

Rental Housing Assistance for the 21st Century

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Abstract

Current rental housing assistance programs are not designed to provide a safety net for people whose lives are volatile, nor are they designed to encourage low-income people to live in good locations. These deficiencies can be corrected. The U.S. Department of Housing and Urban Development (HUD) should establish a program of rental insurance—like mortgage insurance, but for renters. Low-income housing assistance formulas should be revised to reward good neighborhood features, and punish bad.

Introduction

The rental housing market for lower income Americans could work a lot better than it has been working. Tenants (and the landlords who rent to them) could have more security; fewer people could experience homelessness; and subsidies could do more for the people who receive them, and for their neighbors. This article explains how. The key is thinking about security and externalities in 21st century terms—not in Great Depression terms.

This article analyzes two broad functions that government interventions in the rental housing market can perform: (1) providing a safety net and (2) generating external benefits. Our current policies perform both functions poorly: they move too slowly and too arbitrarily to insure people against most of the risks they face, and are least available precisely when most people need them most; and most of the external benefits they generate are the ones that were important in the first half of the 20th century, not the ones that matter in the first half of the 21st. This article shows how both functions can be performed better.

The perspective in this article is overwhelmingly classical. This article identifies market failures and steps that could correct them. It also identifies failures in current policies. Low-income rental housing markets would have serious problems without significant government involvement, and they can still have serious problems if that involvement is not wise.

A Better Safety Net

How It Works Now

Governments perform a useful function when they provide people with valuable insurance that markets would otherwise fail to provide. The major shocks that affect low-income people today are loss of income, loss of health, and loss of relationships (see O'Flaherty, 2009). Families insure against these risks poorly (Bentolila and Ichino, 2008; Dynarski and Gruber, 1997). Governments insure against income shocks very little (especially for adults not accompanied by children and those who have used up Temporary Assistance for Needy Families eligibility), and insurance against health shocks is far from perfect (especially against income losses that sometimes ensue from health shocks). Neither governments nor private insurers offer much meaningful protection against relationship shocks.

All these shocks indirectly affect housing markets. Low-income people primarily spend money on food, clothing, transportation, and housing; rent is generally the largest single bill they receive in a month. Rent is hard to adjust quickly and relatively easy to borrow against. Gas stations and supermarkets do not let customers leave without paying, but landlords cannot evict tenants costlessly when they miss a payment. Thus, landlords become insurers of last resort.

This ability to borrow against rent has consequences. Landlords are not good insurers, and most lack means to spread risk. So they charge too much for this insurance, they screen tenants too strictly, and they under-insure. (To the extent that landlord-tenant law forces landlords to provide more insurance than they want to, landlords charge even more and screen even more strictly.) Even large landlords with wealthy tenants find acting as an insurance company burdensome; evidence of this unwillingness is the apparent success of Insurent[®], a private rental insurance company in New York City that specializes in large, high-end buildings. Tenant payment problems are correlated with the business cycle and so confront landlords exactly when those landlords face the most severe cashflow problems from vacancies and tight money. Most tenants, moreover, live in apartments owned by small landlords. Structure size and ownership do not correlate perfectly, but only 18 percent of tenants in 2009 lived in structures of 20 or more units (U.S. Census Bureau, 2011).

Current housing subsidy programs do little to mitigate the risks that low-income households face. For households who are already subsidized, rents fall when incomes fall or medical expenses rise, and so this group has good insurance. But lags are often long. Current year's rent is based largely on retrospective income, and reporting takes time. The New York City Housing Authority (NYCHA), for instance, begins gathering retrospective income information 5 months before lease renewal (NYCHA, 2008). And, of course, rents are then fixed for the term of a lease. Thus, by the end of a lease, income many months ago has more impact on current rent than income last month. NYCHA has "emergency procedures," but even these are slow. Rent can be reduced during the term of a lease for a tenant who loses a job, but only after 13 weeks.

But most low-income households are not subsidized, and the connection between their misfortunes and any housing assistance they get is approximately zero. Only if a shock lasts the very long time needed to get to the top of the relevant queue does the shock bring housing assistance, and only if the household was foresighted enough to apply early (and does not contain someone with a criminal record).

Indeed, households are least likely to get housing assistance when they are most likely to need it. A household is most likely to need help when a recession hits—either nationally or just locally. But that is when queues are most likely to be longest and help least likely to be forthcoming. (Queues in recessions are likely to be long both because many people need help and because few assisted households are moving up and making way for others. See Ambrose [2005], Hungerford [1996], and Olsen et al. [2005].)

Homeless shelters are probably the most effective safety net in the housing market now, and in locations with a rich array of shelters or a right-to-housing, they may perform this function well. But they are expensive and often demeaning. Like hospital emergency rooms, shelters are necessary but they are not a good substitute for a sound social insurance system.

What To Do

Many economists (for example, Olsen, 2008) have argued for a needs-based housing assistance entitlement program, and on many grounds such a program would be a huge improvement over the current set-up. An entitlement program could also offer much better insurance since households in distress would not have to queue for assistance, and funding would automatically expand in recessions so that access would not become harder.

