back after 30 Years, Washington, DC, March. See also Michael P. Johnson, Helen F. Ladd, and Jens Ludwig (2002), "The Benefits and Costs of Residential Mobility Programmes for the Poor," in Housing Studies, Vol. 17, No. 1, pp. 125-138.

<sup>64</sup> James E. Rosenbaum (1991), "Black Pioneers: Do Their Moves to the Suburbs Increase Economic Opportunity for Mothers and Children?," Housing Policy Debate, Volume 2, Issue 4. See also Stefanie DeLuca and James E. Rosenbaum (2003), "If Low-Income Blacks are Given a Chance to Live in White Neighborhoods, Will They Stay? Examining Mobility Patterns in a Quasi-Experimental Program with Administrative Data," Housing Policy Debate, Volume 14, Issue 3.

<sup>65</sup> US Department of Housing and Urban Development (1996), Expanding Housing Choices for HUD-Assisted Families: Moving to Opportunity, First Biennial Report to Congress, Moving to Opportunity for Fair Housing Demonstration Program. April.

poverty areas appears to reduce youth crime and delinquency, though the results seem to have a more profound and lasting effect on young women than for young men.<sup>66</sup> Recent MTO studies also suggest that living in low poverty neighborhoods has positive effects on adult's and their female children's feelings of anxiety, depression and measures of distress. Finally, mobility appears to have a somewhat more modest impact on educational performance and economic outcomes, though to date many of these findings remain in dispute.<sup>67</sup> With several years left in the MTO program, more comprehensive and conclusive research will become available on neighborhood effects.

### **Today Most Literature Focuses on the Impact of Homeownership**

With the exception of MTO and other longer-term mobility studies, much of the recent policy analysis literature focuses on the economic and social benefits of homeownership. In a recent article, Rohe, Van Zandt and McCarthy examined the relationship between homeownership and economic opportunity.<sup>68</sup> The authors reviewed over fifty separate articles noting that the vast literature on the topic involves efforts to measure the impact of homeownership on both individuals and society. For individuals, Rohe and colleagues noted that homeownership may positively impact the creation of financial resources and wealth accumulation, physical and psychological health, and improve educational outcomes and alter youth behavior. Similarly, the authors reviewed claims that expanding homeownership may positively impact the broader society by increasing participation rates in local voluntary associations and political affairs, and by increasing neighborhood stability and producing stronger social networks.

Recognizing the importance of moving beyond simple statistical correlation, Rohe, Van Zandt and McCarthy sought to identify the mechanisms (or pathways) through which home

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<sup>66</sup> Jeffery R. Kling, Jens Ludwig, Lawrence F. Katz (2004) "Neighborhood Effects of Crime for Female and Male Youth: Evidence from a Randomized Housing Mobility Experiment," Quarterly Journal of Economics, Vol. 120, February 2005 forthcoming.

<sup>67</sup> US Department of Housing and Urban Development (2003) Interim Impacts Evaluation: Moving to Opportunity for Fair Housing Demonstration Program, HUD's Office of Policy Development and Research, Washington, D.C. September. John Goering, Judith D. Feins, and Todd M. Richardson (2002), "A Cross-Site Analysis of Initial Moving to Opportunity Demonstration Results," Journal of Housing Research, Volume 13 Issue 1, pp. 1-30.

<sup>68</sup> William M. Rohe, Shannon Van Zandt and George McCarthy (2002), "Home Ownership and Access to Opportunity," in Housing Studies, Vol. 17, No. 1, pp. 51-61. See also William M. Rohe, Shannon Van Zandt, and George McCarthy (2002), "The Social Benefits and Costs of Homeownership: A Critical Assessment of the Research," in Nicolas P. Retsinas and Eric S. Belsky, eds., Low-Income Homeownership: Examining the Unexamined Goal, (Washington, DC: Brookings Institution Press).

ownership may help produce a potential individual and social benefit. What emerges is a useful assessment of not only the ways that homeownership may expand available opportunities, but also an individual's perception of these opportunities.<sup>69</sup> To the extent that homeownership promotes wealth building, it may enable families to invest in additional education for themselves and their children and/or relocate to "job-rich" environments and better schools. Moreover, to the extent that homeownership has positive impacts on individual self-esteem, home owning families should be more likely to take advantage of available education or economic opportunities.

In another comprehensive review of the literature, Robert D. Dietz and Donald R. Haurin presented an assessment of "the social consequences of homeownership" based on a wide ranging survey of articles drawn from social sciences, medicine, psychology and other academic fields.<sup>70</sup> As was true with the work of Rohe and colleagues, Dietz and Haurin were careful to examine literature that focuses on both the tangible impacts of homeownership – such as increased wealth or improved health – as well as less tangible outcomes – including any impact that homeownership may have on the perceptions that individuals possess about themselves, the place that they live and their community. In an interesting departure from other literature reviews, Dietz and Haurin also included an assessment of the ways that the desire to move from renting to owning may influence the rate of savings and labor force participation prior to the move.

While the Dietz and Haurin review included more than 250 articles and books on the topic, they covered only a subset of the extensive homeownership impact literature. For example, James R Dunn recently presented a detailed assessment of the positive impact of good quality housing on health outcomes,<sup>71</sup> while Joseph Harkness and Sandra Newman have written extensively on the beneficial effects of homeownership on health outcomes, especially health

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<sup>69</sup> For an interesting assessment of how perceptions may influence decision making see George C. Galster and Sean P. Killen (1995), "The Geography of Metropolitan Opportunity: A Reconnaissance and Conceptual Framework," Housing Policy Debate, Vol. 6, Issue 1, pp. 1-23. See also, George Galster (2002), "Trans-Atlantic Perspectives on Opportunity, Deprivation, and the Housing Nexus," In Housing Studies, Vol. 17, No, 1, pp. 5-10.

<sup>70</sup> Robert D. Dietz and Donald R. Haurin (2003), "The Social and Private Consequences of Homeownership," The Journal of Urban Economics, Volume 54, pp. 401-450. See also Robert D. Dietz (2003), "The Social Consequences of Homeownership," a report prepared for The Homeownership Alliance, June, 23.

