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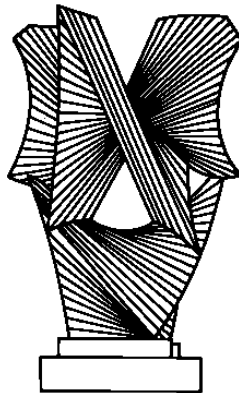
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CONTROLLING RESIDENTIAL STATKES

Lee Anne Fennell and Julie Roin

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CONTROLLING RESIDENTIAL STAKES

Lee Anne Fennell^{*} and *Julie Roin*^{**}

Communities suffer when residents lack sufficient monetary stakes in their homes. This point has been underscored by recent rushes of foreclosures and abandonments,¹ and it also underlies longstanding concerns about the relative impacts on neighborhoods of renters and owner-occupants.² However, residents who have too large a financial stake in their homes also create grave difficulties for local governance, as exemplified by the NIMBYism of William Fischel's undiversified, risk-averse "homevoters."³ "Understaked" households fear losing their homes, whether through foreclosure or gentrification, while "overstaked" households fear losing their primary source of financial security—the value stored in their homes.⁴ These risks generate personal disutility, create conflicts between tenants and homeowners, set neighboring communities against each other, and hobble local improvement efforts at every scale.

Local jurisdictions, ground zero for the fallout from residential "mis-staking," should have an intense interest in helping their residents reach more desirable intermediate stakeholding positions. A community filled with properly staked residents will be less

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¹ We use the term "abandonment" here in its colloquial sense, to refer to an owner's decision to cease all payments and upkeep associated with a property and to vacate the premises. The common law does not permit owners to abandon real property in the legal sense of unilaterally terminating ownership. *See, e.g.,* Lior Jacob Strahilevitz, *The Right to Abandon*, U. PENN. L. REV. (forthcoming 2010).

² *See infra* notes 31-32, and accompanying text.

³ Fischel posits that homeowners vote in ways that will protect and enhance the value of their largest assets—their homes. WILLIAM A. FISCHEL, *THE HOMEVOTER HYPOTHESIS* 9-12 (2001). Risk aversion plays an important role in Fischel's account, making homeowners into "NIMBYs" even when a proposed change carries a positive expected value. *See id.*; *see also* BRENDAN O'FLAHERTY, *CITY ECONOMICS* 384 (2005) (giving an example illustrating Fischel's point and concluding that homeowners' "stake in the community—the community as it now stands—is too big."). "NIMBY" is an acronym for "not in my back yard." *See, e.g.,* FISCHEL, *supra*, at 9.

⁴ The home is the single largest financial asset for most U.S. homeowners. *See* FISCHEL, *supra* note 3, at 4; Brian K. Bucks, Arthur B. Kennickell & Kevin B. Moore, *Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances*, FED. RES. BULL., 2006, at A1, A22-23, available at

<http://www.federalreserve.gov/pubs/oss/oss2/2004/bull0206.pdf>. Because the home is a highly undiversified investment, homeowners tend to be risk averse with respect to changes that might affect its value. *See* FISCHEL, *supra* note 3, at 9-12; O'FLAHERTY, *supra* note 3, at 384.

vulnerable to problems of displacement and exclusion because the incentives of renters and homeowners, and of insiders and outsiders, will be more closely aligned. Such “right-staking” would also avoid spillover-generating cycles of foreclosure and abandonment. Yet although local governments may want to control the size and shape of future residential stakes, existing stakeholders currently control local government policy.⁵ This essay addresses how, under these circumstances, state and local governments might identify and move toward a more productive and cooperative equilibrium.

Many commentators have seized on the ongoing housing meltdown as an apt occasion for rethinking and reworking residential arrangements that have ceased to work well for many households.⁶ But relatively little attention has been paid to the potential role that can be played by state and local governments in this process.⁷ We seek to fill that gap here by examining how and why governmental entities at the state and local levels might regulate or shape the financial stakes that residents have in their homes.

It is worth noting that many jurisdictions already influence stakeholding through measures that regulate the landlord-tenant relationship⁸ or that encourage owner-occupancy;⁹ more direct efforts to regulate mortgage arrangements or to encourage long-term tenancies are not difficult to imagine.¹⁰ More promising stake-shaping alternatives, we suggest, would build on innovative financial tools for rearranging housing market risks.¹¹ Drawing lessons from numerous implemented and proposed approaches, local governments could offer programs that help homeowners offload some of their home’s upside appreciation potential and downside property value risk to investors.¹² Similarly, local governments could make a financial instrument keyed to local property values

⁵ See FISCHEL, *supra* note 3, at 14-16, 92-96. Cf. Richard Thompson Ford, *The Boundaries of Race: Political Geography in Legal Analysis*, 107 HARV. L. REV. 1843, 1871 & n.74 (1994) (noting the “self-perpetuating quality” of exclusionary zoning and other efforts at “community self-definition”).

⁶ Some have questioned governmental promotion of homeownership while others have urged innovation in homeownership. Compare, e.g., A. Mechele Dickerson, *The Myth of Home Ownership and Why Home Ownership Is Not Always a Good Thing*, 84 INDIANA L.J. 189 (2009); with Andrew Caplin et al., *Facilitating Shared Appreciation Mortgages to Prevent Housing Crashes and Affordability Crises*, The Hamilton Project, Discussion Paper 2008-12 (September 2008), ‘-

http://www.brookings.edu/papers/2008/09_mortgages_caplin.aspx.

⁷ In a paper currently under development, two scholars plan to address the extension of the Community Land Trust template to additional households through programs subsidized by local governments. Benito Arruñada and Amnon Lehavi, *Prime Mortgage Institutions for a Subprime Era* (abstract dated February 2009 on file with authors). For past work on this topic, see sources cited in Part II, *infra*.

⁸ See *infra* Part III.A

⁹ See *infra* note 43 and accompanying text.

¹⁰ See *infra* Part II.A (discussing and critiquing these possibilities and noting potential legal impediments).

¹¹ See *infra* Parts II.B and III.B.

¹² Many approaches to reconfiguring homeownership risk have been proposed. See, e.g., ANDREW CAPLIN AT AL., *HOUSING PARTNERSHIPS: A NEW APPROACH TO A MARKET AT A CROSSROADS* (1997); ROBERT J. SHILLER, *MACRO MARKETS: CREATING INSTITUTIONS FOR MANAGING SOCIETY’S LARGEST ECONOMIC RISKS* (1993); see generally Lee Anne Fennell, *Homeownership 2.0*, 102 NW. U. L. REV. 1047 (2008). (discussing literature on these and numerous other homeownership-risk-reallocation approaches, and proposing a new tenure form).

available to tenants.¹³ More radically, local governments, assisted by state law, could formulate shared equity arrangements in which residents hold stakes in the housing markets of surrounding localities, as well as in their own local community.¹⁴

Our goal in discussing these ideas is not to advocate any particular approach, but rather to draw attention to stake-shaping as an important and underexplored state and local policy lever. We do contend, however, that residential risk-shifting mechanisms have some important advantages over more traditional approaches that implicitly address residential stakes.

The essay proceeds in four parts. Part I explains why stakeholding presents a problem for local governance. Part II considers how local governments might alter the stakes of homeowners. Here, we suggest that voluntary risk-offloading programs are likely to dominate efforts to mandate or regulate homeownership stakes. Part III turns to tenant stakeholding. We argue that offering tenants subsidized stakes in the local housing market through financial options is likely to be more promising than the suite of alternatives—lease regulation, rent subsidies, and rent control—that is typically proposed to address problems of tenant displacement and disengagement. Part IV introduces the idea of regionalized stake-sharing to address interlocal spillovers. We maintain that this sort of synthetic regionalization carries advantages over other proposed approaches, such as resort to regional government, extraterritorial voting schemes, and interlocal bargaining platforms.¹⁵

I. COSTLY MIS-STAKES

Because residential life is interdependent, communities want members to have a stake in the common enterprise. Stakeholding has often been implicitly managed at the local level through rough proxies like zoning for single-family homes. Changes in lending practices¹⁶ and ownership patterns¹⁷ have put pressure on that model, however. At the same time, local governments (both individually and collectively) have had to grapple

¹³ See Robert I. Lerman & Signe-Mary McKernan, *Promoting Neighborhood Improvement while Protecting Low-Income Families*, The Urban Institute, Opportunity and Ownership Project, No. 8 (May 2007), available at <http://www.urban.org/publications/311457.html>; see also O'FLAHERTY, *supra* note 3, at 369; Part III. B, *infra*.

¹⁴ See *infra*. Part IV.B.

¹⁵ See *infra* Part IV.A.

¹⁶ See, e.g., EDWARD M. GRAMLICH, SUBPRIME MORTGAGES: AMERICA'S LATEST BOOM AND BUST 13-19 (2007) (chronicling changes in mortgage practices from the post-war period onward, including the recent expansion of the subprime lending sector); Christopher Mayer et al., *The Rise in Mortgage Defaults*, 23 J. ECON. PERSP. 27, 30-33, 36-40, 43-44 (2009) (describing the use of "piggyback loans" (second mortgages) that reduce or eliminate any down payment requirement, low- and no-documentation mortgages, adjustable-rate mortgages with "teasers," and loans with low, zero, or negative amortization of principal).

¹⁷ In 2007, about 7% of owner-occupied units were "manufactured homes" or trailers while another 6% consisted of condominiums or cooperatives. See U.S. Bureau of the Census, American Housing Survey for the United States: 2007, Table 3-1, available at <http://www.census.gov/hhes/www/housing/ahs/ah07/tab3-1.pdf>. By contrast, in 1980, a mere 3.7% of owner-occupied units consisted of "manufactured homes" and 1.75% were condominiums or cooperative apartments.

with the twin distributive concerns of displacement and exclusion. The clashing goals of current and potential residents who are, variously, understaked and overstaked have proven highly problematic for local communities.

A. Understaking

Plummeting housing prices have made communities vulnerable to defaults by understaked homeowners. According to recent estimates, about 20% of U.S. homeowners are currently “underwater” on their mortgages, meaning that they owe more than the home is worth,¹⁸ and foreclosure rates continue to rise.¹⁹ Many households’ downside exposure is greatly limited by their lack of any significant financial stake in their homes. While this is especially true in nonrecourse states, few households have significant assets aside from their homes, making recovery of deficiency judgments against them difficult in other states as well.²⁰ Understaked homeowners, then, can be viewed as holding an option to default.²¹ Despite media coverage of the “jingle mail” phenomenon—homeowners walking away from houses that lost value after mailing the keys to their lenders²²—relatively few underwater homeowners have opted for voluntary default.²³ But

¹⁸ See Ruth Simon & James R. Hagerty, *House-Price Drops Leave More Underwater*, WALL ST. J., May 6, 2009, at A3 (reporting that Zillow.com and Moody’s Economy.com place the percentage of underwater U.S. homeowners at 21.9% and 19%, respectively, and discussing methodological issues that could cause estimates to overstate the extent of the problem); Joint Center for Housing Studies of Harvard University, *The State of the Nation’s Housing 2009* 19 (2009), available at <http://www.jchs.harvard.edu/publications/markets/son2009/son2009.pdf> [hereinafter “2009 Housing”] (reporting Zillow.com’s estimate that 48% of existing home sales in 2008 were effected “at a loss,” below either the seller’s purchase price, outstanding mortgage balance, or both).