Entitlement programs have several drawbacks, however. Bureaucratically, they would be ill equipped to deal with volatile income, health, and relationships, although perhaps good information technology and careful design could create a nimble and fast system. Current rationed housing assistance programs have small work disincentive effects (Ludwig and Jacob, 2008; Olsen et al., 2005; Shroder, 2002; Susin, 2005; Tatian and Snow, 2005), but if program entrance were more closely tied to income, these effects might be larger. Current programs probably have significant sharing-disincentive effects (Ellen and O'Flaherty, 2007; Sinai and Waldfogel, 2005), and an entitlement program would have these effects, too, unless it were restructured to be sharing neutral.¹ And entitlement programs could be expensive (although Olsen [2008] showed some controversial ways that their costs could be considerably reduced, but does not require sharing-neutrality, which any sensible program would have).

Rental Insurance Basics

The most straightforward way to provide insurance is to provide insurance, and it is likely to be the cheapest way too. The federal government already insures mortgages through the U.S. Department of Veterans Affairs (VA) and the Federal Housing Agency (FHA), and mortgage-backed securities through the government-sponsored enterprises (GSEs) (although this last role may not be continuing). Under some circumstances, this insurance costs the government nothing, although, of course, those are not the circumstances that obtain now. Rental insurance markets might be a good way to reduce risks in this market.

¹ Programs have sharing disincentives when they give larger per person subsidies to smaller households. Almost all existing HUD programs have sharing disincentives. Programs are sharing neutral when the size of the subsidy is not affected by the number of adults one shares housing with. See He, O'Flaherty, and Rosenheck (2010) for a discussion of possible reasons for sharing disincentives and evidence that these reasons are not supported empirically.

The basic idea is that a tenant pays a small insurance premium when she leases an apartment. If some predetermined event like a job loss, divorce, or major illness occurs during the term of the lease and makes it impossible for her to keep up with the rent, the insurance kicks in and pays the landlord a fixed amount (say \$500) for a fixed number of months (say 6 months). After the tenant stabilizes her life, the government might seek some repayment, but probably not full repayment. As mentioned, at least one private profit-making company, Insurent in New York, sells rental insurance now, and so the concept is not totally infeasible.

What are the benefits of such insurance? Landlords could relax their screening criteria, require smaller deposits, and charge lower rents; all tenants would benefit. Tenants who encountered setbacks would have breathing room to resolve their problems, or to reduce their consumption deliberately. Social agencies and homelessness prevention services could receive informative advance warnings and possibly target their activities better. Children might not have to move so often, and the length of assistance could even be targeted to the school year. Shelters would see fewer families who were temporarily down on their luck.

This rental insurance program would not insure against rapid rises in the market price of rental housing. The moral hazard problems would be too great. Fortunately, rent shocks do not appear to be a major risk that poor people face or a major direct precursor to homelessness (O'Flaherty, 2009).

Why Not Just Make Other Safety-Net Programs Better?

Is rental insurance just a weak and politically expedient substitute for a more generous social insurance system, one with larger cash payments and more sensitive triggers? No. Two sets of market failures make rental insurance desirable in itself.

The first and probably most important market failures are the external costs of homelessness and of instability for children whose parents do not fully internalize their academic progress. Because of these external costs, the government has an interest in maintaining a tenancy even when a household head would prefer to use the same amount of money for some other purpose, even *ex ante*.

The second market failure is the inability to write enforceable contracts promising the payment of rent. Partly this inability arises from state landlord-tenant codes that make instantaneous eviction impossible; but even without these codes, few landlords would evict all tenants who were a few days late on the rent and promised to pay next week. Because such contracts are not available, some Pareto-improving tenancies never occur. (An equivalent insurance contract would compensate landlords for tenant delinquencies. This contract also appears to be unavailable.)

Some might argue that tenancies can be long-term relationships with flexible prices, and so all mutually beneficial insurance arrangements can be worked out over time. But tenancies can become long-term only if they are allowed to become so, and all tenancies start short. Hubert (1995) and Miceli and Sirmans (1999) showed that serious adverse selection problems prevent first-best contracts from being negotiated in tenancies that have a chance of becoming long-term, essentially because incentive-compatibility constraints need to be satisfied. Benjamin, Lusht, and Shilling (1998) estimated that tenants who are liquidity constrained and cannot make security deposits borrow effectively from landlords at an annual interest rate of around 30 percent.

More deeply, the people who are going to lose their jobs or get sick are going to do these things no matter where they live (to a first approximation). Some landlord is going to have to bear this cost. The time and energy that landlords devote to screening for this possibility is pure waste from a social perspective, since the only goal is to make some other landlord bear this cost instead of themselves. It is just a game of hot potato. Similarly, the distorting contract menus designed to combat adverse selection create obvious deadweight social losses, but are useful only for playing hot potato. Whether they combat adverse selection well or not is irrelevant, as long as they are costly.

