Comment on Enterprise Duty to Serve Underserved Markets

David J Reiss, Brooklyn Law School

Available at: https://works.bepress.com/david_reiss/78/
FHFA SHOULD NOT CONSIDER PROPERTIES WITHOUT AFFORDABLE USE RESTRICTIONS AS PART OF THE ENTERPRISES’ DUTY TO SERVE

DAVID REISS*

FHFA invited further comment on the merit of considering properties without affordable use restrictions as part of the Enterprises’ duty to serve, noting that affordable housing preservation “encompasses efforts to keep unsubsidized properties in good condition while maintaining affordability for low- and moderate-income households.” (Page 32102)

FHFA should be certain that any aid given to buildings without affordable use restrictions will actually be passed on in large part to their tenants, whether through lower rents or improved conditions. I question whether that is in fact the case.

There are two main rationales for subsidizing multifamily buildings without affordable use restrictions. First, they provide housing to the neediest tenants: low- and moderate-income families who are not fortunate enough to have obtained subsidized apartments. Second, the multifamily mortgage market is subject to market failures that make government intervention appropriate. I will assess these two rationales in turn.

A. The Affordability Rationale

John Quigley writes,

“Affordability” is clearly the most compelling rationale for polices [sic] subsidizing rental housing. The high cost of rental housing, relative to the ability of low-income households to pay for housing, means that these households have few resources left over for expenditures on other goods—food, clothing, medicine—which are also necessities.¹

While the affordability problem is uncontroversial and well documented, it is unclear that the best solution for it is to reduce the financing costs for multifamily buildings without affordable use restrictions. Before doing so, one must be confident that landlords will pass on these savings

* Professor of Law, Brooklyn Law School. These comments are based upon David Reiss, Landlords of Last Resort: Should the Government Subsidize the Mortgages of Privately-Owned, Small Multifamily Buildings?, published in the WESTERN NEW ENGLAND LAW REVIEW (2010).

to their tenants and reverse the trend of shrinking the affordable housing stock. In other words, if the benefits of the reduction in landlord financing costs are intended to trickle down to tenants, one should be certain as to its rate of flow.

James Follain and Edward Szymanoski note that it “is wise to consider the relative importance of multifamily mortgage credit subsidy programs in an overall strategy to improve the delivery of housing services to low-income households.”\(^2\) They argue that, for a variety of reasons, “[t]hese subsidy programs should not rank very high.”\(^3\)

First, they argue that there is insufficient empirical evidence to support the argument for supply-side subsidies. Second, they argue that an unacceptable portion of the subsidy flows to the housing providers and related industries.

Follain clearly outlines the argument against a “trickle down,” supply-side subsidized multifamily mortgage policy, based on a fundamental question: what is the price elasticity of the housing supply? If the housing supply is elastic, then tenants may benefit from reductions in the cost of providing the housing. But if it is inelastic, “the primary beneficiaries of such programs are likely to be builders, investors, and other supply-side agents.”\(^4\) This is because reducing production costs for an inelastic supply should not result in price reductions—only an elastic and increasing supply would have such a result. As the housing economics literature has not yet determined whether the housing supply is elastic, it is dangerous to implement public policy based on the assumption that it is.

The concerns set forth by Follain and Szymanoski regarding multifamily mortgage subsidy programs in general must be addressed before the federal government implements a new program of subsidized multifamily mortgage finance for buildings without an affordable use restriction.

B. The Market Failure Rationale

Follain and Szymanoski also explore “market failure” as an alternate rationale for government intervention in the multifamily mortgage sector. In particular, they note that

[i]t is difficult to make a case for government intervention in the multifamily mortgage market when using the standard model of

---

3. Id. at 151-52.
market failure, given the efficiencies of modern financial markets. The case for intervention in the financial markets, if one is to be made, is more subtle and requires a model in which uncertainty about some future events—for example, mortgage defaults—is explicit. Market failure in models with uncertainty is caused by two broad categories of factors in the credit markets: uninsurable risks and information costs.  

While researchers in the 1980s and 1990s found that there was not enough information for multifamily mortgage underwriters to make informed decisions, this seems to be much less the case today. Thus, there is no basis to claim that there is a market failure in the multifamily mortgage market.

**CONCLUSION**

The argument in favor of subsidizing the financing costs for multifamily buildings without affordable use restrictions has not been made. Those who favor such subsidies appear to have succumbed to a logical fallacy: they argue that because such buildings provide affordable housing and are at risk of loss, the most efficient way to protect affordable housing is to preserve those buildings.

For the reasons outlined above, that conclusion does not follow. The indiscriminate subsidy of financing costs for the owners of multifamily buildings without affordable use restrictions has not been demonstrated to be good public policy. More targeted uses of government subsidies (whether explicit or implicit) are therefore warranted to achieve housing affordability for low- and moderate-income households.

---