¹⁹ See Mortgage Banker’s Association, *Delinquencies and Foreclosures Continue to Climb in Latest MBA National Delinquency Survey*, press release dated May 28, 2009, available at http://www.mortgagebankers.org/NewsandMedia/Press_Center/69031.htm (the first quarter of 2009 had a seasonally adjusted delinquency rate of 9.12% and a foreclosure rate at 3.85%, the combined total the highest rate of delinquency ever recorded in the history of the MBA delinquency survey); 2009 Housing, *supra* note 18, at 19 (at the end of 2008, 3.3% of first-lien loans in foreclosure, 4.8% of housing loans at least 60 days overdue).

²⁰ See, e.g., Todd J. Zywicki & Joseph D. Adamson, *The Law & Economics of Subprime Lending*, 80 U. COLO. L. REV. 1, 30 (2009).

²¹ See, e.g., Zywicki & Adamson, *supra* note 20, at 26-27 (discussing and comparing support for the “distress model” and the “option model” of foreclosure decisions). Some recent research has suggested that homeowners who put no money down when purchasing a home are disproportionately likely to default. See Austin Kelly, “Skin in the Game”: *Zero Downpayment Mortgage Default*, 17(2) J. HOUS. RES. 75 (2008); see also Stan Liebowitz, *New Evidence on the Foreclosure Crisis: Zero Money Down, Not Subprime Loans, Led to the Mortgage Meltdown*, WALL ST. J., July 3, 2009, A13 (reporting, based on analysis of loan-level data, “that, by far, the most important factor related to foreclosures is the extent to which the homeowner now has or ever had positive equity in a home”).

²² See, e.g., John Leland, *Facing Default, Some Abandon Homes to Banks*, N.Y. TIMES, Feb. 29, 2008, at A1; Zywicki & Adamson, *supra* note 20, at 29.

²³ See Diana Olick, *Treasury: Jingle Mail a Myth*, CNBC, June 26, 2009, available at <http://www.cnbc.com/id/31570460> (cites Michael Barr, Treasury’s Assistant Secretary for Financial Institutions as saying “we don’t see in the data borrowers who are walking away because they can or because their homes are underwater. We do see borrowers who are unable to make the payment...”); see also Christopher L. Foote, Kristopher S. Gerardi & Paul Willen, *Negative Equity and Foreclosure: Theory*

the ripple effects of waves of involuntary foreclosures continue to drive down prices and drive up incentives to push losses onto lenders.²⁴

Understaked homeowners generate significant costs for local communities. Recent empirical work confirms the intuition that negative spillovers flow from clusters of foreclosures.²⁵ Untended homes and yards attract vandals, squatters, and even wildlife.²⁶ From algae in pools to overgrown lawns, signs of decay telegraph the community's deterioration, invite expectations of further declines, and discourage buyers. In addition to their effects on local property values, concentrated foreclosures are associated with increased residential turnover and heightened criminal activity; they also contribute to local fiscal difficulties and service shortfalls.²⁷ These negative impacts have led beleaguered cities to try everything from suing lenders²⁸ to assessing fines against them.²⁹

While the acute problems associated with understaked homeowners are much in the national spotlight, a more chronic form of understaking also deserves attention. Most tenants have little financial stake in their own housing units, a fact that generates three concerns for communities.³⁰ First is the worry that tenants will do less than homeowners to keep up their homes and contribute to the community. A wide variety of social benefits

and Evidence, FRB of Boston Public Policy Discussion Paper No. 08-3, June 5, 2008, available at <http://ssrn.com/abstract=1153413> (study of 100,000 underwater Massachusetts homeowners in the 1990's).

²⁴ A recent study shows that while no one voluntarily defaults when the equity shortfall is less than 10% of the value of their house, "[t]he percentage of households willing to default strategically increases to 5% if the shortfall is between 10 and 20% of the value of the house and reaches 17% when the shortfall reaches 50%." Luigi Guiso, Paola Sapienza & Luigi Zingales, *Moral and Social Constraints to Strategic Defaults on Mortgages*, June 2009, at 4, available at

http://faculty.chicagobooth.edu/luigi.zingales/research/paper/moral_and_social_constraints_6-25-09.pdf.

²⁵ See, e.g., Jenny Schuetz, Vicki Been and Ingrid Gould Ellen, *Neighborhood Effects of Concentrated Mortgage Foreclosures*, NYU Center for Law and Economics, Working Paper No. 08-41 (2008), available at <http://ssrn.com/abstract=1270121>; Zhenguo Lin, Eric Rosenblatt & Vincent W. Yao, *Spillover Effects of Foreclosure on Neighborhood Property Values*, 38 J. REAL ESTATE FIN. AND ECON. 387 (2009). See also Raphael W. Bostic & Kwan Ok Lee, *Mortgages, Risk, and Homeownership among Low- and Moderate-Income Families*, 98 AM. ECON. REV. (pap. & proc.) 310, 313-14 (2008) (discussing externalities from foreclosures).

²⁶ See Nick Miroff, *Shuttered Homes, Thriving Wildlife*, WASH. POST May 27, 2008, at B-1.

²⁷ For a recent overview of the literature on the community impacts of foreclosures, see G. Thomas Kingsley, et. al., *The Impacts of Foreclosures on Families and Communities* 13-21 (May 2009), available at

http://www.urban.org/UploadedPDF/411909_impact_of_forclosures.pdf.

²⁸ A number of cities have filed lawsuits against lenders. See, e.g., Gretchen Morgenson, *Baltimore is Suing Bank Over Foreclosure Crisis*, N.Y. TIMES, Jan. 8, 2008; Shawn A. Turner & Jay Miller, *Ready for a Fight: With defendants hunkering down, city is prepared for a long battle*, CRAIN'S CLEVELAND BUSINESS, Jan. 28, 2008, at 1 (Cleveland); Donna Leinwand, Bill Conde, *Cities suing lenders in strategy against foreclosures; Various legal claims—from federal civil rights laws to city codes—used in efforts to stem loss of tax base and decline of property values*, USA TODAY, May 16, 2008, at 15A (Minneapolis, Cleveland, Baltimore and Buffalo); *U.S. Lenders are sued for fraud; Credit Crunch*, THE EVENING STANDARD July 24, 2008, at 32 (San Diego).

²⁹ See, e.g., Nicholas Casey, *Banker: "What Did I Do Wrong, Officer? Cop: "You've Got Algae in the Pool, Sir*, WALL ST. J., May 1, 2009.

³⁰ Although our focus here is on community spillovers stemming from tenant understaking, tenant households also bear understaking costs, including the possibility of displacement.

have been associated with owner-occupancy,³¹ although causation is difficult to untangle from selection effects when assessing the significance of tenure form.³² A second concern is that tenants, fearing displacement as a result of rising rents,³³ will oppose initiatives likely to benefit the community.³⁴ Not only may tenants be unable to gain from neighborhood improvements, but any resulting displacement would cause them to lose whatever intangible surplus they have built up in their homes. The evidence regarding actual tenant displacement due to gentrification is mixed and hotly contested.³⁵ Nonetheless, the destabilizing effects of any turnover that does result from community change, as well as the stresses associated with tenant strategies like “doubling up” with other families,³⁶ comprise a third set of potential understaking spillovers.

B. Overstaking

Although the problem of homeowner overstaking has been upstaged by an

³¹ A large literature has examined the social benefits associated with homeownership. See, e.g., Denise DiPasquale & Edward L. Glaeser, *Incentives and Social Capital: Are Homeowners Better Citizens?*, 45 J. URB. ECON. 354 (1999); Donald R. Haurin et al., *The Impact of Neighborhood Homeownership Rates: A Review of the Theoretical and Empirical Literature*, 13 J. HOUSING RES. 119 (2003); See Robert D. Dietz & Donald R. Haurin, *The Social and Micro-Level Consequences of Homeownership*, 54 J. URB. ECON. 401 (2003).

³² See, e.g., William G. Gale et al., *Encouraging Homeownership Through the Tax Code*, 115 TAX NOTES 1171, 1177 (June 18, 2007); Haurin et al., *supra* note 31, at 132–33.

³³ Although rising rents present tenant households with the most obvious understaking-related displacement threat, tenants can also be displaced when housing units are withdrawn from the rental marketplace. Eminent domain is another potential source of displacement, but it presents issues that are distinct from those we address here, in part because its use does not depend on tenure form or a resident’s financial stake. It is, however, possible that some of the mechanisms we discuss below could affect the frequency or impact of localities’ resort to condemnation. See text accompanying notes 108–110, *infra*. Tenants can also be displaced when the property they are occupying is foreclosed upon. See Mary Shanklin, *Renters Become Victims to Home Foreclosures*, Pittsburgh Post-Gazette, June 7, 2009, at H-11. Tenants are thus perversely exposed to downside market risk, even as their lack of a financial stake in the property keeps them from realizing any upside gains.

³⁴ See, e.g., Lerman & McKernan, *supra* note 13, at 1; Lance Freeman & Frank Braconi, *Gentrification and Displacement, New York City in the 1990’s*, 70 J. Am. Planning Assoc. 39, 39–40 (2004) (describing political effects of gentrification fears).

³⁵ For two different takes on the empirical evidence regarding the displacement effects of gentrification, compare J. Peter Byrne, *Two Cheers for Gentrification*, 46 HOW. L.J. 405, 413–15 (2003) with John A. Powell & Marguerite L. Spencer, *Giving Them the Old “One-Two”: Gentrification and the K.O. of Impoverished Urban Dwellers of Color*, 46 HOW. L.J. 433, 465–76 (2003). Recent work on this question includes, for example, Freeman & Braconi, *supra* note 34, at 45 (2004) (finding that poor households living in gentrifying neighborhoods in New York City in the 1990s were less likely to move than similar households living in non-gentrifying New York City neighborhoods); LANCE FREEMAN, *THERE GOES THE ‘HOOD* 127 (2006) (“the process of neighborhood change in gentrifying neighborhoods is often gradual, driven more by succession or a change in who moves into the neighborhood than rapid and widespread displacement”); Kathe Newman & Elvin K. Wyly, *The Right to Stay Put, Revisited: Gentrification and Resistance to Displacement in New York City*, 43 URBAN STUD. 23 (2006) (suggesting that factors such as rent regulation, the selection effects of prior gentrification, and low-income households doubling up or entering shelters limited the extent of observed displacement through gentrification in New York City in the 1990s, and concluding that displacement fears are not unfounded).

³⁶ See Newman & Wyly, *supra* note 35, at 49.

unprecedented glut of understaked homeowners, it remains significant. Most homeowners continue to hold a substantial equity stake in their homes; although the value of the home has shrunk, so too have the other assets of homeowners, such as the balance in their retirement plans and, often, even the marketability of their own human capital.³⁷ If anything, the current economic crisis has left homeowners more vulnerable to changes that might (further) affect the value of their homes.