In this sense, by making landlords less concerned with where people are living when adverse events occur, rental insurance can promote efficiency. A formal analysis of this issue has not been done yet, and would be helpful.

On the other hand, rental insurance might work against efficiency by decreasing geographic mobility—“locking in” people to the wrong locations when, for instance, jobs have shifted elsewhere. These efficiency costs, however, may not be large, since rental insurance payments would probably last less than 6 months, and migration decisions often take longer than that.

Why Can't Private Firms Provide This Insurance?

Maybe they can, but because of the external costs of homelessness and instability, they would have to be subsidized.

Rental insurance markets, however, are likely to suffer from adverse selection. Prospective tenants are likely to have private information about their health and employment situation, and so may small landlords. Landlords also have private information about the channels through which they recruit tenants.

Subsidies offset adverse selection, and a private subsidized insurance scheme might be viable. But it might be better for HUD to start a program with a large, mainly involuntary base built in. For instance, apartment buildings and multifamily homes with FHA or GSE backing might be required to purchase such insurance. The history of mortgage insurance shows that sometimes the government needs to get a market started.

What About Moral Hazard?

Like every other kind of insurance, rental insurance will cause some moral hazard problems. Designing intelligently can reduce the size of these problems when they occur.

On the landlord side, the obvious behavioral response to rental insurance is to loosen screening standards. This loosening may be desirable, in part to reduce homelessness. Nor is it obvious that markets produce optimal screening standards. Screening by landlord A affects the pool of prospective tenants that landlord B sees, and hence the standards that landlord B finds it optimal to adopt. So the social costs of moral hazard on the landlord side may not be particularly big.

On the tenant side, several behavioral responses may occur. Tenants may seek higher quality and higher rent apartments because they have less to fear if something goes wrong; they may also seek riskier jobs because they have less to fear if the job falls through. The social costs of these behavioral changes may not be large. On the other hand, tenants may work less diligently at their jobs

or take less good care of their health. This behavioral response is a real concern, but the amounts involved are modest and the clawback provisions can be adjusted to offset this behavior.

Fraud may also occur, of course. Landlords, for instance, could invent fictitious tenants. A lot needs to be learned about how to run these programs right.

Who Is This For?

Rental insurance is a complement to existing HUD low-income assistance programs, not a substitute for them. These programs have a variety of goals, and this article cannot comment on all of those goals. Unlike these existing programs, however, rental insurance is meant to be an entitlement, and so should be one way of mitigating the unfairness of denying assistance to some households while giving large amounts of assistance to other households that are in no obvious way more deserving.

Because rental insurance is an entitlement, HUD-assisted tenants should be able to purchase it. This new activity would make HUD's current programs work a little better. Currently, the risk of tenant nonpayment is borne by public housing authorities and a multitude of investors and landlords. Many of these are unsophisticated, risk averse, and geographically undiversified; many of them also worry about cash constraints at times of recession. Rental insurance for HUD-assisted tenants shifts some of this risk to the national level, where it can be handled much better. A more efficient allocation of risk should reduce the per-household cost of these programs (including any losses from rental insurance), and allow them to serve a few more households.

Should rich people be eligible for rental insurance, too? Probably they should be: healthy people are eligible to buy medical insurance. Whether tenants need the help depends on their current circumstances, not their past circumstances, and eligibility rules have to be based on past circumstances. But if federally sponsored insurance is losing money and rich people are heavily involved, the subsidy should be reduced so that private companies can enter the market. The danger in operating a program without explicit income guidelines is that it might be relatively more attractive to rich people than poor. If this were to happen, the program parameters could be adjusted in cost-neutral ways to make it more attractive to poor people and relatively less attractive to rich—for instance, by reducing upfront premiums and raising clawback percentages.

Of course, rental insurance is not ready for wide-scale adoption yet. To learn about how it works, starting with specific groups defined by hard-to-change characteristics would be informative and probably productive. For instance, young adults aging out of foster care and returning veterans are two groups that often have trouble finding and keeping apartments. Rental insurance could open doors for them with landlords who might otherwise fear rent delinquencies, and provide social agencies with early warning signs of trouble.

Summary

Designing a practical rental insurance program is tough. Many parameters and details must be chosen carefully and consistently. For many questions, experience will have to be the only guide. Some relevant experience is available to draw on: Insurent, the VA's mortgage insurance program, and the emergency payment systems that some social service agencies run all have some similarities to rental insurance. But real experience can be acquired only through real experiments.

Better Neighbors

The basic low-income housing subsidy programs were designed many years ago to address the problems that bothered people then. Structural conditions seem to have been the major concern. If people lived in homes that were too small, or too drafty, or without enough sunlight, or without proper water and sewer connections, they and their children would not be healthy, physically or morally. Their ill health would spread by contagion and crime. So the entire society would gain by improving the structural conditions of the housing of the poor. Thus, public housing in the 1930s and even Housing Choice Vouchers (HCVs) in the 1970s contained strict rules about structural characteristics but almost no rules about location.

