

Edward Dodson Manager, Fannie Mae (retired)

Mr. Dodson worked at Fannie Mae for many years promoting affordable housing, but the market eliminated two units for every unit they helped create. The basic problem of affordability stems from high land prices, which result from wealth interests holding land out of use in expectation of higher future prices. Today even a two-income household has more difficulty buying a new house than a single-income household did a couple of generations ago. The best way to hold in check the speculative rise of land prices is to adopt a land-only property tax.



Experience at Fannie Mae

I spent most of my professional life working in the area of affordable housing. From 1984 to 2004, I worked at Fannie Mae, the largest mortgage investment firm in the US. It started out as a government agency, but then was privatized at the end of the Lyndon Johnson administration. As a private company, its stock is sold on the stock market. It buys mortgage loans from US banks and mortgage banking firms.

Within Fannie Mae, the mission included expanding home ownership by providing financing to households that could not afford to buy a home. I was part of a team that worked on private-public partnerships to finance first-time homebuyers, low-income individuals, and single heads of households. We were collectively putting our finger in the dike, because the market was moving against our objectives. For every person we managed to put into decent housing, two units of housing stock would become unlivable.

Affordable Housing Criteria

The supply of affordable housing today is inadequate. The rising cost of land and construction makes housing subsidies increasingly costly for government and private foundations. The average family is priced out of the market. People are doubling up with relatives. Those who become unemployed, get divorced, or become ill may find themselves homeless, a problem that is related to the dysfunctional land market.

In the early 1980s, I was involved in projects in places like Harlem and the Bronx in New York. Affordable housing eligibility requirements were tailored to local conditions. Working families making \$75,000 a year (165% of the area-median income) still needed to be subsidized to get into

a starter home, even for homes on free land, which was donated by the city.*

When I started my career in banking and affordable housing, the land cost component of an average home was probably about 15 percent. So if you paid \$15,000 for a house, 15 percent of that was the land cost component. Now an average new home might have a land cost component of 40 to 50 percent. As a result, perfectly good housing is being torn down and replaced by "McMansions." When land costs \$200,000 for a quarter-acre lot, a developer can make a profit only by building a house that sells for four times that amount. That is why so many new homes cost \$800,000. How many working families can afford a 30-year mortgage on that? So, low-income families are doubling up. Even young professionals are having to do that. A few years ago, half of the college graduates under the age of thirty were living with their parents.

Role of Land in Housing Crisis

The housing crisis is tied to the land market. Few people fully understand how the land market differs from labor or capital markets. When most people stop working, they have no income. They may go into bankruptcy and lose their house. Similarly, business machinery has to be maintained. It depreciates, even if it is left idle. Land is different because it does not depreciate. It can be held indefinitely without being used. Wealthy corporations and individuals can afford to hold land idle for decades, merely by paying the property tax, which is low in most cities. That practice may reduce the effective supply of privately owned land by as much as one-third.

Holding land out of use increases competition for it, and that drives up the price. Companies may relocate their production facilities to China or India to save on land costs and avoid environmental regulations. Because land is in fixed supply, raising the price does not induce an increase in supply. Instead, there are booms and busts in the land market.

Policy analysts and elected officials fail to understand the implications of tax policy on housing. So, we penalize housing construction with heavy taxes on improvements, and give land speculators and landowners a free ride.

Effects of Rising Land Prices on Working Households

Rising land costs are a major cost of doing business. That results in a shift of operations overseas, which causes structural unemployment and

* The city had a large inventory of land that it offered to developers for free, so the cost of housing was tied solely to the costs of construction, labor and materials.

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reduced household incomes. American families now compete for shrinking job opportunities. An increasing percentage of them work intermittently or at multiple jobs.

Because of the rising concentration of wealth, the middle class is disappearing. To get people of limited means into housing has meant stretching eligibility limits. When I started out in the 1970s as a bank officer, loan officers would limit housing payments to 28 percent of gross monthly income, based on one income. The income of wives in married couples was generally disregarded, because it was assumed that most women would not continue working long. Nowadays, if both husband and wife work, even their combined incomes may just be enough to pay for an interest-only mortgage payment, such that the principal is never repaid. They may have to accept an adjustable rate mortgage. In a couple of years, if interest rates rise in credit markets, they may get a shock. Their mortgage payment may increase by a couple of hundred dollars. If their household income has not increased, they may lose their house. A serious economic downturn will cause a tremendous increase in mortgage delinquencies and foreclosures.* Personal bankruptcies are already at record levels, yet economists do not generally seem to think this is a serious problem.†

Solution: A Land-Only Property Tax

The current tax system encourages hoarding of land, which drives up the price. The remedy would be to shift to a land-only property tax to take the speculative value out of holding land. That will enable people to buy land to develop it with a house, a factory, or an office building. That not only creates employment; it also makes the land market more competitive, like the labor market or capital markets. Changing the way we raise public revenue would go a long way toward solving the problem of generational poverty, of boom and bust experiences in our economy. The business cycle is man-made. It is not natural. It is caused by bad public policy based on privilege entrenched in law.

* Ed.: This interview was conducted in September 2006. The S&P/Case-Shiller® Index of house prices peaked in May 2006 and began declining in subsequent months, confirming Dodson's prediction. [http://www2.standardandpoors.com/spf/pdf/index/082906_homeprice.pdf] Foreclosure filings rose 42% in 2006 and 75% in 2007. [<http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=3988&accnt=64847>]. Both websites accessed March 29, 2009.

† Ed.: Mr. Dodson spoke here at length about senior citizens taking cash out of their homes through reverse mortgages as a way to cope with rising prices. Other senior citizens are forced to move from their neighborhoods because of gentrification.