

Subprime Housing Crisis

by Peter Marcuse¹

What is called the “subprime mortgage crisis” reflects a fundamental crisis in the housing system of the United States. Subprime mortgages are mortgages given to borrowers whose incomes or credit ratings or the equity in whose property does not justify a conventional mortgage at the prevailing interest rate on prevailing terms. Instead, subprime mortgages carry a higher interest rate and are seen as having a greater risk of foreclosure for non-payment. The subprime mortgage crisis is not a crisis of liquidity in the mortgage market, or a failure of regulation, nor is it the same as the crisis of Fannie Mae and Freddie Mac, two large government-sponsored corporations active in the secondary mortgage market, which is a different crisis with which the subprime market crisis is often confused. It is rather the result of the inability of the housing market system to provide adequate and affordable housing for large numbers of Americans, and of the ideological commitment implicit in that system to private individual homeownership as the incarnation of the American Dream for the masses.

There has long been a crisis of housing affordable to a large portion of Americans. It was recognized at least as far back as the Housing Act of 1937, whose objective was to provide “adequate housing within their means for all Americans.” That promise was never fulfilled, and the history of United States housing policy is replete with one effort after another to solve the problem preserving the dominance of the private housing market². There is an obvious injustice in the results of such a system —today, there is not a single city in the country in which a full-time worker earning the minimum wage can afford even a 1-bedroom apartment, a situation in which African-Americans, Hispanics, immigrants, and women suffer in grossly disproportionate numbers. As a result grass-roots groups, discontent with that situation, mounted substantial pressures for reform. With only one significant exception, and even that one limited (public housing³) very public program to enlarge the supply of affordable housing has relied on bribing the private housing industry to make its housing more affordable. Those programs have systematically been provided with grossly inadequate funds for that purpose, have never been made a matter of entitlement, and have always been conspicuously inefficient in terms of the amount of subsidy siphoned off as profit by those involved in its private provision.⁴

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² See “The Permanent Housing Crisis: The Failures of Conservatism and the Limitations of Liberalism” with W. Dennis Keating. In: [A Right to Housing Foundation for a New Social Agenda](#) edited by Rachel G. Bratt, Michael E. Stone and Chester Hartman. Philadelphia: Temple University Press, 2006, which traces the successive governmental actions dealing with “the housing crisis,” including the suppressed alternatives that were not put on the policy table.

³ See Marcuse, Peter. 1995. “Interpreting ‘Public Housing’ History” [Journal of Architectural and Planning Research](#). Vol. 12, No. 3, Autumn, pp. 240-258. which recounts the limits placed on that program by the forces of real estate industry and the conservative ideological commitment to the private market.

⁴ The largest current program, the low income housing tax credit, is notoriously inefficient, as even the most mainstream of housing analysts concede; Social Forum. Michael Stegman, xxxx.

Not only have prior governmental efforts in housing been subject to the pressures of the private housing industry⁵, they have also been colored by the ideological belief in home ownership as “The American Dream.”⁶ It is a powerful ideology. It relies in part on the prevalent identification of homeownership with the single family home, and that only through “ownership” can security of tenure be attained, that security being identified with freedom from a landlord’s right to evict. Most buyers accepting this ideology are unaware that there are other forms of tenure that can provide equal rights of occupancy, because “ownership” is in fact a complex bundle of rights,⁷ of which security of occupancy may or may not be provided, as so many of today’s foreclosed home “owners” have become painfully aware.

The protest against inadequate housing was thus met by a program that tried to maintain these two causes of that inadequacy intact: promoting for lower-income households private home ownership, in homes supplied by the private market. The programs had a progressive component: preventing discrimination in housing, including mortgage provision, because of race, and the red-lining of minority neighborhoods.. The Community Reinvestment Act of 1977 resulted, requiring banks to allocate prescribed portions of their mortgage portfolios to such neighborhoods if they accepted deposits from residents in them.. That however meant that banks had to modify their normal definitions of risk (which included neighborhood conditions) to satisfy the act, and in turn meant that in some cases they in fact made more conventionally risky loans.⁸

⁵ Included, as the records of the legislative process clearly indicated, are builders, bankers, mortgage brokers, landlord and property owners, real estate brokers, other financial institutions (more on this later), landlords, and, for different reasons many construction labor unions. See McDoougall, The Wagner Housing Act, for a blow-by-blow account of the early battles around the 1937 Act, Friedman for the post-war battles, and many others; but it is a generally acknowledged story.