Times have changed. Structural quality of unsubsidized housing stock has improved tremendously, especially at the bottom of the distribution. The rest of the nation has become more concerned about how well low-income children read, and less about whether they have tuberculosis. The general public worries about diabetes and fast food outlets, not polio and poor ventilation. Crime remains a great concern, but the causes are seen less as inadequate sunlight and more as inadequate role models.

The externalities, in other words, now come more from location and less from structure. A complete study of subsidized housing location externalities in this sense has never been done, and may be impossible to do. However, something is known about some of the relevant parameters.

This section looks at how housing location affects what kind of citizens residents are or become—the traditional focus of housing policy (especially ownership policy). Health, jobs, and education will be the focus in this section. The third section briefly considers two other possible externalities of subsidized housing: how it affects the value of neighboring properties, and how tenant selection affects the cost of other public programs. The final section is about crime, which brings all of these issues together.

This article concentrates on very specific, measurable externalities. Broad questions like whether subsidized housing should be in wealthy neighborhoods or minority neighborhoods will not be addressed. An enormous amount has been written on these questions, yet no consensus on the answers exists. Consensus exists, however, on more direct issues like carbon monoxide, particulate matter, bad schools, and long commutes; and we can put rough numbers on these costs. This article will concentrate on these areas because the science is pretty well known. It is easier to think about trees than to think about forests.

Health

Basic Empirical Results

Recent empirical work in health economics establishes a few fairly strong links from location to health. Currie, Neidell, and Schmieder (2009); Currie et al. (forthcoming a); and Currie and Walker (forthcoming) found that higher carbon monoxide levels induce greater school absenteeism and poor infant health outcomes, even at low levels. Living close to traffic congestion is bad for kids. There is also substantial evidence that particulate matter is harmful. (These dangers seem to

be quite localized, with impacts measured in hundreds of feet; census tracts are too coarse.) Currie et al. (forthcoming b) found that children with more access to fast-food restaurants were more obese.

Exogenous Nuisances

First, suppose that the location and intensity of noxious sites are fixed and exogenous. Then the role of housing policy is to discourage people from living near them. (The next section examines the more realistic case of endogenous nuisances.)

In a perfectly functioning private housing market, fixed noxious sites would be no problem. Housing consumers, realizing that living near these sites was harmful, would lower their bid-rent by the full amount of the damage. No houses would be built near the noxious sites if the lowered bid-rent were not enough to pay for structure and to bid the land away from nonresidential uses. If houses were built, the residents would be compensated for the harm by lower rents, and the landowner would bear the damage cost.

Subsidized housing as it is now run short-circuits this adjustment. To a large extent, the rent that a landlord receives is independent of the attractiveness of the location.² This holds whether the landlord is a public housing authority (PHA) or a private landlord with HCV tenants. Everything else being equal, the absence of location in the subsidy formula is an incentive to place subsidized tenants in the worst possible locations. For supply-side projects, this is because land is cheapest (hence forgone property taxes are the least) in those locations. For HCV tenants, this is because the opportunity cost of renting to a subsidized tenant is least there. Thus, we expect current assistance programs to do worse than the market would in promoting tenant health, not better.

But even doing as well as the market does is not good enough. Tenants do not pay the full cost of poor health, and parents do not fully internalize the health of their children (especially in the long run). Tenants may also not be aware of the best current research. The argument for subsidized housing can only be that it does a better job than the market.

(That is why the many exceptions to the picture of complete independence of rent from location amenities do not change the basic picture. Landlords of HCV tenants with rents above Fair Market Rent [FMR] receive the full value of any change in bid rent at the margin, and so will locate away from nuisances, at least those that are smaller than the difference between actual rent and FMR. Developers planning developments that include both market-rate units and subsidized units like HOPE VI will bear the cost of nuisances to the extent that part of the project is unsubsidized at the margin, but they will bear only a fraction of the true cost.)

Can current housing assistance programs be revamped so that they do the job they should be doing? The answer is yes and the strategy is obvious: make the federal subsidy depend on how healthy the location is. For most programs, the subsidy should decrease dollar-for-dollar with the increase in the total cost of health-related problems associated with the site. For instance, the penalty per housing unit for a project located near a congested highway should equal the sum of private health costs the tenants will bear because of their exposure to the highway (their willingness to pay to

² To be fair, HUD also requires that housing authorities determine that units rented by families assisted under the HCV Program have rents that are "reasonable" in comparison with similar unassisted units in the market area. So, landlords cannot automatically charge the fair market rent for all units.

be free of the morbidity and enhanced mortality associated with the pollution) plus the medical costs that third parties and governments will bear. The same penalty is relevant for HCVs where the tenant is not paying anything on the margin. For HCVs where the rent is greater than FMR, the landlord is already bearing some of the health costs; the penalty should equal only the external costs in this situation (although “external” may, for instance, include most of children’s costs).