The problems of NIMBYism and exclusionary zoning have been recounted at length elsewhere, so a brief mention here will suffice. As Fischel has explained, the political behavior of homeowners is largely driven by their desire to maximize the value of their homes.³⁸ In some ways, this impulse is functional; if what is good for the community is good for the home's value, then homeowners will vote in a way that makes the community better off.³⁹ A catch, however, is that often one's immediate neighborhood or jurisdiction can be made better off by making other neighborhoods or jurisdictions worse off. If we add a hefty dose of risk aversion, we find homeowners not only all too willing to push locally undesirable land uses elsewhere, but also unwilling to experiment with unproven land uses—or, indeed, to entertain many kinds of change at all.⁴⁰ Their reluctance has real bite because, at least outside of central cities, homeowners tend to control the local political process.⁴¹

Local and state governments have an obvious interest in addressing the problems of overstating and understating. In the balance of the essay, we identify and critique some directions that such action might take.

II. HOMEOWNER STAKES

A. Mandating and Regulating Stakes

Whether as a direct response to current conditions or to forestall future crises, local governments might undertake coercive efforts to shore up residential stakes. The idea of regulating residential stakeholding is not new. For example, common interest communities often ban or restrict leasing (or sub-leasing).⁴² Similarly, local governments

³⁷ Since the recession began in December 2007, the unemployment rate has jumped 4.6%, reaching 9.5% in June 2009. See Bureau of Labor Statistics, *The Employment Situation: June 2009*, Jul. 2, 2009, at 1, available at <http://www.bls.gov/news.release/pdf/empst.pdf>.

³⁸ FISCHEL, *supra* note 3, at 75.

³⁹ See, e.g., *id.* at 268.

⁴⁰ See, e.g., *id.* at 8-10, 269.

⁴¹ See, e.g., *id.* at 80-81; see also William A. Fischel, *Political Structure and Exclusionary Zoning: Are Small Suburbs the Big Problem?* in FISCAL DECENTRALIZATION AND LAND POLICIES, Gregory K. Ingram & Yu-Hung Hong, eds. (Lincoln Institute of Land Policy, 2008) (examining the effects of jurisdiction size and the degree of metropolitan fragmentation on local political decisions about land use).

⁴² See David E. Grassmick, *Minding the Neighbor's Business: Just How Far Can Condominium Owners Go In Deciding Who Can Move Into the Building?*, 2002 U. ILL. L. REV. 185, 194 (noting trend towards leasing restrictions in condominium agreements); Katharine N. Rosenberry, *Home Businesses, Llamas and Aluminum Siding: Trends in Covenant Enforcement*, 31 J. MARSHALL L. REV. 443, 461-465 (1998);

often extend more favorable property tax treatment to owner occupants than to absentee landlords or vacation home owners.⁴³ More broadly, de facto regulation of stakeholding has long occurred under the banner of zoning for single-family residences. If zoning for single-family homes or granting tax-preferred treatment to owner-occupants no longer guarantees high-stakes residents, local governments might seek to regulate stakeholding more directly, such as by forbidding loan to value ratios above a certain level, requiring PMI, or outlawing certain kinds of high-risk products. Small-scale regulation of mortgages is not entirely unprecedented, although some past attempts along these lines have foundered.⁴⁴ Local regulation of mortgages premised on a “spillover control” rationale might be viewed quite favorably in the current economic climate. However, local governments would still face significant legal impediments and normative objections to any policy that mandates an equity stake or regulates the residents’ financing arrangements.

Because local governments have only the powers delegated to them by state legislators and their state constitutions, new programs always raise questions about the scope of those delegated powers. Even jurisdictions accorded “home rule” do not have unlimited freedom, especially when policies run afoul of long established limits on local power. Though mandating single-family residences, often a rough proxy for high-staked residents, clearly falls within local jurisdictions’ zoning power, mandating actual high staking, in the form of minimum value to loan ratios or mandatory PMI, may not. After all, mortgage restrictions would not relate to the use of the land per se, as zoning

Zachary M. Rawling, *Reevaluating Leasing Restrictions in Common Interest Developments: Rejecting Reasonableness in Favor of Consent 2* (2007) available at http://works.bepress.com/zach_rawlings/3/. Governmental entities have had less success in their efforts to restrict renting through their zoning codes. See Ngai Pindell, *Fear and Loathing: Combating Speculation in Local Communities*, 39 U. MICH. J.L. REFORM 543, 577-581 (2006) (describing litigation over rental restrictions, which suggests courts are hostile to categorical requirements that a main dwelling be owner-occupied, although more willing to permit restrictions on the rental of accessory dwelling units).

⁴³Many jurisdictions provide tax relief for “homestead” property, defined as property that serves as the owners’ primary residence. This relief may be substantial. See, e.g., FLA. CONST., art. VII, § 4(c) (imposing 3% cap on annual assessment increases on homestead property); MICH. COMP. LAWS 380.1211(1) (2009) (exempting homestead property from school district property tax). See Richard S. Franklin & Roi E. Baugher III, *Protecting and Preserving the Save Our Homes Cap*, 77 FLA. BAR J. 34, 40 (2003).

⁴⁴*Roy v. Ducote*, 399 So. 2d 737 (La. App. 1981) involved a challenge to a subdivision restriction that prohibited homes financed through certain governmental programs. The defendants stated that they wished to “form a neighborhood that does not look like a ‘government program’ and to create a quiet, peaceful neighborhood with attractive surroundings and minimal amounts of noise and extraneous intrusions.” *Id.* at 741. The restriction was struck down on federal and state constitutional grounds. *Id.* More recently, Illinois experimented with implementing mortgage counseling requirements at the ZIP code level in an effort to address subprime lending—a short-lived approach that has since been replaced by consumer protection legislation that applies at the county-wide and state-wide level. See Sumit Agarwal et al., *Can Mandated Financial Counseling Improve Mortgage Decision-Making? Evidence from a Natural Experiment* (Feb 2009) Fisher College of Business Working Paper No. 2008-03-019, available at <http://ssrn.com/abstract=1285603>, at 4-8; Press Release, Governor Blagojevich signs anti-predatory lending law, announces buyer outreach initiative to help fight foreclosures, November 2, 2007, available at <http://www.ihda.org/admin/Upload/Files//5f95c2fa-5427-423d-9361-1cc77ba7e831.pdf>.

generally does.⁴⁵ Further, many states prohibit local governments from enacting laws regulating private or civil law relationships, except as incident to another municipal power.⁴⁶ Although it is unclear exactly how far those prohibitions extend,⁴⁷ outlawing the use of certain financing schemes within the jurisdiction may be construed as regulating a civil law relationship. Because the prohibitions exempt municipal laws that are “incident to an exercise of an independent municipal power,” however, state enabling legislation granting localities the specific power to regulate mortgages would appear sufficient to overcome this obstacle.⁴⁸

Another potential hurdle stems from federal law. Some mortgages are originated by national banks, and state or local regulation relating to such banks raises preemption questions. The measures we have described would protect homeowners and their neighbors rather than bank investors; although this would not necessarily immunize them from preemption, the state has a recognized role in protecting consumers.⁴⁹ Localities

⁴⁵ See, e.g., *CHR General, Inc. v. City of Newton*, 439 N.E.2d 788, 791 (Mass. 1982) (finding ordinance regulating condominium conversions not authorized by the town’s zoning power because “‘a fundamental principle of zoning (is that) it deals basically with the use, without regard to the ownership, of the property involved or who may be the operator of the use.’”) (quoting 1 A. RATHKOPF, *ZONING AND PLANNING* § 1.04, at 1-21 (4th ed. 1982)).

⁴⁶ See Gary Schwartz, *The Logic of Home Rule and the Private Law Exception*, 20 U.C.L.A. L. REV. 671, 690 (1973). Both of the broadly influential model home rule provisions, one promulgated by the American Municipal Association and the other by the National Municipal League, explicitly provided that home rule powers would not “include the power to enact private or civil law governing civil relationships except as an incident to an exercise of an independent municipal power.” See Terrance Sandalow, *The Limits of Municipal Power Under Home Rule: A Role for the Courts*, 48 MINN. L. REV. 643, 675 (1964) (citing language from section 6 of the American Municipal Associations Model Constitutional Provisions for Home Rule). Judicial enforcement of this exception, however, preceded the appearance of the models. See Sandalow, *supra*, at 674-85; see also MCBAIN, *THE LAW AND THE PRACTICE OF MUNICIPAL HOME RULE* 673-74 (1916) (citing the “common understanding” that “such general subjects as crime, domestic relations, wills and administration, mortgages, trusts, contracts, real and personal property, insurance, banking, corporations, and many others” are matters of state rather than local control).

⁴⁷ See Schwartz, *supra* note 46, at 702 (“case law tells little either way about the supposed private law exception.”) For example, one could say that an ordinance preventing the rental of a unit without running water as a residence “interferes” with potential contracts or civil relationships, but it is clear that localities do exactly that when writing and enforcing their building codes. Such regulation, however, can be characterized as falling within the private or civil law exception’s own exception of being “incident to an exercise of an independent municipal power”—here, the jurisdiction’s zoning or building code authority. See, e.g., Sandalow, *supra* note 46, at 675-78. Of course, the bounds of these independent municipal powers are themselves open to question. See *CHR General*, cited in note 45, *supra* (finding condominium conversion regulation was not incident to the municipality’s exercise of its zoning power, and thus was invalid under the civil relationships exception contained the Home Rule Amendment of the Massachusetts Constitution).

⁴⁸ See *supra* notes 46-47.

⁴⁹ The Supreme Court recently held in *Cuomo v. Clearing House Assn., LLC*, 557 U.S. ___ (2009), slip op. at 7, that ordinary enforcement of a state fair lending law was not preempted by the National Bank Act. Although the issue involved in that case was somewhat different than those that our hypothetical regulation would present, the Court’s rejection of a sweeping agency interpretation and its recognition of a role for state law is suggestive. It also may be significant that federal law expressly exempts state usury laws from preemption. See 12 U. S. C. §85. Further, in reaching its holding in *Cuomo*, the Court notes that even the Comptroller of the Currency agrees that “the case law *does* recognize ...that ‘states retain some power to regulate national banks in areas such as contracts, debt collection, acquisition and transfer of property,

might also emphasize that the regulated parties would be mortgagors, not financial institutions: banks may continue to write whatever mortgages they want to write, although local purchasers may not avail themselves of those products.⁵⁰ However, by eliminating part of the potential market, localities would arguably be placing a regulatory burden on federally chartered banks, which might at least trigger preemption analysis.⁵¹

Even if these legal barriers could be surmounted, there remain serious normative objections to this line of regulation. Because the ability to obtain mortgages of various types will vary based on wealth, local governmental mortgage regulation could turn into yet another tool for exclusionary zoning.⁵² Nor is it clear that such regulation would effectively lower affected purchasers' overall debt burden. Since money is fungible, purchasers might substitute other forms of debt for home mortgage debt. They might, for example, keep higher balances on their credit cards, (after using all their available cash to make the required house downpayment). Or they might borrow to purchase a car rather than pay outright.⁵³ These other debts may make it impossible for them to service their mortgage debts (or keep up their property) in times of financial hardship. Additional regulation of the mortgage relationship might do no more than serve an information function, telling purchasers that the larger community thinks they are behaving in a risky manner and should think twice before taking on so much debt. That may or may not make purchasers pause and change their behavior.