<sup>71</sup> James R. Dunn (2000), "Housing and Health Inequalities: Review and Prospects for Research," in Housing Studies, Vol. 15, No. 3, pp. 341-366.

outcomes related to children.<sup>72</sup> William Rohe and Leslie Stewart presented a wide ranging assessment of the relationship between homeownership and neighborhood stability,<sup>73</sup> while other studies examine the impact of tenure choice on labor market outcomes.<sup>74</sup>

### **Current Studies Struggle to Generate Convincing Evidence**

As this historical overview suggests, homeownership undoubtedly confers some benefits to families, but so do efforts that improve the quality of rental housing and enhance the ability of renters to live in resource rich neighborhoods. Unfortunately, it is difficult to measure in any meaningful way the dimensions of home owning that matter, just as it is difficult to identify what constitutes good quality housing and what the important dimensions of a “resource rich” neighborhood are.

Moreover, summarizing a literature that spans over a century of inquiry and now includes hundreds of individual studies is no easy task. It is perhaps understandable that each of the studies just mentioned differ on what they consider to be the most important impacts of housing and tenure choice. There is, however, one remarkable area of agreement: the existing housing impact literature is deficient in many ways. For example, Dietz and Haurin argued that much of the existing literature on the impact of homeownership on individual and social outcomes has “substantial econometric drawbacks,” and is therefore “unreliable.” Rohe and colleagues agreed, noting that much of the existing research suffers from “methodological shortcomings” that undermine its usefulness as a guide to policy deliberations. Existing studies also tend to ignore that any single housing or tenure choice may have different impacts – both positive and negative – on families of differing characteristics. Rohe and colleagues also noted the somewhat surprising failure of existing literature to focus on potential negative outcomes and an equally pronounced tendency to move quickly from correlation to causality.

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<sup>72</sup> Joseph Harkness and Sandra Newman, (2003) “Differential Effects of Homeownership on Children from Higher- and Lower-Income Families,” *Journal of Housing Research*, Vol. 14, Issue 1, pp. 1-19.

<sup>73</sup> William M. Rohe and Leslie S. Stewart (1996), “Homeownership and Neighborhood Stability,” in *Housing Policy Debate*, Vol. 7, Issue 1, pp. 37 to 81. See also Donald R. Haurin, Robert D Dietz, and Bruce A, Weinberg (2003), “The Impact of Neighborhood Homeownership Rates: A Review of the Theoretical and Empirical Literature,” *Journal of Housing Research*, Vol. 13, 119-151, and Robert D. Dietz (2002), “The Estimation of Neighborhood Effects in the Social Sciences: An Interdisciplinary Approach,” *Social Science Research*, Vol. 31, pp. 539-575

<sup>74</sup> N. Edward Coulson and Lynn M. Fisher (2002), “Tenure Choice and Labour Market Outcomes,” in *Housing Studies*, Vol. 17, No. 1, pp.35-49.

The tendency to ignore countervailing evidence or ignore the diversity of potential outcomes reflects the understandable tendency of many researchers to hold strong *a priori* views on what housing policy should be. As noted earlier, in pushing for their idealized view of what national housing policy should be, housing reformers and their social science research allies of the 1930s and 1940s advocated for massive construction of publicly owned and operated housing. At the time, public housing represented a vast improvement over the housing it replaced. Yet in their zeal to advance their views, housing advocates of the time ignored the many potential shortcomings of their proposed programs. It may be true that some ideal notion of “improved housing” may generate many important benefits, but in linking housing improvements to massive slum clearance and urban renewal, these policies generated many offsetting and largely unanticipated negative consequences.

Today, even as many researchers continue to search for the positive individual and social benefits of homeownership, there is a growing chorus of voices suggesting that ongoing efforts to expand homeownership to low-wealth and low-income households may cause more harm than good. Noting the recent rise in foreclosures, Rohe and colleagues stressed the importance of acknowledging the potential downside of homeownership and recognizing that homeownership impacts may vary depending on the family’s ability to make required mortgage payments, the physical condition of the home and the characteristics of the surrounding neighborhood. Just as the reformers of old were blinded by their idealism, Rohe and colleagues concluded that “those involved in promoting home ownership should be careful not to oversell it, particularly among those who are less likely to be successful.”<sup>75</sup>

### **Understanding the Complexity of Housing Policy Analysis**

Analysis of the impact of housing and tenure choices on individual and societal well-being is an admittedly complex undertaking. Various types of housing are differentially present in individual neighborhoods and communities, and economic and social opportunities vary from one community to the next. Adding to the complexity is the recognition that individual decision making is itself endogenous to the functioning of housing and housing finance markets. As a result, observed housing and tenure choices may prove to move in unpredictable ways and be a poor guide in housing policy deliberations.

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<sup>75</sup> Rohe, Van Zandt and McCarthy (2002) p 59.

## Tenure Decisions Represent a Complex Multi-Period Assessment

In purchasing a durable asset, owners must evaluate the benefits and costs that accrue over time. Financing decisions add another dimension of complexity to this multi-period assessment as the potential home buyer must decide whether to purchase a unit outright or, more commonly, decide how large a down payment to make as part of entering into a multi-year mortgage commitment. Economic models of tenure choice focus on these issues, and address that the transaction costs of owning are substantially higher than the transaction costs of renting – a factor that tends to encourage renting by households with a desire to move in the near future. Understanding how best to make these multi-period assessments will depend on many factors, including whether or not a family or individual wants to “settle down” or adopt a more mobile life-style.