Notice that nothing in this proposal necessarily raises or lowers aggregate subsidies. HUD can either penalize unhealthy locations, reward healthy locations, or do a combination of both. Some combination will be expenditure-neutral. In some ways, this proposal just asks HUD to calculate FMRs in a way that recognizes location, not just structure: the FMR for an apartment in a lousy location is not the same as the FMR for an apartment in a great location, and HUD should recognize this.

This basic proposal does not specify whether changes in subsidy should manifest themselves as changes in payments to landlords or changes in rents paid by tenants. As further complications are introduced, this issue will be resolved.

One may also ask whether this problem would be better addressed by rules than monetary payments. HUD uses rules to establish minimum structural standards, which every subsidized housing unit must meet; why not use minimum location standards too? There are many interesting economic arguments around this question in general, but in this case the advice of practicality is pretty direct. A very large fraction of currently assisted housing would probably fail any minimum location standards that HUD could with good conscience promulgate. Rather than mandate healthy living, this proposal “nudges” tenants and landlords toward it.

Endogenous Nuisances

The previous argument treats the locations of noxious activities as fixed. The locations are not fixed, and efficiency may require that the noxious activities move or lower the intensity of their operations. Nuisance corrections in housing assistance formulas make these efficient outcomes more likely.

Consider first a Coasian world. The Coase theorem implies an efficient outcome if the parties can bargain costlessly. Efficiency still fails in the current system because children and third-party payers of medical costs are affected parties who are unlikely to take part in any bargaining with the nuisance source. Nuisance corrections in this sense set the table properly for Coasian bargaining.

Transactions-cost reasoning also implies that nuisance corrections should affect landlord payments, not tenant rents. If the landlord internalizes all the nuisance costs that the tenants (and others) bear, she becomes the proper person to negotiate with the nuisance source; the free-rider problem is mitigated or eliminated.

Much of this Coasian reasoning carries over into a world where nuisances are regulated by state and local governments, not by Coasian bargains. A landlord who has internalized the nuisance externality has good reason to lobby for stricter regulation of the nuisance, since she will gain from any mitigation. Big landlords and PHAs often lobby well.

(An alternative approach would be for HUD to tax nuisances near subsidized housing. Efficiency would be achieved if nuisance sources could pay subsidized housing decisionmakers not to locate near them. Such a system would probably be legally and administratively unworkable.)

Tenants Without Subsidies

Imposing a system of nuisance corrections will have three possible outcomes for any apartment that is now subsidized.

The first outcome is that it continues to be subsidized. In that case, no efficiency is gained, unless the nuisance is abated, since the physical fact of harm will continue.

The second outcome is that the apartment ceases to be subsidized, but continues to be a residence. In that case, there is no efficiency gain either; only the name of the household being harmed is changed. But the landlord bears the private cost of the nuisance in lower rent, and so has a greater incentive to bargain or lobby for abatement than a subsidized landlord under the current system does (although not as great as a subsidized landlord in the improved system would have).

Finally, nuisance corrections may cause the site to be abandoned for residential use; it might become a parking lot or a warehouse. This is clearly an efficiency gain if the nuisance is large and cannot be abated; it cuts exposure.

Thus, under any outcome there is potential for efficiency gains. The fact that under some circumstances nuisance corrections will only change the name of the household getting sick does not vitiate the scheme's utility. Over time, moreover, the efficiency effects are likely to grow: for instance, as stores or single-family houses are built where multifamily subsidized housing might have been built.

Equity

Are there equity impacts as well as efficiency impacts? Definitely, but they depend on many important details of how the programs are implemented and how the market responds.

If the nuisance is abated, there are likely to be equity gains as well as efficiency gains. The people the nuisance would have been harming are low-income, and those who bear the ultimate cost of abatement are probably not all low-income. In many cases, moreover, the nuisances are local public bads, and so their abatement may benefit unsubsidized households as well as subsidized, at least until rents adjust. If the nuisance is not abated, but the area it affects becomes a parking lot or warehouse, the equity implications are similar.

If the nuisance is not abated and subsidized tenants continue living next to it, there is little equity impact. Taxpayers gain and the landlord loses if the subsidy goes down.

The case where the nuisance is not abated and unsubsidized tenants replace the subsidized tenants is slightly more complicated. The equity implications depend on how the subsidies account for externalities—whether the reform punishes unhealthy locations relative to the status quo, or rewards healthy locations. If the reform raises average subsidies by rewarding more than punishing, then the gap in well-being between subsidized and unsubsidized tenants widens—a result that is probably undesirable from an equity viewpoint—and landlords gain at the expense of taxpayers. If the reform punishes bad locations instead of rewarding good ones, on average, the result is the opposite, generally. This is what you would expect intuitively.

How does this work out on the ground? Consider a reform that only rewards good locations. The subsidized tenant moves to a healthier apartment because the new apartment's landlord is now willing to accept the larger subsidy HUD is offering. The nonrecipient who would otherwise be renting that apartment is worse off, and possibly less healthy, too. The landlord of the new apartment is better off. Some nonrecipient ends up in the old apartment, but it is not known whether that nonrecipient is healthier or not, since it is not known where that household would have been living otherwise. So in this case, the gap between recipients and nonrecipients widens.