Moreover, while approaches of this sort would address the problem of understaked homeowners, they would exacerbate the problem of overstaked homeowners. These overstaked homeowners, in turn, have interests that often run directly counter to those of another traditionally understaked group—tenants. This raises the question of whether a

zoning, criminal, and tort law.” Slip op. at 10 (quoting Comptroller’s statement of basis and purpose, contained at 69 Fed. Reg. 1896 (2004) (internal citations omitted)). Maximum loan to value regulation and mandatory PMI requirements could be characterized as falling within these areas of residual state power.

⁵⁰ The Court’s opinion in *Cuomo* expressly distinguishes between oversight of “corporate affairs” and “the power to enforce the law,” 557 U.S. at ___, slip op. at 4. Cf. *McClellan v. Chipman*, 164 U.S. 347 (1896) (state law voiding certain conveyances of real property by insolvent persons was not preempted).

⁵¹ See, e.g., *Watters v. Wachovia*, 550 U.S. at 13 (“Beyond genuine dispute, state law may not significantly burden a national bank’s own exercise of its real estate lending power, just as it may not curtail or hinder a national bank’s efficient exercise of any other power, incidental or enumerated under the NBA.”). To forestall preemption concerns, states sometimes exempt banks from regulatory regimes. Although preemption claims would cover only national banks, state “bank parity laws” may require that exemptions applicable to national banks be extended to cover state-chartered banks. See, e.g., Public Law 094-0280, 765/ILCS 77/70(a) (HB 4050; exempting from coverage mortgage originators exempt from coverage under the Residential Mortgage License Act of 1987, a category including both nationally chartered and state banks under 205 ILCS 635/1-4(d)(1)(ii)); Public Law 095-0691, 765 ILCS 77/70(a) (SB1167; same). Obviously, such exemptions would dilute the force of the measure and distort borrower decisions.

⁵² It is even possible that constitutional challenges might be raised about the power to enact such regulations, if they were viewed as a mere pretext for wealth discrimination. Cf. *Roy v. Ducote*, discussed *supra* note 44.

⁵³ To the extent that people are already at the limit of their capacity to incur nonhousing debt, however, equity requirements would have an effect.

more transformative approach to local stakeholding might do a better job at addressing the issues presented by these different constituencies.⁵⁴

B. Facilitating Stake-Shifting

One antidote to NIMBY-generating overstating is to reduce the degree to which the fortunes of individual homeowners turn on fluctuations in area home values.⁵⁵ The idea of home equity insurance has been around for decades.⁵⁶ The most well-known local implementation of the concept is Oak Park, Illinois's equity assurance program, adopted in the 1970's in an effort to forestall "white flight"; the plan covered only highly localized price changes that were uncorrelated with larger metropolitan trends.⁵⁷ A number of policies along similar lines have since been adopted in other localities.⁵⁸ A recent pilot program in Syracuse, New York extended downside market protection to a broader spectrum of housing market risks by keying payouts to a ZIP-code based home price index.⁵⁹ Such programs have not attracted widespread participation,⁶⁰ but they may have had a positive impact in reassuring residents.⁶¹ In addition to programs that address downside market risk, a wide spectrum of affordable housing programs have featured "limited equity" or "shared equity" arrangements that leave some percentage of the home's upside appreciation potential with the local government or with a community group.⁶² Private variations on these programs, including shared-equity mortgages, attempt

⁵⁴ Given our focus on state and local initiatives and our interest in identifying politically plausible alternatives, we do not discuss another issue relevant to residential stakeholding in the United States—the federal income tax advantages granted to homeowners.

⁵⁵ See, e.g., William A. Fischel, *An Economic History of Zoning and a Cure for Its Exclusionary Effects*, 41 URB. STUD. 317, 335-36 (2004); Adam Yarmolinsky, *Reassuring the Small Homeowner*, 22 PUBLIC INTEREST 106, 106 (Winter 1971).

⁵⁶ See, e.g., Matityahu Marcus & Michael K. Taussig, *A Proposal for Government Insurance of Home Values Against Locational Risks*, 46 LAND ECON. 404 (1970); Yarmolinsky, *supra* note 55.

⁵⁷ See, e.g., Maureen A. McNamara, *The Legacy and Efficacy of Homeowner's Equity Assurance: A Study of Oak Park, Illinois*, 78 NW. U. L. REV. 1463, 1468-69 (1984). A variety of other conditions and limitations applied. For example, the plan covered only 80% of qualifying losses, and also excluded from coverage declines in value attributable to damage to the property in question. See *id.*

⁵⁸ See, e.g., Robert J. Shiller, *Radical Financial Innovation*, in ENTREPRENEURSHIP, INNOVATION, AND THE GROWTH MECHANISM OF THE FREE-ENTERPRISE ECONOMIES 306, 316 (Eytan Sheshinski, ed., 2007); Liz Hersch, Profile of Existing Home Equity Assurance Programs, Fall 2001, available at www.pauljsentner.com/no_wehav/referenc.all/homeeqcha.rts/heqchts_.doc

⁵⁹ Andrew Caplin et al., *Home Equity Insurance: A Pilot Project* (Yale Int'l Ctr. for Fin., Working Paper No. 03-12, May 3, 2003), available at http://ssrn.com/abstract_id=410141.

⁶⁰ Sarah Max, *Selling L.A., Buying Chicago*, CNNMONEY.COM, Aug. 9, 2004, http://money.cnn.com/2004/08/06/real_estate/investment_prop/hedging/index.htm ("Since the [Syracuse] program was launched in August 2002, . . . only 76 homeowners have signed up, according to its director[,] Virginia Smith."); Hersch, *supra* note 58 (showing relatively low participation rates for ten surveyed programs, although a few programs in Chicago have attracted hundreds or thousands of households and at least two of them appear to be growing).

⁶¹ See, e.g., Caplin et al., *supra* note 59, at 28 (suggesting that even where participation in a home equity insurance program is low, there might be positive effects for the community such as increased confidence). Paid claims have been low to nonexistent in such programs. See, e.g., Hersch, *supra* note 58.

⁶² See, e.g., JOHN EMMEUS DAVIS, NAT'L HOUS. INST., SHARED EQUITY HOMEOWNERSHIP: THE

to deliver a form of equity financing to homeowners instead of requiring them to rely exclusively on debt.⁶³

These two approaches (offloading downside risk, and selling off upside potential) could be combined in a single product or policy package.⁶⁴ A simple example will convey how such a program for reducing homeownership risk would work. Suppose Holly Homebuyer wishes to purchase a home in Maroon Meadows that costs \$200,000. Ivan Investor makes the following two-part deal with her: First, he will give her a lump sum now, and when Holly sells, she will pay him an amount that represents the portion of her home's appreciation (if any) attributable to housing market changes (that is, screening out appreciation attributable to changes made on-site to the home and grounds).⁶⁵ Second, he will collect a lump-sum premium from her now, and when she sells, he will pay her the portion of the home's loss in value (if any) attributable to housing market changes (again, screening out losses caused by changes to the property itself). When all is said and done, Holly gets some money upfront⁶⁶ and Ivan bears most of the home's upside and downside risk.⁶⁷ If the home later sells for \$250,000 due to a general rise in home values in the area, Ivan collects \$50,000 of the proceeds. If the home later sells for

CHANGING LANDSCAPE OF RESALE-RESTRICTED, OWNER-OCCUPIED HOUSING 65 (2006); J. Peter Byrne & Michael Diamond, *Affordable Housing, Land Tenure, and Urban Policy: The Matrix Revealed*, 34 FORDHAM URB. L.J. 527, 541–51 (2007); Duncan Kennedy, *The Limited Equity Coop as a Vehicle for Affordable Housing in a Race and Class Divided Society*, 46 HOW. L.J. 85 (2002); Rick Jacobus and Jeffrey Lubell, *Preservation of Affordable Homeownership: A Continuum of Strategies*, Center for Housing Policy, Policy Brief (2007), available at <http://www.ncbcapitalimpact.org/uploadedFiles/downloads/JacobusLubelloption4-07.pdf>.

⁶³ See, e.g., Andrew Caplin et al., *Shared-Equity Mortgages, Housing Affordability, and Homeownership*, 18 HOUSING POL'Y DEBATE 209, 217 (2007); Andrew Caplin et al., *A Report Commissioned by the Menzies Research Center for the Prime Minister's Home Ownership Task Force, Vol. 1: Innovative Approaches to Reducing the Cost of Homeownership* (2003) at 7–8, available at http://www.mrcld.org.au/research/home-ownership/volume_1.pdf.

⁶⁴ One of us has elsewhere suggested that the offloading of upside and downside risk associated with offsite factors could be combined in a new default tenure form. Fennell, *supra* note 12.

⁶⁵ There are a variety of ways to accomplish this disaggregation, including the use of housing price indexes. See, e.g., *id.*, at 1073–78 and sources cited therein; Robert J. Shiller & Allan N. Weiss, *Home Equity Insurance*, 19 J. REAL ESTATE FIN. AND ECON. 21, 25–26 (1999).

⁶⁶ We assume here that the proceeds from alienating upside potential would be larger than the premium required to insure against downside loss.

⁶⁷ When effectuated with respect to marketable stocks, securities, or commodities, this arrangement is denominated a “collar.” Typically businesses and investors enter into collars to lower the cost of hedging against unfavorable price movements, as collars have a lower cash price than one way options. The cash discount comes from the sale of the rights to the gains generated by favorable price movements. See Jeffrey L. Rubinger, *Tax Planning Strategies With Equity Derivatives*, 76 FLA. BAR J. 45, 45 (2002). However, most collar arrangements cover stated—and relatively short—time periods, rather than being open-ended. That is, prices, gains and losses are determined and paid at the end of six months or a year, rather than (as envisioned in this essay) waiting until the sale of the underlying property. Settling options based on sales rather than at specific temporal intervals introduces complications in pricing that have received some attention in the literature. See, e.g., Robert J. Shiller & Allan N. Weiss, *supra* note 65, at 41–43; Caplin et al., *supra* note 63, at 218–19.

\$150,000 due to a general decline in home values in the area, Ivan pays Holly \$50,000 to cover her loss.⁶⁸

Because it is hard to imagine ordinary homebuyers making deals with investors in this fashion, an intermediary institution would be necessary to bring about the changes just described.⁶⁹ That institution would arrange the cash transfers incident to the risk shift, and seamlessly (from Holly's perspective) move the upside and downside risk associated with the home to Ivan and his ilk. While private entities could (and to some extent have)⁷⁰ taken on this risk-shifting role, local governments might be especially well-positioned—and well-motivated—to spearhead a move to a new homeownership paradigm. With the increasing availability of financial instruments tied to local housing prices, local governments would not have to engineer the risk shifts from scratch, but rather could serve as a user-friendly conduit for matching homeowners with investors. Program options could range from mere information provision⁷¹ to policies that encourage or even require the use of risk-shifting tools.⁷²

Increased use of markets in housing risk would help protect against both understaking and overstaking. Selling off upside appreciation potential makes homes more affordable and, other things being equal, reduces the need for mortgage debt and hence the

⁶⁸ In this simple example, we ignore the effects of interest and inflation, and also make the simplifying assumption that Holly would alienate 100% of the upside and downside risk associated with “offsite” factors. Many homeowners would wish to retain at least some portion of the upside, and, for affordability reasons, would likely keep part of the downside as well.