Given the complexity of home buying decisions, even consumers with detailed information concerning the availability and cost of alternative housing choices may have difficulty using this information to guide their decision making. Once again, actual practice may differ substantially from economic theory. For example, there exists an extensive and technically sophisticated literature on how to generate a single variable that combines many housing cost factors into a single number. The technique involves use of discount rates and calculation of the present value of a stream of payments over the life of a loan.<sup>76</sup>

Unfortunately, even the most mathematically sophisticated borrower will find it difficult to complete the required multi-period discounting arithmetic implicit in this approach. In a recent paper Suzanne Shu (2002) argued that the complexity of discounting mathematics and an inability to estimate this function in their head leads people to turn to alternative “Short Cut Methods,” such as heuristics or simplified linear models.<sup>77</sup> One short cut method might be for the consumer to estimate the total loan payments (number of payments times the payment size) and

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<sup>76</sup> In simple terms, this approach assumes that when comparing mortgages of differing characteristics, a consumer should select the mortgage with the lowest discounted present value of the initial outlays and stream of mortgage payments made over the life of the loan. Once the most cost effective method of financing is selected, the tenure choice decision then depends on the relative discounted present value of the costs of purchasing and operating a home compared with the discounted present value of the annual costs of renting. Note that these comparisons all assume some time frame over which the home is to be owned or rented, the consumer’s tax situation and any anticipated gains from capital appreciation, as well as an appropriate discount rate that reflects the consumer’s general inflationary expectations and the value the consumer places on making payments (or receiving benefits) today versus some future date.

<sup>77</sup> Suzanne Shu (2002), “Choosing for the Long Run: Making Tradeoffs in Multi-period Borrowing,” draft working paper, University of Chicago, September.



look for a loan that minimizes this total. If the loan terms being compared were held constant, this approach is equivalent to finding the loan with the lowest present value discounted loan payments. Yet over loans of various terms, the loan with the lowest total payments may not be the loan with the lowest present value discounted payments.<sup>78</sup> Also, total loan payments were just one method used by survey participants to select the “best” financing option. Some survey participants focused on minimizing the length of the loan term, while others sought out loans with the lowest monthly payments.

As a result, rather than using the “mathematically precise” method of comparing the cost of owning with the cost of renting, undoubtedly consumers use some alternative method. Given the general public support for homeownership, this may result in consumers falsely concluding that buying a home is a cost effective alternative to renting, even when renting might be the lower cost alternative. This can be especially problematic when readily available mortgage loans feature low required monthly payments – payments that might seem favorable when compared to current rents, yet focus less attention to fees or other costs that are spread out over time and require more sophisticated discounting approaches to evaluate.

### **Measuring Impact Presents Difficult Statistical Challenges**

At its best, quantitative housing policy analysis can “probe not prove.” Indeed, in complex real life situations, “proving” something is particularly illusive. The methodological challenges confronting efforts to measure the impacts of alternative housing policies are numerous. In large measure, understanding the consequences of tenure choice is difficult because this research requires the isolation of a single variable in what is often a complex series of behavioral relationships.<sup>79</sup>

What is difficult to do even under the most carefully controlled laboratory settings, is nearly impossible to accomplish in the complex world of spatially defined housing markets. Consider the contention that children of homeowners do better in school, at least as measured by commonly utilized test scores. But suppose also that the children of parents that place a higher value on education also do better in school, as do children that attend better quality suburban

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<sup>78</sup> Based on an experiment conducted with a panel of students enrolled in the MBA program of the University of Chicago, which noted even well educated and presumably financially literate individuals often have trouble determining a cost minimizing way to borrow funds.

<sup>79</sup> For an excellent overview of the art and science of program evaluation see Richard J. Light et al. (1990), By Design, (Cambridge, Massachusetts: Harvard University Press).

schools, and children that move less frequently from one school to the next. Further complicating the situation, many – but not all families – have multiple reasons for choosing single-family detached housing, housing that is most commonly available in suburban communities with better quality schools. And finally, because of the higher transactions costs of moving, children of home owners tend to move less frequently than children of renters.<sup>80</sup>

Sorting out the direct impact of homeownership on educational outcomes presents many methodological challenges. In attempting to assess whether a simple correlation signals the presence of a causal relationship, it is important that the analysis controls for all variables that contributed to the observed outcome. For example, it is possible that an unobservable factor – or even a poorly measured observable factor such as a parent’s assessment of the importance of education or homeowners moving less frequently than renters – is not included in a study. The possibility that an omitted variable influences both the decision concerning tenure choice, as well as the likelihood of engaging in some other behavior is particularly problematic. Absent inclusion of this variable, a researcher may falsely conclude that homeownership helps promote good education, when in fact “good parents” promote “good educational outcomes,” or that “residential stability” avoids the disruption to the learning process caused by a change in schools.

In this context, there is a growing body of literature that attempts to better understand the direct influence of residential stability on individual and family well-being, and to isolate this effect from other potential effects of homeownership. Residential stability not only appears to promote community involvement and development of beneficial social capital, but also appears to be an important determinant of educational outcomes. In the educational arena, residential stability helps students avoid the disruption linked to the relocation from one school to another. In a recent paper, Eric Hanushek, John Kain and Steven Rivkin find that this “disruption effect” not only negatively impacts the educational achievement of moving students, but it also lowers the achievement of non-moving students attending schools with higher turnover. Moreover, they find that these adverse disruption effects tend to be greater for lower-income and minority students who typically attend schools with much higher turnover rates.<sup>81</sup>

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<sup>80</sup> In addition to low transactions costs of moving, many renters have low and arguably volatile incomes, which can result in higher mobility linked to difficulties in meeting rent payments, and the resulting need to either move or face eviction. See Chester Hartman and David Robinson, (2003) Evictions: The Hidden Housing Problem,” in Housing Policy Debate, Volume 14, Issue 4, pp. 461 to 501.

<sup>81</sup> Eric A. Hanushek, John F. Kain, and Steven G. Rivkin, (2004), “Disruption Versus Tiebout Improvement: The Costs and Benefits of Switching Schools,” Journal of Public Economics, Volume 88, Number 9, pp. 1721-1746.

