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"Efficiency - Equity - Clarity"

Transportation Redlining

How The Mortgage Banking Industry Promotes Excessive Use Of Cars

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Abstract

This paper describes how current residential lending practices encourage sprawl by ignoring the transportation cost savings provided by more urban locations. Households often face tradeoffs between lower housing and higher transportation costs in suburban locations, and higher housing and lower transportation costs in urban neighborhoods. Residents of more urban neighborhoods can save thousands of dollars annually in transportation costs, money that can be used to help pay mortgages. But lenders generally ignore these tradeoffs, which makes suburban housing seem artificially cheap and urban housing seem artificially expensive. The result is less urban redevelopment and more sprawl, with harmful economic, social and environmental consequences.

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It is hard to believe that mortgage bankers are behind most of our transportation problems. In fact, they are. They have made exurban living artificially affordable. They have also made urban living artificially unaffordable. They have made it artificially unaffordable to live near affordable transportation.

Transportation savings are the economic essence of cities. Transportation savings from living in urban neighborhoods often amounts to 15% of household income. Because of those savings, urban homes in good neighborhoods cost more than equivalent exurban homes. And because of those savings, people can afford the higher prices of urban homes. At least they could if banks considered transportation savings when approving mortgages. If banks considered transportation savings, people buying in the city could spend up to an additional 15% of income on their homes. They could spend up to 45% of their income on urban homes, instead of the 30% of income currently allowed. Since they can't, they buy in the exurbs. In the exurbs there are no transportation savings to push up the land costs of urban housing.

Here is another way to look at mortgages and urban versus exurban choices. The combined cost of housing and transportation for most homeowners is about 55% of income. For exurban homebuyers, the split is 30% for the home, and 25% or more for cars. In urban neighborhoods with good transit, the split is very different. It's 45% of income for the urban home, and 10% for cars and transit.

But mortgage bankers say housing payments can't exceed about 30% of income. In other words, mortgage bankers say urban homes at 45% of income are, "mortgage unaffordable." Yet both urban and exurban locations are equally affordable, because both cost 55% of income for housing and transportation. Good urban homes in neighborhoods with good transit cost 15% more of a household's income. But they should be just as affordable because they offer transportation savings equal to 15% of household income.

Mortgage bankers silently say: "Sure, buy in the city. We love cities. But you will spend up to half your housing money on the cost of the transportation savings your new neighborhood provides. You won't have much money left for the home itself. Do you want a closet in a good neighborhood? Or a roomy disaster in a bad neighborhood?"

In reply, most homebuyers drive away from cities. Urban neighborhoods shrink at their edges and die. Good urban neighborhoods are sustained by the few middle class people willing to live in homes that are very small for their income, and by people with family money or high incomes. Few middle class people will accept the drop in housing size or neighborhood quality required to buy an urban home. Most young homebuyers can only afford the homes they expect in exurban development, where there are no transportation savings to push up house prices.

Exurban homes may be cheaper, but the transportation is not. Exurban buyers typically spend 25% of their income or more for car costs. New exurban buyers often spend more on cars than housing. But mortgage bankers don't look at transportation costs, so exurban homes are, "mortgage affordable." And sprawl spreads.

This mortgage system of shrinking cities and spreading sprawl needs a name. A good candidate is "Transportation Redlining."

Ignorance of transportation savings by the mortgage industry redlines good urban neighborhoods. It makes them unaffordable. "Transportation Redlining" also forces buyers out to exurban locations, which continually increases the length of commutes and shopping trips, and has done so since World War II. Transportation Redlining pushes oil demand up to the point of continual crisis. To use a term from old pressure gauges, it "redlines" national demand for oil.

Transportation Redlining forces individual homebuyers and the country as a whole to make an artificial and completely unnecessary choice between good homes and efficient transportation.

Fannie Mae has a pilot program called "Smart Commute" in which urban buyers can use their transportation savings to justify about $10,000 in additional purchasing power. The program may be the first acknowledgement of a serious national problem by an industry leader. It may also be just a PR crumb thrown to environmentalists. Boston's Massachusetts Bay Transportation Authority provides up to $92,000 in additional home purchasing power for people who buy near transit stations. That is much closer to the mark. It is only a little less than the rightful added purchasing power of urban homebuyers with combined income of $80,000 a year.