⁶⁹ See, e.g., Shiller & Weiss, *supra* note 65, at 33–34 (discussing the potential for insurance companies to offer “pass-through futures and options”); See Juerg Syz, Paolo Vanini & Marco Salvi, *Property Derivatives and Index-Linked Mortgages*, 36 J. REAL ESTATE FIN. & ECON. 23 (2008) (proposing that index-based risk shifting be built into mortgages).

⁷⁰ A number of private enterprises have offered products for rearranging homeownership risk. Recent examples include REX & Co., <http://www.rexagreement.com> (product offers funds in exchange for a share of home equity); Equity Finance Mortgage, <http://www.efm.info/> (shared equity mortgage product offered by Rismark International through Australia's Adelaide Bank); Advanced e-Financial Technologies, Inc., SwapRent, <http://www.swaprent.com/> (product would let homeowners toggle to and from an “economic renting” mode that offloads upside and downside home price risk). See also *supra* notes 56–63 and accompanying text (describing several models for shifting homeownership risk through public or private mechanisms).

⁷¹ At the very least, local governments could inform residents of the existence of products for hedging homeownership risk. Many are undoubtedly unaware, for example, that futures and options based on local housing indexes exist. Financial instruments keyed to home prices in a number of cities, developed by Robert Shiller and Karl E. Case, became tradable on the Chicago Mercantile Exchange (now CME Group) in the spring of 2006. See e.g., Robert J. Shiller, *Derivatives Markets for Home Prices* (NBER Working Paper No. 13,962, April 2008), available at <http://www.nber.org/papers/w13962.pdf> (discussing history and future prospects of these derivative markets).

⁷² Encouragement might take the form of subsidies, tax preferences, or regulation. While mandating a particular level of risk shifting seems implausible and even unwise, local governments could require a reduced-risk version of homeownership to be the default option for residents, so that purchasers would have to affirmatively opt into the traditional level of homeownership risk. See Fennell, *supra* note 12; cf. Michael S. Barr et al., *An Opt-Out Home Mortgage System*, The Hamilton Project, Working Paper No. 2008-14 (2008) available at www.brookings.edu/papers/2008/09_mortgage_system_barr.aspx (presenting a proposal that would require lenders to offer borrowers a certain set of standard terms as a default matter).

likelihood of default.⁷³ Buffering downside housing market risk reduces the mortgage default risk and increases liquidity in housing markets. Homeowners protected against market downturns will be better able to sell or refinance in a down market, both because the payment they will receive from the program will enable them to meet their existing mortgage obligation, and because potential buyers will not be frightened away from purchasing by the prospect of losing money.⁷⁴ The homeowner's reduced stake in both upside and downside price changes would also be expected to dampen the impulse toward risk-averse NIMBY-like behavior.⁷⁵ There are, of course, numerous design choices that would be required in setting up such a program.⁷⁶ While space does not permit us to address them here, a large literature examines the inner workings of such risk-shifts, and the many past and existing entrepreneurial efforts along these lines offer useful case studies.

Voluntary municipal programs offering homeowners risk-shifting options would confront fewer legal obstacles than the direct regulation of mortgages; at most, state enabling legislation would be required.⁷⁷ Such legislation could either authorize specific programs⁷⁸ or grant local governments broader authority by explicitly including within "general welfare" and "home rule" powers the right to develop risk-shifting mechanisms

⁷³ Some homebuyers may instead opt for more expensive homes, retaining traditional levels of debt, just as they may undermine the goals of mortgage regulation by increasing their levels of nonmortgage debt. See text accompanying note 53. Tightening credit standards may limit access to debt financing, however. See Caplin et al., *supra* note 6, at 5..

⁷⁴ As it is, falling prices may discourage rather than encourage sales—as Ian Ayres and Barry Nalebuff put it, buyers do not want to “catch a falling knife.” Ian Ayres & Barry Nalebuff, *Price-Protect Your Home*, FORBES, Sept. 16, 2002, at 10. Further, getting bank approval for “short sales” is a difficult and lengthy process, chasing away buyers. With option money in hand, a seller should be able to afford to pay off the mortgage in full even if the sales price is less than the amount of the outstanding mortgage.

⁷⁵ See *supra* note 55 and accompanying text; see also Fennell, *supra* note 12, at 1100-03.

⁷⁶ Technical issues include the appropriate construction and use of indexes, the treatment of inflation, the timing for exercising an option, the structure and timing of payments and payouts, and other details affecting price. See, e.g., SHILLER, *supra* note 12, at 96-98, 116-200; Shiller & Weiss, *supra* note 65. Regulatory oversight would need to address, among other issues, concerns about investor “capture” of local governance, consumer mistakes and confusion, and discrimination in the pricing or availability of risk-shifting mechanisms. See, e.g., Fennell *supra* note 12, at 1095-98, 1104-07, 1115-17. The new program's interface with existing regulatory structures, including those governing lending, securities, and insurance, as well as with federal, state, and local taxation mechanisms, would also require attention. See, e.g., Caplin et al., *supra* note 59, at 24-28; Andrew Caplin et al., *Rectifying the Tax Treatment of Shared Appreciation Mortgages*, TAX L. REV. (forthcoming), <http://ssrn.com/abstract=1267064>; Fennell *supra* note 12, at 1107-09.

⁷⁷ The underlying financial instruments would be subject to federal regulation, however, and it is possible that changes in the legal treatment of derivatives could affect the availability or structuring of those instruments.

⁷⁸ The State of Illinois, for example, specifically authorized cities with populations of more than 1 million to create homeowner equity assurance programs of the type pioneered by Oak Park. See The Illinois Home Equity Insurance Act, §65 ILCS 95/1 et seq. (2009). For a short description of the politics underlying this enactment, see Caplin, et al., *supra* note 59, at 5-6.

aimed at improving housing security. Given the nascent state of knowledge, the latter approach would carry distinct advantages.⁷⁹

Beyond mere enabling, state governments could help by providing administrative support for these innovative programs. Although local governments may work together and share information in the normal course of events, a state agency or commission charged with oversight of housing programs may provide resources or simply coordination. Resulting exchanges of information and ideas could hasten the development of valuable programs and perhaps avoid perpetuating some of the errors which will undoubtedly arise in the course of what will be a trial and error experimental process. Moreover, some localities may be too small to create these types of markets and market devices; a state coordinating entity could provide a platform for joint ventures.

The development of such programs raises normative as well as legal concerns. One primary worry relates directly to stakeholding itself—will homeowners who have offloaded risk care too little about their communities? Two factors would be expected to constrain this effect. First, homeowners will still live in the community,⁸⁰ and thus will continue to have a direct consumption interest in the community's fortunes.⁸¹ Second, the offloaded risk is that associated with area housing price trends; homeowners will still enjoy (or suffer) the results of any maintenance, renovation, or decorating choices that they make. If homeowners primarily contribute to the community through behaviors like maintaining their homes and forming robust ties to others in the community, reductions in home value risk would not be expected to have a significantly negative behavioral effect. When the salutary effects of reducing exclusionary homeowner behavior are taken into account, net gains appear likely.

Another concern is that reconfiguring homeownership would work all too well—for homeowners. Even if homeownership is made more affordable through risk-shifting, many households will choose to rent for at least some portion of the life cycle. When communities flourish and property values rise, concerns emerge about gentrification and

⁷⁹ See Caplin, *supra*, note 59, at 7-8 (detailing shortfalls in programs enacted pursuant to Illinois' statutory scheme).

⁸⁰ Although the program may make it easier for residents to leave a declining area, the disruption and costs of moving would remain a significant disincentive to doing so. Perhaps more important, the risks of staying are greatly reduced; one need not fear additional property value decreases, or worry about selling before others do. See, e.g., Yarmolinsky, *supra* note 55, at 109; Thomas C. Schelling, *A Process of Residential Segregation: Neighborhood Tipping*, in *RACIAL DISCRIMINATION IN ECONOMIC LIFE* 157, 174 (Anthony H. Pascal ed., 1972). Homeowners also should be reluctant to leave improving areas, since the benefits of that improvement are not portable.

⁸¹ While that same consumption interest might also drive NIMBY-like behaviors (rendering them less responsive to risk reduction), it is possible that the latter are driven primarily by risk aversion about home values rather than a belief that the changes in question actually reduce quality of life. See, e.g., FISCHEL, *supra* note 3, at 9-11. Significantly, with the risk of property value declines out of the picture, homeowners would have to justify their objections in terms of the housing consumption experience rather than rely on the assertion that the change would harm property values. See, e.g., Yarmolinsky, *supra* note 55, at 106; Fennell, *supra* note 12, at 1101.

tenant displacement.⁸² Addressing these concerns requires reconfiguring the stakes of tenants as well as homeowners.

III. TENANT STAKES

Perhaps the most important drawback of leasing rather than owning is that tenants lack the option to remain in their homes for as long as they wish.⁸³ There are many ways to deliver this option to tenants, including familiar devices like rent control, rent subsidies, and longer leases. We will discuss these traditional responses briefly before turning to a more innovative approach to reconfiguring tenant stakes.

A. *The Usual Suspects*

Rent control is typically proffered as the solution to concerns about tenant displacement. The pros and cons of rent control have received considerable scholarly attention which we will not attempt to summarize here. Instead, we wish to focus on two features of rent control that make it less than ideal for addressing the problem of understaked tenants. First, rent control concentrates the costs of avoiding tenant displacement on landlords and their current and future tenants, leaving open only the question of how costs will be distributed among and between those groups.⁸⁴ Controls that suppress rents below market levels deliver benefits to current tenants, but the associated costs are absorbed within the rental housing market. Either landlords chisel on maintenance and services to the detriment of their current tenants,⁸⁵ or their profits

⁸² Interestingly, rising property values could present difficulties not only for tenants, but also for homeowners who have alienated their upside appreciation rights under the scheme discussed above—without rights to the increasing equity, rising property taxes would become problematic. See Fennell, *supra* note 12, at 1107-09 (discussing this problem and some possible approaches to it). Politically, such difficulties may lead to support for “welcome stranger” property tax assessment rules or other tax caps. See *Nordlinger v. Hahn*, 505 U.S. 1, 6 (1992) (describing “welcome stranger” assessment).

⁸³ For discussions of the significance of security of tenure, see, e.g., Margaret Jane Radin, *Residential Rent Control*, 15 PHIL. & PUB. AFF. 350, 359–63, 368–70 (1986); Florence Wagman Roisman, *The Right to Remain: Common Law Protections for Security of Tenure: An Essay in Honor of John Otis Calmore*, 86 N.C. L. REV. 817, 820-29 (2008); Richard Arnott, *Tenancy Rent Control*, 10 SWEDISH ECON. POL’Y REV. 89, 111-12 (2003).

⁸⁴ See, e.g., WILLIAM TUCKER, ZONING, RENT CONTROL AND AFFORDABLE HOUSING 37 (1991) (describing effects of rent control as “war between tenants and landlords”); ANTHONY DOWNS, A REEVALUATION OF RESIDENTIAL RENT CONTROLS 3 (1996) (“Much evidence indicates that all rent controls, even temperate ones, transfer income from owners to tenants or between various classes of tenants.”).