The influence of the disruption effect on both moving and non-moving students is a reminder of the difficulty in sorting out the impact of homeownership from the highly correlated impact of residential stability. In one recent attempt to do so, Denise DiPasquale and Edward Glaeser find that the length of residences is a more important determinant of community involvement than homeownership. Numerous studies seem to indicate that homeownership is nevertheless still positively associated with the educational outcomes of children, but that these effects are exceedingly difficult to isolate. Joseph M. Harkness and Sandra J. Newman observe that while homeownership raises the educational attainment of children from higher-income families, these positive results do not extend to the long-term outcomes of children in lower-income families.<sup>82</sup> In interpreting these results, Harkness and Newman observe that owning a home may exert financial pressure on the budget of a low-income family and actually negate whatever benefits that flow to more higher-income homeowners. Given this, they speculate that mechanisms other than homeownership – such as assisted rental housing – may serve to reduce residential mobility and hence provide an alternative means of improving the educational attainment of lower-income children.

While noting the methodological flaws of many studies, Dietz and Haurin argued that recent advances in econometric techniques, along with improved data, provide hope that researchers will eventually be better able to avoid problems linked to simultaneous equation bias, left out variables, and reverse causality. Indeed, they pointed to studies by Denise DiPasquale and Edward Glaeser<sup>83</sup> and Richard Green and Michelle White<sup>84</sup> as examples that used the best of the new econometric approaches.

In advocating for more attention to methodology, Dietz and Haurin believe that new and more rigorous statistical techniques will “confirm established and intuitively sensible results.” Even so, given limited availability and high costs associated with assembling detailed data on the characteristics of individuals, the characteristics of housing units available on the market, as well as measures of the potential outcomes associated with any particular housing choice, realizing the full benefit of these enhanced statistical techniques will be prove most difficult.

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<sup>82</sup> Joseph Harkness and Sandra Newman (2003), “Differential Effects of Homeownership on Children from Higher- and Lower-Income Families,” *Journal of Housing Research*, Vol. 14, Issue 1, pp. 1-19.

<sup>83</sup> Denise DiPasquale and Edward L. Glaeser (1999), “Incentives and Social Capital: Are Homeowners Better Citizens?” *Journal of Urban Economics*, Volume 45, pp. 354-384.

<sup>84</sup> Richard K Green and Michelle .J. White (1997), “Measuring the Benefits of Homeowning: Effects on Children,” *Journal of Urban Economics*, Volume 41, pp. 441-461.

Moreover, whatever the state of available data and statistical methods, the pressure for researchers to “prove something” will still persist. At some level, this plays out in subtle ways – including the understandable tendency to more readily accept results that seem “intuitively sensible,” and in doing so, cease “probing” for greater understanding.

Situations where research becomes overtly political are even more problematic: the best data, methodology and researchers are deployed to support a preconceived idea or a particular political agenda. While not all research sponsored by political interest groups (or even politically motivated business, government or not-for profit organizations) is biased in this way, given the complexity and the expense of deploying the best data and latest econometric technology, those who use research to guide policy making should retain a healthy degree of skepticism about any particular set of results – remembering the notion that policy analysis is better at “probing” than at “proving.”

### **Preferences and Behavior Are Malleable Not Fixed.**

One final feature that limits the value of economic research is the influence of individual perceptions and preferences by the specific economic, political and social contexts in which choices are made. In its simplest form, elementary economics postulates that individuals seek to maximize their well-being given preferences for alternative goods and services subject to the way market prices and their income limit available choices. While there has been considerable effort to better understand the role of prices and income – along with lifetime earning potential, wealth holdings and other related financial concepts – until recently, there has been surprisingly little work by economists on how families and individuals actually make choices.

Social psychologists and consumer marketing specialists have long sought to better understand individual decision making. For example, consider the contrast between widely utilized economic models of consumer choice, and what psychologists and market consumer product marketing specialists call “buyer-behavior models.” While traditional economic analysis tends to focus on the outcomes or choices made by consumers, “buyer-behavior models” focus on the decision making process, including how consumers acquire, understand, and use information to make decisions, and how they evaluate the outcomes of a decision once made. This last step involves identifying the extent to which consumer satisfaction with the purchase decision works to reinforce their initial attitudes about the product, or whether dissatisfaction

with the experience leads them to either revise their initial attitudes or reevaluate their search process.<sup>85</sup>

Examples of how available choices are shaped by the context in which the choice is made are plentiful. For example, George Galster and Sean Killen noted that many young people living in economically disadvantaged areas may engage in what appears to be self-destructive behavior.<sup>86</sup> Consider students who “choose” to drop out. While the parents of these students may have instilled a belief in the value of education in them, Galster and Killen noted they are also exposed to conflicting messages. If the schools in their neighborhood are not very good and the job opportunities lacking, young people in this context may quickly learn that working in school does not pay off enough to be worth the effort.

Similar examples are common in the housing arena as well. For example, recognizing that schools in largely African-American central city areas were often under funded, large numbers of middle-class African-Americans moved the suburbs. At the same time, many African-Americans have historically shied away from choosing to move to predominately white communities because they were fearful of the negative and unpleasant reception they might receive from their new white neighbors. As a result, many minority home seekers adapted a “learned behavior” and came to “prefer” integrated neighborhoods, even though in a world with more equitable allocation of public school funding they might have preferred to remain in a largely African-American center city area. Or alternatively, in a world with greater racial tolerance, they might have only cared about the quality of the schools and not about the racial make up of their neighborhood.<sup>87</sup>

Similarly, local land use and zoning ordinances may also limit available choices. For example, a particular family might prefer (and have the resources sufficient to rent) a three bedroom apartment in a particular suburban community, but find themselves unable to act on this preference because local land use and zoning prohibit the construction of such a unit. Like the previous example, this family may be forced to select what they consider to be a second best option – and may decide that while they would prefer to avoid the relatively high transactions

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<sup>85</sup> See a recent article that deployed the “buyer behavior approach” see Gregory Elliehausen and Edward C. Lawrence (2001), “Payday Advance Credit in America: Analysis of Consumer Demand,” Monograph # 35, Credit Research Center, Georgetown University.

<sup>86</sup> George C. Galster and Sean P. Killen (1995), “The Geography of Metropolitan Opportunity: A Reconnaissance and Conceptual Framework,” *Housing Policy Debate*, Vol. 6, Issue 1, pp. 1-23.