The mortgage industry should add the percent of income saved by urban transportation directly to the 30% of income that is now the industry standard for maximum housing payments. Then, in neighborhoods with good transit, maximum housing payments would go up to 45% of income.

With that change, buying where transportation is inexpensive will be the fastest route to affordable housing. With that change, there will be a new day for American cities. People will move to the city the way they moved to the exurbs, and for the same reasons: to get affordable housing in good neighborhoods. But without an end to Transportation Redlining, the mortgage industry will continue to make moving to where transportation is expensive the fastest route to affordable housing. The mortgage industry will continue to drain cities, and continue to spread sprawl, and continue to redline national demand for oil.

Once the need to correct Transportation Redlining is accepted, some interesting policy issues become apparent.

Correcting Transportation Redlining requires replacing the current figure of 30% of income as a maximum for housing payments. That figure should be replaced by a sliding maximum that reflects the transportation savings of different neighborhoods. The sliding maximum should be the subject of public debate based on empirical research. Based on present information, 45% of income appears to be an appropriate maximum for housing payments for urban buyers in neighborhoods well served by transit, although in some circumstances the figure might be higher. The goal is to create "Mortgage

Transportation Equity" between exurban housing and urban housing with good transit and shopping.

As stated earlier, 55% of income can be considered a standard for total spending on housing and transportation. Correcting Transportation Redlining would create flexibility on how that amount is divided between housing and transportation costs. It would create equal mortgage affordability for comparable homes that had different prices because of the different levels of transportation savings their locations offered. Correcting Transportation Redlining would create Mortgage Transportation Equity.

Creating Mortgage Transportation Equity will mean major changes in housing markets. Setting it as a goal is essential to creating better cities, better development outside existing cities, and a transportation system that reduces reliance on cars and reduces the impacts of cars on the environment and the impact of their energy demands on international tension. A clear goal, however, does not necessarily mean that immediate and full implementation of that goal is the best policy.

First, it is possible, perhaps even likely, that immediate national implementation of Mortgage Transportation Equity will rapidly and dramatically increase confidence in the strength of urban housing markets. It may lead to "overheating" of those markets, creating displacement, speculation, and profits not justified by value added or risks taken by developers. Over time speculation and displacement will be corrected as urban developers begin producing additional urban housing. But in the short run, it may be important to guard against problems of displacement and unjustified profits. It might, for example, be worth implementing Mortgage Transportation Equity for new urban housing first and very quickly, and implementing it for existing housing more slowly.

Second, Mortgage Transportation Equity for urban housing may cause a deflation in exurban housing markets, although this will probably be offset, or counteracted, by the demand for vacation houses and land which in many areas overlaps exurban markets. In any case, once the goal of Mortgage Transportation Equity is accepted, there should be debate over whether or not to introduce it gradually in order to insure stability in both urban and exurban housing markets.

A third consideration, with no immediately obvious problems, seems to be that Mortgage Transportation Equity will produce new urban housing that is much more generous than existing new urban development. Existing urban housing developers are building under the constraints of a home buying market in which urban purchasing power for housing is dramatically reduced to pay for urban transportation savings. As noted earlier, because urban buyers get no credit for transportation savings, the purchase cost of those savings is directly subtracted from available housing dollars. In consequence, as noted earlier, urban buyers only have about half of the housing purchasing power of exurban ones, and so, except for the very rich, can only afford small urban homes. With the implementation of Mortgage Transportation Equity, urban buyers will have the same amount to spend on housing itself as exurban buyers. As a result, developers may produce urban homes that are much larger and more generous because buyers will have up to 50% more to spend on

urban homes with more amenities. Generous middle class urban homes will return, the modern equivalent of the generous urban homes of the turn of the century.

Homes in multi-story buildings may still be smaller than exurban homes, assuming it is true that multi-story construction still costs more than two and three story urban homes. Even that may not be a constraint, however. In general, the higher the density, the greater the transportation savings. Mortgage Transportation Equity in high-density, multi-family neighborhoods may mean permitting maximum housing payments higher than 45% of income. In Manhattan, it is very common for affluent urban "yuppies" households to own no cars at all, and rely exclusively on rental cars when needed. Consider, for example, a young Manhattan couple that traveled little outside the city, worked largely at home, and relied heavily on walking and biking in addition to transit. It might have transportation savings well above 15% of income. As a result, a couple with a "very Manhattan" transportation style might be well able to support housing payments above 45% of income, and perhaps almost as high as 55% of income.