⁸⁵ For empirical work on this question, see, for example, Choon-Geol Moon & Janet G. Stotsky, *The Effect of Rent Control on Housing Quality Change: A Longitudinal Analysis*, 101 J. POLIT. ECON. 1114 (1993) (studying how housing quality in New York City varied over time depending on the magnitude of the implicit subsidy delivered to tenants through rent control). While Moon and Stotsky found that units with proportionately larger rent control subsidies were less likely to experience quality improvements, their evidence on quality declines was mixed. See *id.* at 1139; see also DOWNS, *supra* note 84, at 12, 55-58 (noting that although empirical studies suggest that “stringent” rent controls lead to more deterioration in housing units, the evidence is mixed on whether “temperate” controls have that effect). The picture is

decline. Reduced landlord profits can translate into a diminished stock of rental housing,⁸⁶ making it more difficult for newcomers to find accommodations.⁸⁷ Second, rent control tends to lock existing tenants into particular units.⁸⁸ While it might seem that keeping people in the community is the point of rent control,⁸⁹ an option to remain is different than a distortive pressure to remain, which can, among other things, reduce the responsiveness of labor supply⁹⁰ and keep tenants in larger or smaller units than desirable given their current family configurations.⁹¹

Rent subsidies funded by local taxation would avoid the cost-concentration of rent

complicated by the fact that tenants receiving large subsidies under rent control tend to stay in their units for a long time, and hence have greater incentives to engage in maintenance on their own. *See Moon & Stotsky, supra*, at 1125, 1139.

⁸⁶ *See, e.g.,* Lerman and McKernan, *supra* note 13, at 1. As Anthony Downs explains, controls that keep rents below market levels suppress price signals that would otherwise induce entry when demand increases; to the extent profits are diminished below “normal” returns, controls send an erroneous signal that induces exit. *See* DOWNS, *supra* note 84, at 21-26; 45-48; *see also id.* at 48-52 (discussing empirical findings suggesting that “stringent” rent controls reduce supply, but noting that studies of “temperate” controls had not evidenced a supply effect). Rent control is viewed as a major reason for the decline in private rental markets in Europe. *See* GAVIN MCCRONE AND MARK STEPHENS, HOUSING POLICY IN BRITAIN AND EUROPE 20-21 (1995); E. JAY HOWENSTINE, ATTACKING HOUSING COSTS: FOREIGN POLICIES AND STRATEGIES 75 (1983); *see also* DOWNS, *supra* note 84, at 48 (“The experience of the United Kingdom strikingly confirms that stringent rent controls reduce new construction of rental units in the long run.”). Where rent control ordinances have avoided supply problems, it may be because their price caps are so relaxed as to have had little binding effect. *See* MARGERY A. TURNER, HOUSING MARKET IMPACTS OF RENT CONTROL: THE WASHINGTON, D.C. EXPERIENCE 95-96 (1990) (“evidence suggests that rent control in the District of Columbia has had little or no supply effect,” noting that “the rent control regime is a moderate one that explicitly seeks to maintain the profitability of investment in rental housing”); *id.* at 97 (“It is possible that the reason rent control has had no impact on supply is that its impact on price has been negligible....” but finding that rent control in D.C. suppressed rents by an average of \$50 per month); JOHN I. GILDERBLOOM & RICHARD P. APPELBAUM, RETHINKING RENTAL HOUSING 134 (1988) (review of studies suggests that “neither moderate nor strong [as distinguished from restrictive] forms of control have caused a decline in either the quality or supply of the rental stock”); *id.* at 220 (“both the positive and negative economic effects of moderate rent control (its most widespread form) ... [are] limited”).

⁸⁷ The prevalence of long-time tenants in controlled units is consistent with rent control’s effect on newcomers. *See* TUCKER, *supra* note 86, at 48 (“Most rent-controlled apartments [in NYC] are occupied by people who have been in continuous residence since 1971—and some have been occupied by the same people (or their friends or relatives) since 1943.”). Another concern is that shortages of rental housing will lead landlords to screen based on improper criteria. *See* DOWNS, *supra* note 84, at 61.

⁸⁸ This result follows most clearly if stricter limits on rent increases apply within a given tenancy than between tenancies, as with “vacancy decontrol.” *See* Arnott, *supra* note 83, at 95-96; DOWNS, *supra* note 84, at 58. But any controls that produce scarcity in rental housing will contribute to lock-in; no tenant wants to give up her place if she will have difficulty finding another. *See* DOWNS, *supra* note 84, at 59-60.

⁸⁹ *See* Radin, *supra* note 83, at 368-71 (discussing a communitarian justification for rent control). Rent control might solve a collective action problem in keeping a community that is highly valued by all of its members from unraveling as a result of households’ individual actions to move to cheaper markets. *See id.* at 369. A fully portable tenant benefit, even one that enables households to stay if they wish, would lack this advantage. *See* text accompanying notes 107-109, *infra*.

⁹⁰ *See* Arnott, *supra* note 83, at 110-11. Related points have been made in the context of homeownership: owners facing a difficult market tend to become stuck in place, potentially reducing their ability to take advantage of job opportunities elsewhere. For discussion of this issue and how downside home equity protection would help, *see, e.g.,* Yarmolinsky, *supra* note 55, at 107; Fennell, *supra* note 12, at 1109-10.

⁹¹ *See* DOWNS, *supra* note 84, at 59-60,

control but, depending on program design, may still have a lock-in effect. They are also likely to be politically vulnerable, and any uncertainty about the program's continuing viability will erode tenants' time horizons, and accordingly, the social benefit of such programs.

Requiring landlords to offer prospective tenants longer lease terms might seem to offer another solution. We might first ask why the market does not already produce lengthy residential leases. One possible reason is that they tend to be asymmetrically binding on the parties. A landlord could be compelled to comply with the lease for its entire term, but the landlord would be unlikely to collect anything beyond the security deposit from a low-income tenant who breaks a long lease. Pricing this one-way option into the rental amount is certainly possible, but would run counter to the goal of housing affordability.⁹² Forcing landlords to offer longer leases at the same price as shorter leases would raise landlord costs and produce the same dynamics as rent control.

B. Giving Tenants Options

Robert Lerman and Signe-Mary McKernan have proposed another way to confer on tenants the right to remain in place: financial options that are keyed to local rent levels.⁹³ The basic outlines of an option-based approach can be illustrated with a simple example.⁹⁴ Suppose Tara Tenant, who is on a fixed income, leases a unit for one year at \$1000 per month. She could expect her rent to go up by about \$10 a month or \$120 a year for every one percent increase in area rents. Suppose she obtains a one-year call option that is indexed to rental values within her ZIP code, at a value that corresponds to her lease's rental amount. If, in a year, prices have shot up 20%, her option would be worth \$2400 (\$120 X 20).⁹⁵ Assuming her unit tracks the area trend, the payment she receives

⁹² This point is analogous to the "front-end load[ing]" associated with forms of rent control that apply only within, and not between, tenancies. See Arnott, *supra* note 83, at 94.

⁹³ Lerman & McKernan, *supra* note 13; see Robert I. Lerman, *Promoting Neighborhood Improvement While Protected Low-Income Families*, prepared for presentation at the 29th Research Conference Association for Public Policy Analysis and Management, Nov. 8, 2009 (unpublished manuscript, on file with authors) (expanding on the ideas in Lerman & McKernan, *supra* note 13, and including options pricing estimates). The idea of such a financial instrument is also raised in O'FLAHERTY, *supra* note 3, at 369.

⁹⁴ In the interest of providing an intuitive illustration of how tenant options could work, this example ignores some important refinements that will be discussed below; accordingly, it should not be viewed as an operational template. More generally, because Lerman and McKernan have provided relatively few details about their proposal, the descriptions in this section may diverge in some respects from the options regime they envision.

⁹⁵ Although this example suggests that tenants would receive complete protection against area rent increases, options would likely be structured to provide somewhat less protection. For example, the tenant's option might begin to gain value only after increases in area rents have outpaced inflation by a small amount. In options terminology, the "strike price" would be adjusted upward, constricting the circumstances in which the option is "in the money" (valuable to exercise), and thereby reducing the price of the option itself. See Lerman, *supra* note 93, at 10-12. Similarly, rent control systems generally permit annual percentage adjustments of some sort. See DOWNS, *supra* note 84, at 34.

under the option would cover the cost of any rental increases associated with renewing the lease for another year at her present location. Alternatively, Tara might take the cash and rent (or buy) elsewhere, having benefited from the general improvement in her community.⁹⁶ If, instead, area rental prices stayed the same or fell, the option would not pay anything.⁹⁷

In effect, such a call option would insure tenants against area rent increases.⁹⁸ A tenant holding such an instrument would have a stake in the community's improvement that she currently lacks.⁹⁹ By lengthening the tenant's time horizon and protecting against displacement, the program would be expected to foster the development of social capital and reduce opposition to community changes that are likely to have positive effects on property values.¹⁰⁰

Many additional design details would have to be worked through, however. Chief among them is the issue of who would pay for the option. Tenants, especially those most at risk of displacement through gentrification, are unlikely to have the ability to, let alone much interest in, spending money on complex financial investments. Local governments, who have much to gain from tenant stability (and who may have to spend money on some form of affordable housing) might purchase such instruments to give to low-income

⁹⁶ See Lerman & McKernan, *supra* note 13, at 2. For example, her landlord may not keep up the unit in a fashion that reflects the overall improvement in the area. If the landlord nonetheless raises the rent to a level consonant with overall price trends, Tara may decide to use the money to move to a nicer unit. If her landlord opts for a smaller (or no) rental increase, Tara might stay and spend the cash on non-rental needs.

⁹⁷ Conceivably, a tenant could sell an instrument exposing her to the risk of downward fluctuations in area rental values. She could collect a premium for selling a "put" requiring her to pay out an amount corresponding to the decline in area rents. For example, suppose the area's property values went down in value by 10 percent, reducing the rent demand by Tara's landlord from \$1000 per month to \$900 per month. Tara would have to pay the holder of the put \$100 per month, or \$1200 per year, leaving her in the same position (from a cash perspective) as if her rent had stayed at \$1000. Builders or landlords with an interest in buffering the risk of falling rents might wish to hedge against that eventuality, and, in theory, tenants could take the other side of those transactions. See Lerman, *supra* note 93, at 5, 8. Although the sale of the put would allow tenants like Tara to partially offset the cost of obtaining protection against upward rent movements, we assume such arrangements would be too risky to interest many tenants. Tenants would find it hard to make the necessary payments if falling area rents correlated with labor market declines or if their particular units failed to experience a rent decrease.

⁹⁸ A tenant protection policy might be explicitly structured as an insurance policy against rent increases rather than as a tradable option. See Lerman & McKernan, *supra* note 13, at 2; Lerman, *supra* note 93, at 7-8.

⁹⁹ See Lerman, *supra* note 93, at 12.