<sup>87</sup> Reynolds Farley, Elaine L. Fielding, and Maria Krysan (1997), “The Residential Preferences of Blacks and Whites: A Four Metropolitan Analysis,” *Housing Policy Debate*, Volume 8, Issue 4.

cost of buying a home, this is the only way to move into their community of choice. Once there, they may find that owning a home is not a satisfying experience. In this instance, the high transaction costs of moving may force them to remain owners, despite having discovered that homeownership does not suit their desire for a more mobile lifestyle.

In sum, because empirical analysis of the impact of housing choices poses difficult methodological challenges, it argues for extreme caution in translating existing research into policy action. While much has been learned over the past century concerning the impact of housing and tenure choices on individual and societal well-being, further work needs to be done. Given the complexity of the task, it is important to both unlearn many of the “received results” that have been handed down from previous studies and begin a new effort to more carefully assess the true impact of housing and tenure choices on societal well-being. Even as research goes forward, policy analysts face the problem of designing today’s housing policy. The next section of this report focuses on how best to fashion national housing policy in a world of complex and often contradictory policy analysis.

### **Choice Enhancing Principles for a New Housing Policy**

Results emerging from the field of behavioral economics and critical reviews of current housing impact studies raise serious questions about what is actually known about the impact of various housing choices on individual and social well-being. While there can be little doubt that more research on housing choices and consumer preferences is needed, it is also important not to fall into the trap of “policy analysis paralysis,” namely the tendency to defer decision making until better information is available. For now and for some time to come, public and private decision makers will have to muddle along using the information that is available and doing the best job that they can.

### **Policy Deliberations Should Focus Less on Means and More on End Goals**

Today, homeownership is widely viewed as the “silver bullet” solution to a range of individual and social problems. Undoubtedly, becoming a homeowner is a widely shared goal for most Americans. For many low-wealth and low-income families, however, an even more important and immediate goal is to secure access to decent and affordable housing of any type. Public policy should focus on the larger goals of promoting access to decent and affordable

housing, along with expanding social and economic opportunity for all, and in doing so recognize that promoting homeownership is just one of many possible means for achieving these end goals.

In seeking to create a more balanced approach to expanding housing opportunities, it is important to remember that there are downsides to the current focus on homeownership. While homeownership can be an important component of an asset building and/or a community development strategy, homeownership is not for everyone. Unable to properly assess the real risks and responsibilities of homeownership, many low-income and low-wealth families become homeowners even if this choice is a risky and potentially costly mistake. When families take on debt that they are unable to repay, homeownership does not build wealth. Rather, it diverts scarce resources away from meeting other pressing needs. In the worst case scenario, over-extended homeowners may face a financially devastating foreclosure that undermines their ability to gain access to credit and capital for years to come. And, when concentrated in low-income and low-wealth communities, foreclosures can serve to destabilize already distressed communities and undo decades of community revitalization efforts.

### **Work To Eliminate Continuing Discriminatory Barriers**

Now more than three decades after the enactment of comprehensive fair housing and fair lending legislation, discrimination persists. Clearly, efforts to promote expanded homeownership opportunity fall short when people who would benefit from homeownership are denied access. Similarly, the full benefit of good quality rental housing that does exist is not realized when racial and ethnic minorities face differential treatment by residential property owners and managers. Launching an all out effort to confront the last vestiges of housing market discrimination is a second cornerstone of a choice enhancing housing policy.

In order to root out housing market discrimination, it is important to understand the changing nature of discrimination. Discrimination in housing and mortgage markets is more subtle today than in previous decades when entire neighborhoods were “redlined” and realtors refused to serve minorities searching for housing in largely white neighborhoods. Even so, there is ample evidence that discrimination in housing and mortgage markets persists. A recent study by the US Department of Housing and Urban Development noted that discrimination persists in both the rental and sales markets of large metropolitan areas, though the incidence of

discriminatory practices did generally decline over the decade of the 1990s.<sup>88</sup> Similarly, a recent HUD study of mortgage lending in Los Angeles and Chicago concluded that in both areas African American and Hispanic homebuyers face a significant risk of receiving less favorable treatment than whites when they visit mortgage lending institutions to inquire about financing options.<sup>89</sup>

At the same time, it is important that policy not err in the other direction and push people into home buying decisions that are not in their best interest. Clearly, the exaggerated claims by some realtors concerning the benefits of homeownership, or the high pressure lending tactics or otherwise abusive lending practices on the part of some mortgage brokers may saddle unsuspecting families with high-cost and otherwise inappropriate mortgage products. Similarly, this emphasis on homeownership, combined with the persistence of rental market discrimination, may lead many low-income renters to overlook the potential benefits of good quality rental housing that better suites their needs. The recent rise in foreclosures – and especially the concentration of foreclosures in largely minority low-income communities – is reason enough to pause.<sup>90</sup> Given how little is known about how and why families and individuals go about deciding what housing options are best for them, the mistake of over selling the virtues of homeownership (and by implication undervaluing the potential contribution of good quality rental housing) is not only possible, it appears to be an all too prevalent outcome of today's policy focus.

### **Helping Families Make Better Choices**

Rather than promoting a limited range of policies and programs, housing policy works best when it expands available choices and enhances the capacity of families to make informed choices. Unlike efforts to push one tenure choice over another, choice-enhancing demand-side approaches improve the ability of low-wealth and low-income families to make choices that are

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<sup>88</sup> US Department of Housing and Urban Development (2002), Discrimination in Urban Housing Markets: National Results from Phase I HDS 2000 HUD's Office of Policy Development and Research, (Washington, D.C. November).

<sup>89</sup> US Department of Housing and Urban Development (2002), All Other Things Being Equal: A Paired Testing Study of Mortgage Lending Institutions, Office of Policy Development and Research, (Washington, D.C. April).