A fourth consideration is that Mortgage Transportation Equity may change the nature of development outside existing urban centers. Suddenly, it will be financially viable to provide "urban amenities" that offer transportation savings because mortgage practices will enable homeowners to pay for them as well as a good house. As a result, large developers may build new cities, identified as such, rather than suburban cities like Reston and Columbia and Irvine. It is a sign of the universal impact of Transportation Redlining that in more than 50 years of rushing development since World War II, no new high-density American cities have been built.

In addition to its stimulus of new cities developed from scratch, Mortgage Transportation Equity in housing markets means existing suburban developments may become mini-cities. There will be a demand for homes near mixed uses in order to respond to sudden new buying power for homes that offer low transportation costs. For example, shopping centers have often been referred to as town centers without towns. Parking lots of shopping centers will probably be redeveloped as housing and office buildings and transportation centers. The shopping centers may become shop/live/work centers, with non-auto transportation links to other urban centers. Shopping center owners will recoup purchasing power lost by reducing parking through shared parking used by residents at night, and shoppers during the day. In addition, shopping center owners will also gain semi-captive customers who can shop with no travel time or travel costs.

A fifth area of policy debate is the arguable need to compensate cities for years of Transportation Redlining by mortgage banks. For those people who have not been forced to move out of decaying urban neighborhoods, it is hard to understand the human cost of urban neighborhood decay. It is hard to understand the cost in quality of life when you are forced to retreat back inside locked doors and live like semi-prisoners, or the cost of being forced to see your children exposed to risks of violence and often to actual violence, or of, finally, if you able, the cost being forced to pull up roots, and leave a crumbling community and the friends with whom you raised your kids, if they have not already left before you. Many whites may assume that this is "white flight," and primarily a white immigration pattern. But go to almost any well-established black urban church,

and you will find that very high percentages of its members no longer live in neighborhood where the church is located. On a Sunday morning near downtown Washington, DC, you can find a black church in a black neighborhood with the cars are triple parked outside, and with members of the congregation missing church to stand as guards for the cars. No one walks to the church because no parishioners still live in the decaying neighborhood.

Forced migration is only the personal cost of Transportation Redlining. There is equal devastation to urban property values and the tax base and ability to provide services. In addition, among even the most astute professionals in land use and development, it will take a while for most to understand the scale of distortion that the Transportation Redlining has created in housing markets, and through them in other areas.

Like urban advocates, environmentalists who understand Transportation Redlining may also argue that the environment deserves compensation for the impact of Transportation Redlining on unnecessary automobile use and land development, and through them, unnecessary air pollution, paving, and energy consumption, and global warming. Both the claims of advocates for cities and the environment probably depend in part on proof that mortgage bankers and other were aware, or should have been aware, of what they were doing. Such proof is probably out there. The logic behind Transportation Redlining and Mortgage Transportation Equity is the basic logic of land economics. At some point over the last 50 years it is very likely that more than one mortgage banker understood and argued publicly, and in writing, at least within the industry, that higher urban housing costs reflect urban transportation savings, and should justify higher urban mortgages. If the proof is there, both urban advocates and environmentalists could argue for compensation.

But even without proof, they may argue for appropriate compensation based on the damage to cities and the environment, and the simple and legitimate need to improve cities and help the environment recover. One form that compensation should probably take is also worth debating. It would be to set Mortgage Transportation Equity above actual equity to accelerate urban neighborhood revitalization, and to reduce auto ownership and use.

Mortgage bankers, forced to learn basic land economics rapidly and accept some loss of self-image as “the good guys,” will argue against any and all of these changes, including Mortgage Transportation Equity itself. They will argue that they cannot take risks with buyers who may default because they are unable to meet higher housing payments on bigger mortgages granted on the basis of some, to them, bizarre economic ideas. There are several responses to this argument. The first is that ignoring the economics of transportation is in itself bizarre, especially when transportation costs exceed 25% of the income of many exurban buyers, so that many buyers are spending almost as much on cars to get to an affordable home as they spend on the house itself. Second, ignorance of transportation savings by mortgage banks creates devastation in urban areas, making urban mortgages incredibly risky, if not worthless, because there are so few middle class buyers for urban homes. Third, ignorance of transportation savings by mortgage banks creates sprawl in rural ones, and all the problems associated with overuse of cars.