¹⁰⁰ See *id.* We do not mean to suggest that a tenant stakeholder program will—or should—make all tenants support every change with a positive expected impact on property values. Both tenants and homeowners might rationally oppose changes that would increase property values but alter the character of the neighborhood in ways that would reduce their desire to remain. Homeowners seek to maximize the sum of their consumption flow and their investment returns, and may rationally forgo some of the latter in favor of more of the former, especially if they plan to stay for a long time. See, e.g., FISCHER, *supra* note 3, at 150. Tenants given the equivalent of an investment stake would be expected to make similar tradeoffs. As Lance Freeman makes clear in his book, *THERE GOES THE 'HOOD*, although gentrification often brings desired amenities to an area, such as increased retail and improvements in city services, it also often brings conflict regarding the use of public space, FREEMAN, *supra* note 35, at 137, and can evoke "feelings of anger and racially based disrespect," see *id.* at 111.

tenants living within their jurisdictions, while making the options available to other tenants at market rates or on a sliding-scale basis.¹⁰¹ To the extent funding comes from general property tax revenues, such a program would partially redistribute gentrification gains from landowners to tenants.¹⁰² Unlike rent control, the costs of this redistribution would be borne by the entire class of landowners, rather than the smaller subset of rent-controlled landlords. The possibility that the costs would be shifted back onto tenants would diminish accordingly.

Once local government funding enters the picture, however, additional complications arise. For example, subsidized options would have to be pegged to median rents in the area, adjusted for family size, rather than to a household's actual rental costs to prevent distortion in housing choices; tenants choosing relatively more expensive accommodations could then purchase additional protection at market rates if they desired.¹⁰³ Subsidized programs could also encounter state law impediments. In addition to generalized attacks on such programs on "public purpose" grounds,¹⁰⁴ some jurisdictions may lack the authority to provide tenants with rent subsidies taking the form of financial instruments offering cash-out options. A broader normative concern that would be exacerbated by the subsidy feature is that tenant households could cash out their option gains only to later suffer displacement or even homelessness. To avoid these problems, communities might have to place limits on how payouts from subsidized options could be used.¹⁰⁵

Two additional design decisions—the degree of mobility that these tenant options should facilitate, and the timing and structure of option payouts—raise a bevy of issues. Although one advantage of the call option structure is that it grants tenants the ability to

¹⁰¹ One possibility would be for the local government to provide the hedge itself (rather than merely act as a conduit for passing risk to investors). See Lerman & McKernan, *supra* note 13, at 3 (explaining that the local government would only make payouts in when property values have risen; the rise in property values could increase property tax receipts by enough to fund the required payouts). A locality taking this approach could achieve the same economic result by executing a contractual rent subsidy agreement with selected tenants making payouts contingent on changes in local rental values. Use of the option format, however, may make it easier for localities to price and to fund the protection being provided given the existence of an outside market for such instruments.

¹⁰² Alternatively, one might characterize the program as compensating tenants for the harm of gentrification. See Barbara Bezdek, Putting Community Equity In Community Development: Resident Equity Participation in Urban Redevelopment, U. Md. Legal Studies Research Paper No. 2009-3 available at <http://ssrn.com/abstract=1322277>, at 10-14 (enumerating harms inflicted by gentrification).

¹⁰³ Lerman and McKernan may have this issue in mind when they note that under their proposal, "[t]he benefit paid would not depend on the price of the renter's own unit, as this could create incentives for abuse by renters and landlords." See Lerman & McKernan, *supra* note 13, at 2.

¹⁰⁴ Most states have constitutional, if not legislative, prohibitions against spending governmental money for anything other than "public purposes." Historically, subsidized housing programs have been attacked as diversions of public money for the "private" gain of the subsidized tenants. Although most courts now accept that subsidized housing confers a public benefit, the new forms of subsidies discussed in this article—particularly the multi-year cash out option—may reinvigorate this issue.

¹⁰⁵ See Lerman & McKernan, *supra* note 13, at 3 (suggesting that "[s]ome limitations might be placed on those assets purchased with government subsidies").

move to other accommodations,¹⁰⁶ unlimited tenant mobility may decrease the social value of the program by reducing continuity. At least in some jurisdictions, the point of offering a housing subsidy (whether in the form of an option or otherwise) is to maintain an economically diverse community. If the option follows the tenant rather than the rental unit, such diversity will be lost whenever the tenant prefers cash and residence in a cheaper jurisdiction to continued residence in the community.¹⁰⁷ Other jurisdictions, however, may be seeking another type of diversity, such as the introduction of wealthier members to the community¹⁰⁸ or the creation (or preservation) of job opportunities, both of which may require the displacement of some members of the existing community.¹⁰⁹ Options that enable tenants to move as community conditions change could diminish the need for more invasive displacement actions, notably the exercise of eminent domain.¹¹⁰

A related question is how the cash-out option ought to be structured. If the option covers only a year's worth of rental increases at a time, with subsequent pay-outs linked to continued residence in a jurisdiction, tenants may be loathe to move, reducing the difference between the call option mechanism and a place-based rental subsidy. On the other hand, if tenants are granted a spatially unrestricted call option offering a stream of payments over a multi-year period, which could be sold for a lump sum equivalent to several years' worth of payments,¹¹¹ a series of tenants could cash in (and move out) in

¹⁰⁶ Absent this ability, landlords might treat their tenants as a captive audience, skimping on maintenance and other services, essentially overcharging those tenants (and the subsidizing government) for the accommodations provided.

¹⁰⁷ Though sympathetic scholars such as Bezdek, *supra* note 102, at 8, assume that tenants would want to stay in gentrifying areas if only they could afford to, and recent studies suggest that most in fact stay, *see* Freeman & Braconi, *supra* note 34, at 48, some might prefer to move. Even long-time residents may feel out of place as their neighborhood changes around them. Their friends may die or leave, new stores catering to a different clientele may replace the establishments they used to patronize, and community organizations may develop a different focus. *See* FREEMAN, *supra* note 35, at 83 (citing literature decrying changes brought by gentrification "loathed by long-term residents").

¹⁰⁸ For discussion of the potential advantages of income mixing, *see*, for example, Alex F. Schwartz, HOUSING POLICY IN THE UNITED STATES: AN INTRODUCTION 263 (2006); Henry J. Wexler, Goals, Strategies and Midterm Lessons of HUD's Urban Revitalization Demonstration Program, 10 J. AFFORDABLE HOUS. 195, 204-206 (2001); Alastair Smith, Mixed Income Housing Developments: Promise and Reality, Joint Center for Housing Studies, Harvard University 1 (2002), available at http://www.jchs.harvard.edu/publications/W02-10_Smith.pdf. But *see* FREEMAN, *supra* note 35, at 204 ("there seems to be little reason to expect gentrification to significantly alter the class trajectories of residents indigenous to gentrifying neighborhoods—at least in the short run").

¹⁰⁹ Perhaps the most famous example of resident displacement in the name of job preservation was Detroit's use of eminent domain to displace the residents of Poletown in order to facilitate the construction of an automobile assembly plant. *See* Poletown Neighborhood Council v. City of Detroit, 301 N.W. 2d 455, 410 Mich. 616 (1981) *overruled by* County of Wayne v. Hathcock, 684 N.W.2d 765 (Mich. 2004).

¹¹⁰ We do not mean to suggest that tenant options would always make eminent domain unnecessary, nor that voluntary moves prompted by community changes are necessarily free from negative normative implications. Nonetheless, eminent domain is often thought to constitute a particularly damaging form of displacement.

¹¹¹ *See* Lerman & McKernan, *supra* note 13, at 2 (discussing plans guaranteeing tenants 10 years of expected future benefits, regardless of whether they move).

sequence, causing the costs of the program to balloon.¹¹² A third alternative would be to provide multi-year options to only those tenants who happen to live in a jurisdiction at the time such a program is enacted.¹¹³ This may be appropriate, or at least no worse from a social justice standpoint, than the one-time bonus (in the form of price appreciation) enjoyed by area landowners at the time such appreciation occurs. But if gentrification is a lengthy and unpredictable process, the program's failure to cover incoming tenants could prove problematic. While new tenants would initially lack the sorts of social or economic networks that would be disrupted by gentrification (or the need to move) and might come in at rent levels that at least partially accounted for anticipated property value increases, their incentives to invest in the community could be clouded by their uncertainty about future rent increases.

The answer may be that different communities should adopt different programs. Those interested in maintaining diversity should enact programs tied to, if not particular rental units, a specified number of units located within the community. This might be accomplished by providing payouts in the form of rental vouchers valid only within the community. Communities seeking to compensate likely-to-be displaced residents might opt for programs providing longer-term, cash basis options or rental insurance policies available to a specific group of current residents. Although designing workable programs will be challenging, we think there is considerable room for experimentation with this suite of alternatives.

Putting these ideas together with the one in the previous section would give local governments an interesting and powerful new role in managing resident stakeholding. Local governments could educate, facilitate, subsidize, and coordinate programs that shift local housing market risk away from homeowners and (as to the upside potential) toward tenants. Differences in the time horizons of the two groups—homeowners need to wait until sale to settle their options, while tenants will need payouts timed to cover annual rental increases—prevent them from directly trading risk with each other. But local governments would be well-positioned to broker trades with investors who can take the other side of both kinds of transactions.

¹¹² For example, if the call option generates cash representing the value of 10 years of rental increases, one tenant may move out at the end of year 1, entitled to receive a further 9 years of payments, while another tenant moves in at the start of year 2, moving out at the end of the year and becoming entitled to a further 9 years of payment, a third may take up residence in year 3 and move out in year 4, and so on. Ultimately, multiple tenants may become entitled to payments for each year's increase in rental costs with respect to that single apartment. And, of course, former tenants may be entitled to collect similar payments under similar plans offered with respect to their new places of residence.

¹¹³ This dilemma—the conflict between subsidizing existing tenants and preserving assets for future tenants—is similar to the choice faced by designers of shared equity programs for low-income homeownership. See Rick Jacobus and Jeffrey Lubell, *Preservation of Affordable Homeownership: A Continuum of Strategies*, Center for Housing Policy, Policy Brief 19 (2007), available at <http://www.ncbcapitalimpact.org/uploadedFiles/downloads/JacobusLubelloption4-07.pdf>.

IV. REGIONAL STAKES

The devices described above are aimed at changing stakeholding arrangements within a given jurisdiction. But a central dilemma of local governance, exacerbated by the phenomenon of overstaked homeowners, is that of interlocal spillovers. Exclusionary zoning presents one example of an oft-noted problem created by territorial boundaries within metropolitan areas: the ability of some jurisdictions to reap the general agglomeration benefits of the metropolitan area without fully sharing in the costs of that agglomeration, and indeed, by failing to share, increasing overall costs.¹¹⁴ Even if deconcentrating poverty would produce large net gains throughout the region, few communities are sufficiently altruistic to attract households likely to be a net financial burden.

One impetus for altering stakes, then, is to foster a style of local governance that responds more cooperatively and efficiently to problems that are regional in nature. While permitting homeowners to reduce their exposure to housing market fluctuations in the manner suggested above should help to curb NIMBY tendencies, metropolitan areas might want or need to do more to align the interests of residents of different jurisdictions.

A. Regionalization, Extraterritoriality, and Bargaining

Some existing doctrines, such as the requirement that annexed areas be “contiguous,” help to address some of the most egregious efforts to offload costs on other jurisdictions.¹¹⁵ Revenue sharing can also spread costs and benefits interlocally, although it often generates significant political backlash.¹¹⁶ Legal restraints and post hoc

¹¹⁴ See Richard Briffault, *The Local Government Boundary Problem in Metropolitan Areas*, 48 STAN. L. REV. 1115 (1996).