<sup>90</sup> For example, a recent study documented the extent of "push marketing" practices in the subprime market and the recent rapid rise in foreclosures in low-income Chicago neighborhoods and other low-income areas across the country. See Neighborhood Housing Services of Chicago (2004), Preserving Homeownership: The Community-Development Implications of the New Mortgage Market, March



in their best interests. A choice enhancing policy must not only provide financial incentives and pre-purchasing counseling, it must also help potential homebuyers access mortgage financing that is best for them and post-purchase counseling to help them keep their homes. Finally, a choice-enhancing policy must also help consumers understand when homeownership is not a good option and instead work to help them identify viable rental housing alternatives.

Providing housing search assistance to both prospective owners and renters is another important element of a choice enhancing strategy. Unable to afford entry into homeownership, all too often low-income families settle for apartments in low quality neighborhoods, rather than search for the best available rental options, including rental housing in more resource rich neighborhoods. In some instances, a potential mover may lack information about housing options in other neighborhoods. Alternatively, they may be reluctant to move to some neighborhoods, fearing that they will encounter hostility because of differences in race or class background. And with the increased availability of high-risk, high-cost, zero downpayment subprime loans, many renters unaware of available rental options may be lured into purchasing a home of their own. Unfortunately, in all too many cases, buying a home of their own may prove to be a disaster, undermining their ability to secure decent housing for years to come.

Expanded efforts to promote housing mobility should assist non-subsidized lower-income renters to relocate to areas with greater economic opportunity. Current homeownership counseling programs should be modified to ensure that they present a balanced picture of the advantages of owning and renting. By using the number of clients able to purchase a home as a measure of programmatic success, some homeownership counseling programs may in subtle but important ways reinforce the inappropriate “push marketing” of homeownership. A more useful goal of all counseling programs, as well as national housing policy in general, is to help families secure decent and affordable housing that best fits their needs, independent of whether that housing is owned or rented.

### **Help Renters Build Credit**

Renters that have amassed a record of steady rent-paying often get little recognition for doing so, especially when it comes to establishing their credit record. Given the importance of establishing a good credit history in accessing a wide range of financial services, renters would benefit from creation of a national system that helps them to translate a good rental and utility

payment record into a good credit rating. Unlike the case of monitoring steady mortgage payments, credit bureaus typically do not have the mechanisms in place to capture the fact that a family or individual may have a steady rent payment record. The “Pay Rent Build Credit” Bill Payment Scorecard is one approach to help low-wealth renters realize the benefits associated with regular payments<sup>91</sup>. Other rental housing initiatives could expand on this concept. For example, all rental properties financed by or otherwise benefiting from public resources could be required to report the rent payment record of its residents to “Pay Rent Build Credit” and other existing credit bureaus. In this way, rental housing would not only provide simple shelter, it would help families gain access to less expensive financial services and be in a stronger position to apply for a prime mortgage loan when and if they are ready to do so.

### **Promote New Types of Housing Tenure**

Assisted housing efforts tend to divide into rental and homeownership programs, but there are numerous examples of blended tenure forms in the assisted housing arena that may prove helpful. Creating new and more flexible forms of owner and renter options is a final aspect of a choice enhancing housing policy.

There are numerous examples of choice enhancing tenure options, but often these struggle to move to scale in a world where so much of the legal and institutional infrastructure focuses on just two options – owning and renting. For example, recognizing that a poor credit history can block a family from securing the financing needed to purchase a home, rent to own programs hold open the promise that through systematic savings and steady rent paying, participants can improve their credit record and accumulate the downpayment needed to purchase their unit at a later date.

Programs to facilitate non-profit or other socially motivated forms of ownership of rental housing represent efforts to capture some of the benefits of both owning and renting. Alternative tenure arrangements designed to make housing more affordable, and/or to enhance tenant rights associated with rental housing are common in Western European countries. In United States there are numerous examples of alternative tenure forms, but they have yet to obtain broad political or market acceptance. Limited equity cooperatives and community land trusts reduce

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<sup>91</sup> See PRBC Bill Payment Scorecard at [www.payrentbuildcredit.com](http://www.payrentbuildcredit.com). See also Harney, Kenneth R. (2004), “Renters Soon Get a Chance to Boost Credit Records,” [The Washington Post](#), January, 10.

the speculative aspects of home buying and lower the initial sale price of units, and in doing so enable lower-income families to more affordably achieve most of the benefits of homeownership without precluding the next low-income buyer from realizing the same benefits.<sup>92</sup> In order to enhance the choices available to low-income and low-wealth individuals and families in the United States, national housing policy should not only explore, but should embrace these alternative tenure models

### **Rental Housing Can Serve as a Pathway to Opportunity**

Many policy makers point to homeownership as a means to obtain stability of residential occupancy, to build wealth, establish a favorable credit history, and gain access to the increased social and economic status associated with living in better quality neighborhoods. There is, however, nothing magical about homeownership. Good quality rental housing located in a resource rich community can also serve as a pathway to opportunity. First and foremost, housing policy must focus on preserving the stock of good quality rental housing. Preserving the existing subsidized inventory is a good place to start, but attention must be given to preserving privately-owned, non-subsidized rental housing that is also at risk of loss.

Comprehensive housing assistance programs must also help low-income and low-wealth families and individuals gain access to needed health and human services, child care, transportation and other work force development initiatives that will enable low-income and low-wealth families to increase their ability to earn a decent income. This could involve expanded efforts to promote the construction of affordable rental housing in resource rich communities, as well as the production of service enriched housing in more distressed inner city markets. In this manner, a balanced housing policy not only expands the range of rental housing options available in the market place, but also increases the potential for using housing construction to revitalize the distressed areas where most low-income renters now reside.<sup>93</sup>

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<sup>92</sup> Heather McCulloch and Lisa Robinson, Sharing the Wealth: Resident Ownership Mechanism, a PolicyLink Report, (Oakland, California).

<sup>93</sup> Ingrid Gould Ellen, Michael H. Schill, Amy Ellen Schwartz, and Ioan Voicu, (2003) "Housing Production Subsidies and Neighborhood Revitalization," in FRBNY Economic Policy Review, June, pp. 71 to 85. See also Ingrid Gould Ellen, Michael H. Schill, Scott Susin, and Amy Schwartz, (2002), "Building Homes, Reviving Neighborhoods," in Nicolas P. Retsinas and Eric S. Belsky, eds., Low-Income Homeownership: Examining the Unexamined Goal, (Cambridge, Massachusetts).