In the other case, when the reform punishes bad locations, the subsidized tenant leaves an unhealthy apartment because the landlord can get more from an unsubsidized tenant than from the subsidy. The new unsubsidized tenant is no worse off than she would have been in the absence of the reform, and probably is better off, because she moved willingly from her old apartment, even though she may be less healthy. The subsidized tenant is living somewhere else and is probably healthier, but it is not known whether she is better off or not. In this case, the gap in well-being between low-income recipients and nonrecipients does not necessarily widen, and nonrecipients become better off. Existing subsidized landlords lose.

Job Access and Commuting Cost

The arguments about job access and commuting cost are similar to the arguments about health and need not be repeated. In the private market, apartments with better job access and lower commuting costs command higher rents, and so land prices absorb these advantages. Subsidized landlords realize no such premium, at least in the short run, and so have little incentive to choose locations that are near jobs or more convenient commuting. HUD is likely to do worse than the market.³

The solution is for HUD to pay greater subsidies for apartments with better job access (calculations very similar to those involved in such subsidies can be found in Fisher, Pollakowski, and Zabel [2009]). Note that HUD should compensate for external benefits of job access, too, such as increased taxes, reduced commuting, better role models for others, and psychological well-being (Phelps, 1997).

Education

To the extent that educational quality depends only on school inputs, observed or unobserved, the same logic applies to health and job access. HUD should pay landlords more for apartments near great schools, less for apartments near lousy schools, and the correction should be greater than the premium that the private land market reflects, because education produces considerable external benefits. PHAs and landlords under such a system would become active advocates for better schools. (They have little or no stake in good schools now, and so school districts with large amounts of subsidized housing do not feel the same sort of economic pressure to perform well that other school districts feel.)

³ Private owners of subsidized rental housing typically retain a right to convert their development to market-rate housing after the subsidy expires.

Education, however, is more complicated than health or jobs. Peers may matter, not just school inputs, for both cognitive and noncognitive outputs. Yet the U.S. Department of Education seems dedicated to developing measures of school quality, independent of student body composition, and so HUD can use their conclusions. It is important for this program that the measures of school quality be independent of student body composition. The purpose is not to induce the children of subsidized tenants to run away from other low-income children.

The interesting question in this case is whether the subsidy should depend on what the inhabitants of the apartment do. Should a PHA be rewarded for locating senior housing in a great school district, or be penalized for lousy neighborhood schools if most resident kids go to good charter schools? Since the goal is to spur education, not to imitate the land market, the penalty or reward should depend on the actual children and the actual schools. This promotes efficiency. A PHA, for instance, faced with poor neighborhood schools will decide for itself whether to try to improve these schools or give its residents incentives to send their kids elsewhere. Buildings closest to the worst schools will end up being predominantly for seniors, as they should be.

Other Kinds of Externalities

Effects on Neighbors

Subsidized housing affects the value of surrounding properties. John Quigley reviews the literature that examines this phenomenon. To the extent that the external benefits are the same across locations, they are an argument for subsidized housing per se, not for any changes in formula. But if the external benefits differ in different settings, then HUD subsidies to landlords should reward settings that are more beneficial to neighbors.

These externalities interact with those previously discussed. If PHAs or subsidized landlords become advocates for cleaner air, more frequent bus service, and better schools, the neighbors will gain too. Subsidized housing tenants may also gain if neighboring properties are more valuable—for instance, they may be less likely to be rented to fast-food outlets or to be taken over by drug-dealers. This is only speculation, however.

Tenant Selection

Who receives subsidies can also affect what taxpayers are asked to cover for other programs and how other citizens experience the world. The big issue here is homelessness. A tenancy that reduces homelessness is more valuable than one that does not, *ceteris paribus*. Since homelessness is intrinsically hard to predict and because existing tenant selection processes are formalized, basing payments on probability of homelessness is not likely to be a good idea. But practices that alter the mix of tenants in the direction of high-homeless-probability people should be encouraged. The best predictor of future homelessness is current homelessness, and so landlords and PHAs should be encouraged to select tenants from shelters and streets (through programs like Housing First). They should also be encouraged to serve more single nonelderly adults, since most homeless people are single non-elderly adults (another reason why tenant-subsidy formulas should be sharing-neutral). Current income may not be terribly accurate as a predictor.

Crime and Safety

Concerns about crime and safety have dominated discussion of subsidized housing during the last two decades. This article begins with the easy issues and progresses to the harder ones.

Long-Run Criminogenic Influences

The traditional concern in housing discussions has been how the circumstances under which children grow up affect their propensity to commit index crimes in adolescence and adulthood.

The strongest result on this score is that exposure to lead in childhood is very bad (Reyes, 2007) (for reasons of education as well as crime). Children can be exposed to lead in paint and lead in the atmosphere. HUD guidelines that prohibit leaded paint—a structural issue—are thus a major crime-fighting tool. Since leaded gasoline was phased out in the 1980s, the author is unaware of how atmospheric lead concentrations vary. It would be good to know this. Treating atmospheric lead as a nuisance in the ways described in the section on health could thus cause a long-run reduction in crime, if there still are meaningful differences in atmospheric lead concentration.