A fourth response to mortgage bankers protests about change is that within reason, wherever the mortgage system makes buying reasonable, there will be a safe mortgage market with very few foreclosures. Very few people lose their houses to foreclosure except in the devastated urban markets created by mortgage bankers. Elsewhere they sell to get their equity and appreciation out long before their homes are foreclosed. Foreclosure is almost exclusively for those who live where they can find no buyers, typical in urban areas devastated by Transportation Redlining.

Mortgage bankers do have one strong argument against remedial levels of Mortgage Transportation Equity, or at least against their own guilt. They can argue that they do not operate in a vacuum. Land use planners, land economists, urban leaders, organizations like the Urban Land Institute, and others have as much responsibility as mortgage bankers for understanding urban transportation savings and urban housing affordability. They also bear responsibility for not having understood the problem. But the real issue is not simple responsibility, or pining them blame on some institutions. It is how much an improved mortgage system will contribute to improved cities and an improved environment.

Finally, aside from the US mortgage system, there is issue of the rest of world. If mortgages worldwide also ignore transportation savings from urban locations, growing Third World cities will explode in sprawl and cars. They have already started to.

All of these policy issues need debate. First, however, the basic issue of Transportation Redlining, and the urban and rural devastation it creates, and its responsibility for oil dependence and climate change, must be put firmly on the table. In other words, the first challenge is to accelerate the debate over the key issue itself: the inability of mortgage banks to understand that higher urban house prices reflect the costs of buying future transportation savings, and that those savings make urban housing both higher priced, and, at the same time, just as affordable as comparable exurban housing, except in the biased mortgage market the mortgage bankers have created.

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Resources For More Information

Affordable Housing Design Advisor Website (www.designadvisor.org), sponsored by the U.S. Department of Housing and Urban Development, provides information on developing more affordable housing, redeveloping urban communities and implementing Smart Growth.

Patrick Hare, *Planning, Transportation, and the Home Economics of Reduced Car Ownership*, Hare Planning (1246 Monroe St NE, Washington DC, 20017-2915; phone 202-269-9334), 1995.

Patrick Hare, "One Car Mortgages and One Car Rents," *Land Development*, Spring-Summer 1994, pp. 19-21.

Patrick Hare, *Clunker Mortgages and Transportation Redlining; How the Mortgage Banking Industry Unknowingly Drains Cities and Spreads Sprawl*, Hare Planning, 1995.

John W. Holtzclaw, *Smart Growth – As Seen From The Air: Convenient Neighborhood, Skip The Car*, Presented at the Air & Waste Management Association's 93rd Annual Meeting; available at the Sierra Club Stop Sprawl website (www.SierraClub.org/sprawl/transportation), June 2000.

Institute for Location Efficiency (www.locationefficiency.com) is an organization that works to encourage implementation of Location Efficient Development.

Wenya Jia and Martin Wachs, "Parking and Affordable Housing," *Access*, Vol. 13, Fall 1998 (www.uctc.net), pp. 22-25.

LGC, *Creating Great Neighborhoods: Density in Your Community*, Local Government Commission (www.lgc.org), US Environmental Protection Agency and the National Association of Realtors, 2004; available at www.lgc.org/freepub/PDF/Land_Use/reports/density_manual.pdf.

Todd Litman, *Parking Requirement Impacts on Housing Affordability*, VTPI (www.vtpi.org), 2004.

Non-Profit Housing Association (www.nonprofithousing.org) provides a variety of materials to support development of affordable housing, including Location Efficient Development.

Regulatory Barriers Clearinghouse (www.huduser.org/rbc), by the U.S. Department of Housing and Urban Development helps to reduce unnecessary regulations that reduce housing affordability.

Ryan Russo, *Planning for Residential Parking: A Guide For Housing Developers and Planners*, Non-Profit Housing Association of Northern California (www.nonprofithousing.org), 2001.

SPUR, *Reducing Housing Costs by Rethinking Parking Requirements*, The San Francisco Planning and Urban Research Association (www.spur.org), 1998.

VTPI, "Location Efficient Development," *Online TDM Encyclopedia*, VTPI (www.vtpi.org), 2005.

WCEL, *Smart Bylaws Guide*, West Coast Environmental Law Foundation (www.wcel.org/issues/urban/sbg), 2004. This comprehensive guide describes smart growth practices, provides technical standards and model bylaws that can be tailored to specific municipal circumstances, and includes numerous case studies.