## **Confront Barriers to Construction of Affordable Rental Housing**

To the extent that families seek both good quality rental housing and access to better quality education and public services, efforts must continue to eliminate restrictive land use policies that limit the supply of affordable higher-density multifamily rental housing in tax and resource rich suburban communities. Much is made of the status associated with owning, as opposed to renting, a home. Allowing neighborhoods with high levels of homeownership to block the construction of decent rental housing not only reduces the supply of affordable rental housing, but further reinforces the perception of the status differential between owning and renting a home.

Admittedly, regulatory reform is politically difficult to achieve. Many elected officials embrace lower-income homeownership programs because they are seen as a more politically acceptable way to enable lower-income people to gain access to resource rich suburban communities. Yet despite recent efforts to expand homeownership programs, there is no evidence that the “Not in My Back Yard” (or NIMBY) pressure is abating. Indeed, NIMBY opposition to construction of affordable housing appears stronger than ever. To be effective, a comprehensive housing policy must confront this NIMBY opposition head on. Simply put, land use restrictions not only harm lower-income renters, but they also promote land intensive sprawl developments that raise housing prices and impose costs on all households – rich and poor, owners and renters alike.

Removing barriers to the construction of affordable rental housing will require leadership at all levels of government. At the federal level, national housing and urban development policy tends to focus on the divide between poor cities and rich suburbs and fails to recognize the diversity of the suburbs. Understanding that the continuation of status quo restrictive land use policies and a sprawl pattern of development imposes costs on many suburban jurisdictions is a key first step in building a broad bipartisan movement for greater regional cooperation.<sup>94</sup>

Unfortunately, the Community Development Block Grant (CDBG) and other federal grant programs promote less than productive competition by local jurisdictions seeking to gain their share of available federal resources. Federal programs must reward efforts to streamline the existing regulatory structure, encourage inter-jurisdictional planning and cooperation, and

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<sup>94</sup> For a discussion see Myron Orfield (2002), *American Metropolitcs: The New Suburban Reality*, (Washington DC, Brookings Institution Press).

condition federal housing assistance on a region's ability to create comprehensive land use policies that facilitate the construction of subsidized and otherwise affordable rental housing throughout the area.

At the same time, much of the work of barrier removal must be crafted locally. Restrictive zoning and other practices that limit the capacity to build more affordable higher-density multifamily housing have adverse consequences for all, but progress can be made. For example, the coming together of local elected officials in the Boise Idaho metropolitan area under the banner of the Treasure Valley Partnership demonstrated that communities can work together to resolve thorny land use disputes. Similarly, the experiences of New Jersey, Oregon, and Minnesota and a growing list of other states show that state legislatures can provide significant incentives to promote greater cooperation among local jurisdictions.<sup>95</sup> Not only will such regional scale cooperation help expand the availability of decent and affordable rental housing, it can also lessen the disparities between rich and poor communities, strengthen region wide economic and fiscal health, curb sprawl development and strengthen local land use planning.

### **Better Utilize Privately Owned and Managed Units for Voucher Programs**

Some 2 million units of privately owned housing are currently part of housing voucher and other similar leasing programs. In the vast majority of cases, units are leased one by one on an annual basis by a local housing authority with rent payments shared by the tenant and the agency. While annual leases can represent a flexible mechanism to secure housing, most holders of housing vouchers remain in their leased units for many years. And if they do choose to move, there is a long list of others on waiting lists ready to replace them. Indeed, a recent HUD report noted that the waiting lists are so long, that some local housing agencies have stopped taking new applications for rental assistance.<sup>96</sup>

Purchasing or otherwise securing multi-year leases – especially for units in low-poverty, service rich neighborhoods – would allow local governments to build an inventory of available affordable units. These units could then be subleased to housing voucher holders, while still

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<sup>95</sup> For a discussion of the Treasure Valley Partnership and other innovative regional partnerships see Joint Center for Sustainable Communities (1997), Innovative City/County Partnerships in Ten Localities Across the Region, (Washington, DC). See also, Joint Center for Sustainable Communities (1999), Growing Together: City/County Smart Growth Profiles, (Washington, DC).

<sup>96</sup> US Department of Housing and Urban Development (2000), Waiting in Vain, (Washington, DC)

preserving the option of individual residents to relocate as their situation dictates. Of course, for private sector property owners to be willing to enter into a multi-year lease commitment, the local housing agency would have to be financially strong, and be able to obtain credit enhancements or in other ways guarantee that the terms of the lease will be honored over the life of the deal.

The nearly two decade old Moderately Priced Dwelling Unit (MPDU) Program in Montgomery County Maryland is a good illustration of one practical application of this policy idea.<sup>97</sup> Operating under the auspices of an inclusionary zoning ordinance, Montgomery County purchased hundreds of town homes and other multifamily units located throughout the county in developments largely designed to accommodate middle- and upper-income homeowners. These in turn were leased out to low-income families, enabling residents of distressed public housing programs to use their housing vouchers to relocate to resource rich communities in the county.

In today's soft market, it would be possible to expand on this concept. For example, a local authority could lease or purchase outright a currently vacant unit in a multi-family development and then sublease these units to families with rent vouchers. Such an approach could enable local authorities to lock in favorable rents for years to come. Of course, the ability to complete this transaction will depend on the current owner's cost of holding the units vacant. Moreover, entering into such a transaction exposes the local housing agency to the risks associated with potential future rent declines or operating cost increases. Over time, however, purchasing units outright or gaining control via long-term leases should not only reduce costs, it should also ensure that subsidized residents don't get squeezed out of the best housing inventory during times of rapid rent increases.