Another strong result is that education reduces future crime (Lochner, 2010; Lochner and Moretti, 2004). The steps outlined in the section on education therefore reduce crime.

Aside from these two results, there are no other strong results about childhood experiences that cause future criminality. In particular, nothing about architecture, poverty concentration, or public housing seems to make kids grow up to be criminals.

Thus, to reduce long-run criminality, HUD should continue to be vigilant about structural lead paint, penalize atmospheric lead, and reward good schools in the ways that have been discussed.

Short-Run Criminogenic Influences

Other neighborhood features may increase or decrease the total volume of crime more immediately. Landlords should be rewarded for locating in neighborhoods that have good features, and penalized for locating in neighborhoods that have bad features.

Unfortunately, not a lot is known about what these good and bad neighborhood features are. Numerous papers report an association between liquor stores and bars on the one hand and crime on the other, and many assume that churches help to reduce crime. Yet, no hard evidence exists demonstrating that these property uses actually shape levels of crime. (Gyimah-Brempong (2006) tried to connect liquor stores and crime but did not have a convincing identification strategy.) Wilson and Kelling (1982) argued that visible disorder in a neighborhood (for example, broken windows) encourages crime, but this hypothesis has not fared well empirically (Fagan and Davies, 2000; Harcourt and Ludwig, 2006). DiTella and Schargrodsky (2004) showed that police patrol reduces crime in a natural experiment. But police patrol levels are usually correlated with unobserved features that increase crime—police patrol more in dangerous neighborhoods—and so it makes little sense to reward landlords in neighborhoods with greater police presence.

Dahl and Della Vigna (2009), however, found that violent movies tend to incapacitate violent people while they watch them, and that these people do not compensate fully for the period of

incapacitation after the movies. Perhaps landlords should be rewarded for locating near theaters that show violent movies.

In general, incentives should be based on evidence, not speculation. Hence, only violent movies should even be considered at this point as a short-run criminogenic influence.

Short-Run Neighborhood Effects

“Not in my backyard” (NIMBY) fits in this section. People who live in subsidized housing may tend to commit more crimes than wealthier Americans, and so their unsubsidized neighbors may be upset about their presence. Perhaps victimizing neighbors may be an external cost of subsidized housing that should be internalized.

This reasoning, however, is incomplete. Suppose that some subsidized tenants have a high propensity to commit index crimes against their neighbors. Moving them from neighborhood A to neighborhood B hurts the people in neighborhood B, but helps the people in neighborhood A. To the extent that the location of subsidized housing affects merely the location of crime, not its volume or severity, it should be of minimal social concern (although it could affect proper allocation of police resources). (An analogy is domestic violence: to a first approximation at least, where a family is living when a domestic violence incident occurs is of no concern.)

It is possible to offer various hypotheses about the type of neighborhoods where crime should be highest, but there is little empirical evidence about the causal influence of neighborhood conditions. For instance, bringing low-income people into a rich neighborhood might increase burglary because there is more to steal, but it might decrease motor vehicle theft because cars are more likely to be in garages at night. White neighborhoods might encourage robbery because evidence suggests that White people are less likely to resist, but research finds that Black people tend to carry more cash, making them potentially more attractive targets (O'Flaherty and Sethi, 2008). Dense neighborhoods present more criminals with more targets but also confront them with more potential witnesses.

The Moving to Opportunity (MTO) experiment sheds some light on this issue, but not much. Young men who moved to richer neighborhoods committed a few more crimes than those who stayed in lower income neighborhoods, and this evidence suggests that richer neighborhoods are relatively criminogenic in the short run. But the net change in crime in either set of neighborhoods is not known (the extent to which crimes committed by MTO teens would have been committed by someone else if the MTO teens were not around). Nor does MTO tell us much about older potential criminals.

Until more research is done, then, it seems best to consider criminal effects on neighbors as essentially a wash in social terms.

Index Crime Between Tenants

The same conclusion applies to index crimes between tenants. If some prospective tenants are likely to commit crimes against their neighbors, it does not matter who their prospective victims are: HUD has no stake in deciding who the victims are. (Indeed, fairness suggests that

if HUD should protect someone, it is those low-income people who are not lucky enough to receive subsidies; hence, HUD should not be eager to encourage potential criminals to move into neighborhoods with the unlucky low-income people who do not get subsidies, as seems to be the consequence of the “one-strike” policy, for instance.)

Street Vice

Street vice means illegal commercial transactions involving a willing seller and a willing buyer, where the seller deals with many buyers, but has ongoing relationships with few of them, and where buyer and seller must come together in close physical proximity (O’Flaherty and Sethi, 2010). Open-air, anonymous drug selling is the variety of street vice that receives the most attention, and presents special issues for HUD.