¹¹⁵ For discussion of the contiguity requirement, see, e.g., Clayton P. Gillette, *Expropriation and Institutional Design in State and Local Government Law*, 80 VA. L. REV. 625, 670-86 (1994). While the contiguity requirement can prevent cities from annexing far-flung wealthy communities while ignoring intermediate poor ones, it cannot prevent communities from refraining from all annexation in order to avoid the annexation of poor areas. Remedying that situation requires changes in state annexation rules. Scholars advocating such changes have come up with different suggestions based on differing assumptions about the location of needy individuals. Compare Michelle Wilde Anderson, *Cities Inside Out: Race, Poverty and Exclusion at the Urban Fringe*, 55 UCLA L. REV. 1095, 1159 (2008) (advocating “state legal reforms that increase territorial outsiders’ ability to initiate annexation”) with Laurie Reynolds, *Rethinking Municipal Annexation Powers*, 24 URB. LAW. 247, 253-254 (1992) (advocating allowing municipalities greater power to annex “nonresidents on the fringe”).

¹¹⁶ There is an ongoing scholarly debate over whether the California Supreme Court’s decision in *Serrano v. Priest*, 96 Cal. Rep. 601 (1971), striking down California’s reliance on local property taxes for financing public schools, was responsible for the later success of Proposition 13. The leading proponent for causality, Professor William Fischel, argued that by de-linking local taxes from local service provision, *Serrano* turned local taxes into a “deadweight loss” for most voters, making them more likely to vote for Proposition 13. See William A. Fischel, *Did Serrano Cause Proposition 13?*, 42 NAT’L TAX J. 465, 469 (1988). Others attribute Proposition 13’s enactment to other causes. See Kirk Stark & Jonathan Zasloff, *Tiebout and Tax Revolts: Did Serrano Really Cause Proposition 13?*, 50 UCLA L. REV. 801, 853-854 (2003) (“Our analysis has shown, we believe, that there is little empirical foundation for Fischel’s claim

redistribution can only go so far. What is needed is a mechanism for affirmatively knitting together the interests of different jurisdictions within a metropolitan area.

One response that has attracted some scholarly adherents involves changing the size of the decisionmaking unit through regionalization.¹¹⁷ The disadvantage of this approach is that it undercuts local control that might be scaled appropriately for a variety of other problems, and diminishes the potential for useful interlocal variation and competition along the lines suggested by the Tiebout Hypothesis.¹¹⁸ At the other end of the spectrum, metropolitan areas might simply rely on interlocal bargaining, buttressed by repeat play among neighboring jurisdictions.¹¹⁹ Yet interlocal bargains often fail to emerge, generating conflicts among jurisdictions.¹²⁰ In between these extremes lie a variety of possible approaches, including multi-tiered governmental structures,¹²¹ cross-border voting,¹²² and interlocal liability rules designed to sidestep bargaining impediments.¹²³ We cannot do justice to these proposals here, but it is worth noting that each would

that *Serrano* caused Proposition 13.”) Professor Fischel stands by his original position. See William A. Fischel, *Did John Serrano Vote for Proposition 13? A Reply to Stark and Zasloff’s ‘Tiebout and Tax Revolts: Did Serrano Really Cause Proposition 13?’*, 33 STATE TAX NOTES 381 (2004). Other state plans that have reallocated local property tax revenues to equalize school funding have encountered serious political resistance. See, e.g., Laurie Reynolds, *Uniformity of Taxation and the Preservation of Local Control in School Finance Reform*, 40 U.C. DAVIS L. REV. 1835, 1885 (2007) (Texas and Vermont experiences “leave no doubt about the political volatility of this school funding system”); Maurice Dyson, *The Death of Robin Hood? Proposals for Overhauling Public School Finance*, 11 GEO. J. ON POVERTY L. & POL’Y 1 (2004) (Texas).

¹¹⁷ See, e.g., MYRON ORFIELD, *METROPOLITICS: A REGIONAL AGENDA FOR COMMUNITY AND STABILITY* (1997); Scott A. Bollens, *Concentrated Poverty and Metropolitan Equity Strategies*, 8 STAN. L. & POL’Y REV. 11, 14-15 (1997); Richard Briffault, *supra* note 114, at 1165. Some examples of regional governance exist. See LYNN A. BAKER & CLAYTON P. GILLETTE, *LOCAL GOVERNMENT LAW CASES AND MATERIALS* 725-731 (3d ed. 2004) (describing existing regional governments and discussing the issues that gave rise to them). However, most believe the political support necessary for the establishment of comprehensive forms of metropolitan government is absent. See, e.g., ANTHONY DOWNS, *NEW VISIONS FOR METROPOLITAN AMERICA* 170 (1994); Richard Briffault, *supra* note 114, at 1171; Anmon Lehari, *Intergovernmental Liability Rules*, 92 VA. L. REV. 929, 981 (2006).

¹¹⁸ See Richard Briffault, *supra* note 114, at 124; Richard Briffault, *Localism and Regionalism*, 48 BUFF. L. REV. 1, 16-17 (2000) (stating arguments of “advocates of decentralization”); Clayton P. Gillette, *The Conditions of Interlocal Cooperation*, 21 J. LAW & POL. 365, 365 (2005); Robert P. Inman & Daniel L. Rubinfeld, *Rethinking Federalism*, 11 J. ECON. PERSP. 43, 47 (1997).

¹¹⁹ Fischel suggests that municipalities have disincentives to engage in “beggar thy neighbor” tactics, arguing that neighboring jurisdictions “are locked into a web of mutually beneficial exchanges at both the political and the personal levels.” FISCHEL, *supra* note 3, at 184. *But see*, e.g., Lehari, *supra* note 117, at 942-46 (discussing Fischel’s account and suggesting he “may have been overly optimistic”); Briffault, *supra* note 114, at 1149 (describing how local decisions can create “a tragedy of the regional ‘commons’”).

¹²⁰ See, e.g., Briffault, *supra* note 114, at 1144-51; Gillette, *supra* note 118, at 373-382 (describing “contracting cost” barriers to inter-local cooperation); Lehari, *supra* note 117, at 943-944 (“Empirical evidence further indicates that local governments usually deal with each other on a more short-term, subject-specific accountability basis than the order without law approach would suggest.”).

¹²¹ See Briffault, *supra* note 114, at 1165-1166.

¹²² See Jerry Frug, *Decentering Decentralization*, 60 U. CHI. L. REV. 253, 329 (1993); Ford, *supra* note 6, at 1909; *see also* Aaron J. Saiger, *Local Government Without Tiebout*, 41 URBAN LAWYER 93, 120-37 (2009) (proposing a redistricting scheme for local governance that would employ periodically shifting boundaries).

¹²³ See Lehari, *supra* note 117, at 988.

require either a significant political restructuring, a difficult set of normative determinations about the magnitude and direction of spillovers, or both. The conflicting interests that motivate these proposals would also likely impede the formulation of the solutions themselves.

B. Synthetic Stake-Sharing

It is possible that some of the instruments and strategies described in Parts II and III for off-loading and reallocating risks within a community could be reconfigured to accomplish analogous risk reallocations between communities, and in the process, reduce political resistance to measures and mechanisms designed to promote regional objectives like socioeconomic integration. The idea would be to explicitly link the financial and social fortunes of politically distinct entities within a metropolitan area—in a sense, to replicate the strategy-proofing advantages that Henry Smith has attributed to the medieval common field arrangement.¹²⁴

The medieval common field arrangement interspersed privately owned strips of farmland throughout a larger grazing commons, creating what Smith has termed a “semicommons.”¹²⁵ Each individual farmer owned a number of scattered strips rather than owning one consolidated field.¹²⁶ This physical interspersing of land made it harder for participants to selectively burden others; actions which degraded one area of the field were likely to affect everyone and not just a disfavored few.¹²⁷ Although the idea of discontinuously interspersed local jurisdictions (or even jurisdictions that are contiguous but intricately interlocked) seems both fanciful and deeply problematic, a virtual (or synthetic) interspersing could be accomplished through community-indexed investments reciprocally held by residents of different localities.

While space does not permit a detailed exploration of this idea here, the basic building blocks would be the area-indexed investment instruments discussed above, which allow homeowners to shed the risk associated with local housing markets and tenants to share in the gains of the community. The earlier discussion suggested that (aside from tenants), most of those accepting risk from homeowners would be investors with well-diversified portfolios and no particular ties to the community. But housing risk could be shifted around much more selectively, so that residents (either directly or through their local government institutions) take home equity stakes in jurisdictions neighboring their own. While this approach would do little to relieve the problem of poor diversification that has been associated with homeownership (a region’s housing markets are likely to be at least somewhat correlated) it would help to address the misalignment of

¹²⁴ See Henry E. Smith, *Semicommon Property Rights and Scattering in the Open Fields*, 29 J. LEGAL STUD. 131 (2000).

¹²⁵ See *id.*

¹²⁶ See *id.*; Robert C. Ellickson, *Property in Land*, 102 YALE L.J. 1315, 1388-90 & fig. 3 (describing and depicting this arrangement).

¹²⁷ See Smith, *supra* note 124.

incentives that causes local governments to impose negative externalities on other parts of the larger metropolitan system.

To illustrate how the concept might be applied (without endorsing this particular approach), suppose a state legislature passes a Stakeholding Enabling Act granting local governments the power to buy and sell securities indexed to local property values and to subsidize the provision of options to tenants, on condition that the local government agrees to participate in a regional risk-sharing arrangement. This regional arrangement would be conducted in accordance with state-prescribed standards, would require a state-prescribed minimum level of investment, and would require each local jurisdiction to adopt a residential stakeholding plan that meets certain state standards. Each jurisdiction could then set up residential stakeholding programs offering homeowners the ability to shed local market risk and tenants the ability to accept local (upside) market risk. Pursuant to the regional arrangement, the jurisdictions would be required to buy a certain number of locally-indexed options from each other, pursuant to the regional risk-sharing requirements, and to either hold onto them for a given period or to sell them to residents within their own communities. In addition, or alternatively, each locality could set up tax preference schemes or other incentives to encourage those local homeowners who wish to bear housing market risk to trade in some of the appreciation rights associated with their own local area for an option indexed to a compilation of surrounding jurisdictions.

The resulting cross investment would mean that jurisdictions' investment losses would (at least partially) offset any gains from adopting "beggar thy neighbor" policies that produce negative externalities. This rewiring of the economic interests of residents should induce localities to act more cooperatively.

CONCLUSION

The problem of suboptimal residential stakeholding is nothing new, but the present financial crisis has thrown it into bold relief. In this essay, we have tried to suggest that this crisis offers an opportunity to rethink in a more comprehensive manner the way in which residential risk is held and shared. While our discussion here has been brief and tentative, we hope that it will help to spark interest in residential stake management as a important policy instrument for state and local governments. We think it is one that might be creatively wielded in ways that would not only respond to current realities, but also help to address longstanding conflicts of interest between homeowners and tenants, and between residents of different localities in the same metropolitan area.

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