### **Create New Financing Tools for Construction of Affordable Rental Housing**

Most affordable housing finance is development specific, i.e. the subsidy is made available on a project by project basis. Following the lead of a series of innovative finance approaches now in use by the Department of Defense (DoD) and being discussed as part of new national housing trust legislation, it would be possible to deploy a "portfolio approach" to construction of affordable rental housing. The government could provide reduced cost land or

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<sup>97</sup> Montgomery County Maryland, Department of Housing and Community Affairs, "MPDU Program Summary and Background," available online at <http://www.montgomerycountymd.gov>

other types of subsidy, including future occupancy guarantees, and perhaps even become a joint venture risk-sharing partner in the deal. The private partner would contract to develop a portfolio of rental housing units and to manage this housing according to clearly articulated performance management standards. The resulting housing need not be a single development, but could be a number of separate projects that meet designated standards.

While to date the results are somewhat mixed, the DoD initiative (working in conjunction with each of the three major branches of the armed-services) has recently completed, or has in the pipeline, some 130,000 units of housing for military personal bases.<sup>98</sup> Given the range of flexible, performance based contracting procedures being used to build and manage military housing, this recent DoD experiment could provide useful insights concerning how best to create cost effective approaches to the construction and management of the next generation of subsidized rental housing.

Moving beyond project by project financing should also prove a beneficial way to meet the capital needs of the growing number of regional housing partnerships. Although they vary from one region to the next, these non-profit entities seek to adapt the best private sector practices to develop and operate a relatively large number of affordable rental properties located throughout a city, region or state. As these housing partnerships grow in scale, and the capital markets continue to centralize, accessing capital on a project by project basis is increasingly inefficient. What is needed are new structures to aggregate, pool and syndicate capital so that it can be obtained more efficiently and on terms that reflect the higher performance and lower risk associated with funding a more spatially diverse portfolio of developments.<sup>99</sup>

### **Develop New Financing Mechanisms for Smaller Multifamily Properties**

It is important to consider ways to expand capital access to support the acquisition and preservation of smaller rental properties. Given the heterogeneity of this stock, accessing capital for this sector shares many of the complexities associated with larger multifamily structures, but

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<sup>98</sup> United States Department of Defense (2004), "Overview," Department of Defense Military Housing Privatization Website, <http://www.acq.osd.mil/housing/overview.htm>. This and other references to the Military Housing Privatization Initiative (MHPI) were suggested by Mark Hafner in his paper "The Privatization of U.S. Military Housing," prepared in fulfillment of course requirements for a Masters in Design Studies in Real Estate at Harvard's Graduate School of Design, May, 2004.

<sup>99</sup> The Joint Center for Housing Studies, along with several leading national foundations, is now working with the Housing Partnership Network under the leadership of Network President Thomas Bledsoe to develop strategies designed to enable regional housing partnerships realize their full potential.

lacks the scale sufficient to spread the financing and underwriting costs. Once again, there is a need to explore new wholesale approaches to accessing capital for this sector. On the financing side, one approach is to perfect “pooled approaches” where a set of individual properties are financed with a single mortgage transaction.

On the equity side, current policy discussions would do well to consider how best to facilitate the creation of new types of real estate investment trusts designed to raise capital from private investors to make equity investments in a number of smaller apartment projects. To further reduce the cost of capital, the trust could combine private capital with federal, state and local resources, while at the same time reducing costs associated with obtaining subsidies on a project by project basis. Whether subsidized or not, however, the new trust structure would facilitate the ownership transfer of the critically important small-multifamily rental inventory from individual owner to institutional investor, and in doing so help gain needed scale economies to reduce the costs of property management, repair and maintenance.<sup>100</sup> Hopefully this will help breathe new life into the stock of older, small-multi-family rental properties that play such a crucial role in providing affordable rental housing in many markets.

### **Create Additional Stable and Service Enriched Rental Housing**

Most low-income and low-wealth families have needs that extend well beyond housing. In creating new affordable rental housing initiatives, careful attention must be made to provide “more than just housing,” but rather provide residents access to needed health and human services, child care, transportation and other work force development initiatives that will enable low-income and low-wealth families to increase their ability to earn a decent income. Just as with homeownership, well designed and managed rental housing can serve as a platform for expanding economic opportunity. Unfortunately, efforts to limit the cost of subsidizing housing can inadvertently undermine the ability of owners and managers of subsidized housing to produce service enriched housing. Though some progress is being made in creating service enriched housing for seniors, more is needed to ensure that low-income families not only have access to decent and affordable housing, but also have access to the other elements of what comprises a suitable living environment.

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<sup>100</sup> For further proposal of what he labels S-REIT for small multifamily REIT see Shekar Narasimhan (2001), “Why Do Small Multi-Family Properties Bedevil Us?” [Capital Xchange](#), (November).



In addition, families do best when they are able to avoid the economic and social disruption of frequent moves. As noted earlier, there is reason to believe that one of the homeownership benefits is that homeowners tend to remain in a particular community for an extended period, a fact that among other things enables their children to avoid the stress and disruption of frequent changes in where they attend school. Residential stability also enables parents to develop deeper and more meaningful attachment to social support networks, and to access existing job and human service referral networks.

Of course, the ease of mobility is one of the major advantages of rental housing, especially for those who value a more mobile lifestyle. Yet many families with children presumably would also value a chance to remain in their rental apartment for some time, but lacking a steady and secure source of income struggle to do so. To help families maintain longer term occupancy, and make better use of available support services, it would be useful to create model landlord tenant laws that include clearly articulated and easily enforceable residential leases designed to promote longer-term, more stable occupancy. Recognizing that lower-income families may have less than stable incomes, for example, these new leases could incorporate creation and use of escrow or reserve accounts to help renters better manage their often uneven rent paying ability.

## **Conclusion**

Developing basic guiding principles is important in any effort to rethink rental housing policy. All too many research studies seem content to simply prove why a single approach is best, rather than probe into how individuals make decisions and understand how housing of any type can promote economic opportunity and upward mobility. By expanding the range of choices available in the marketplace, and by attempting to endow rental housing with many of the attributes now commonly associated with owner occupied housing, the United States can move beyond the false dichotomy of owning versus renting and develop policies that are worthy of the \$160 billion dollars now spent by the Federal Government to promote access to homeownership and affordable rental housing.

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