Street vice is a business (and almost certainly a business smaller than clandestine, relationship-based drug-selling) that locates where it is most profitable to locate.⁴ O’Flaherty and Sethi (2010) set out several reasons why street vice tends to be concentrated in African-American neighborhoods, even though drug demand is not concentrated in these neighborhoods.

Within any neighborhood, the best locations for street vice depend on physical features that have not been studied—perhaps easy access to highways or clear sightlines in many directions, for instance. Hence, in many neighborhoods, HUD-assisted housing, particularly public housing, may be among the best locations for street vice. It would be good to know this for sure.

Some clear solutions to this problem would be legalizing most currently illicit drugs or subsidizing the development of good substitutes. Such a program, however, is not within HUD’s purview.

This situation presents two kinds of problems for HUD.

One problem is how to reduce street vice in developments that have not been built yet. Obviously, research needs to be done on the structural and locational correlates of street vice. Future developments should be designed with these in mind.

To some extent, of course, better architecture will just shift street vice to less lucrative locations; if that were the case, the investment in architecture would be misdirected. As long as the supply of street vice sites is not perfectly elastic, however, there will be real effects. While the elasticity of demand for illicit drugs is low, it is not zero, and the elasticity of demand for anonymously purchased illicit drugs is almost certainly higher than the overall elasticity of demand (Becker, Murphy, and Grossman, 2006). Hence, making HUD’s buildings less attractive places for street vice may not just dump the externalities on someone else. (Clandestine drug sales have considerably lower external costs than anonymous sales.) Moreover, to the extent that HUD-assisted developments are more densely populated than other neighborhoods where street vice might locate in the same city, moving street vice away from these developments reduces the external costs that street vice produces, even if the total volume does not change.

Buildings that have already been built present a different issue. Street vice is a neighborhood blight just like air pollution, and so the basic response should be to reduce landlord subsidies when

⁴ For estimates on the relative size of the clandestine drug market, see O’Flaherty and Sethi (2010).

street vice is occurring nearby. The difficulty with this approach is measurement: people cannot be rewarded or punished for something that is not credibly and verifiably measured. Arrests, for instance, are evidence of action being taken against drug-selling, not of street vice or even drug-selling. HUD, however, could employ testers to try on a random basis to buy drugs anonymously in or near assisted housing, or subsidize local police departments to do so. Testing programs might create big risks for landlords if they sampled too little, and would be very expensive if they sampled too much; the definition of “near” would also produce other tradeoffs. But sampling programs are a straightforward attempt to provide the right incentives, and so some decent tradeoff might be found.

Maybe a better measurement strategy would be to look at reported violent outdoor index crime (excluding rape and domestic violence) and shootings in the vicinity of HUD-assisted housing. This is actually measured, and may be closer to the thing that should be measured. The external costs of street vice are the problem, not street vice itself, and so landlords should have incentives to minimize these costs. (As technology becomes cheaper, HUD might want to install shot-monitoring devices on all assisted housing; this could serve deterrence as well as incentive purposes.)

One-Strike Rules

Direct incentives like these are likely to be more effective than one-strike rules because they address the real problem—index crime and street vice near HUD-assisted housing—rather than some variant—index crime and street vice by HUD-assisted tenants. No known serious empirical evaluation of one-strike rules has ever been attempted, and theory suggests that their effectiveness is probably tiny.

To understand the theory, consider this scenario. Suppose that Congress were dominated by vegetarians who had not studied basic economics. To discourage meat-eating, they order periodic surprise raids on McDonald's restaurants. In these raids, they detain all the employees. Any HUD-assisted tenants among the employees are evicted immediately; other employees are blacklisted so they may never receive HUD assistance in the future.

What does this policy do? It raises the price of hamburgers a little bit and raises the wage of McDonald's employees, but many substitutes for HUD tenants and aspiring tenants are available, and so the effect is not large. Most importantly, it does not substantially change the locations that McDonald's chooses for its restaurants. If McDonald's found it profitable to put a restaurant near or inside a HUD-assisted project before the vegetarians took over, it would almost certainly continue to find it profitable.

Since it appears that labor is supplied to street vice pretty elastically (Reuter, MacCoun, and Murphy, 1990), the drug-selling one-strike rule should have the same effect on street vice locations—approximately nothing. That is why a serious empirical evaluation would be helpful. (Essentially, the question is whether the elasticity of land supply to anonymous drug-selling is less than the elasticity of labor supply to anonymous drug-selling.)

The current one-strike rule, moreover, imposes real costs on tenants and prospective tenants—breaking up families, for instance. Treating young single adult minority males as pariahs contributes to many social problems that have large external costs—homelessness and homicide, for instance. In thinking about the role of subsidized housing in the larger society, HUD may want to move toward a more goal-oriented and less soundbite-oriented policy. Landlords in a goal-oriented regime may very well bar felons in many cases, but they would be doing so for real reasons.

Conclusion

Not all these goals need to be accomplished immediately. Just remember that a safety net today is different from a safety net in the 1930s, and externalities today are different too. All the rest follows.

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