⁶ The approach has a long history, going back to the days of Jefferson and Hamilton, Herbert Hoover’s commission on home ownership, FDR’s moratorium on evictions and adoption of Federal mortgage insurance, the Section 235 program, Clinton’s National Homeownership strategy, etc.

⁷ For a detailed discussion of ownership as a bundle of rights, see Marcuse, Peter. 1972. "The Legal Attributes of Home Ownership." Washington, D. C., The Urban Institute, April 13, Working Paper #209-1-1. A discussion of some alternate forms of tenure may be found in Marcuse, Peter. 1996. "Privatization and its Discontents: Property Rights in Land and Housing in Eastern Europe." in Andrusz, Gregory, Michael Harloe and Ivan Szelenyi, eds, Cities After Socialism: Urban and Regional Change and Conflict in Post-Socialist Societies. London: Blackwell, pp. 119-191.

⁸ For a discussion (of the extent to which they actually were forced to make “risky” loans, see Marcuse, Peter. 1979. "The Deceptive Consensus on Redlining," in Journal of the American Planning Association, 45, 4, October.

Fannie Mae and Freddie Mac, government-sponsored private corporations that bundle individual mortgages into packages that are then turned into marketable securities (their dealer or liquidity function). The history of these two corporations is in fact interesting, and too little discussed⁹. Originally Fannie Mae was a governmental corporation, an agency of government, that served the function of packaging private loans and reselling them for a moderate fee to cover possible losses, its “dealer” or liquidity-enhancing function, but it was later pushed to accept also a “special assistance” function, buying below-market-rate interest mortgages from banks and covering the difference between below-market and market rates from its profits on other mortgage packages on other loans. The argument for this was were encouraged to buy loans to low-income households as proof that they were in fact serving a public purpose, and engaged on large-scale advertising programs to market such loan. In 1968, when accounting rules required the risk on all Fannie Mae loans to be shown on the Federal Government’s books as debt, this special assistance function was spun off to a new corporation, the Government National Mortgage Association (GinnieMae), and Fannie Mae was privatized, where the implied but not formal Federal guarantee would be off the books.¹⁰ Formal subsidies were intended to be provided to qualified low-income buyers then only through Ginnie Mae, which then bought below-market-rate mortgages issued under various Federal programs and resold them, often through Fannie Mae, covering the difference between the underlying mortgage rates and the rates Fannie Mae required on the market with Federal subsidies (the Tandem Plan). When it turned out that the packaging-resale process in fact could in fact be self-supporting and Fannie Mae could itself make a profit by buying the packaged loans itself and thus generate a handsome profit for the owners of its own stock.. Thus, when the agency was split into two, GNMA (The Government National Mortgage Agency) was kept as a government self-financing but not profit-making corporation dealing only in government-insured loans, keeping the fees it received for making loans as a reserve against possible defaults, and Fannie Mae became a private profit-making corporation, entitled to siphon off and return to investors any profits it might make.¹¹ Yet Fannie Mae was given an expected if not formalized government guarantee against major losses, exemption from state and local taxes, qualification of its debt as legal investments for federally supervised institutions and exemption from SEC oversight.¹² Thus the profit from mortgage packaging activities was privatized and in part subsidized, and the risk of loss remained ultimately public.

So government policy massively promoted home buying by low-income households: As a result, many homes were in fact provided to families who could not afford them. As long as their price on the market went up, the expectation that the increase in price would be even greater than the discrepancy between current costs and current incomes left everyone happy; as soon as prices stopped increasing, the problems began to mount. And today we have a crisis in multiplying foreclosures of those homes.

⁹ See Patrick H. Hendershott and Kevin E. Villani, “Direct Intervention in the Mortgage Market,” in J. Paul Mitchell, ed. 1985. Federal Housing Policy and Programs, Past and Present. Rutgers: Center for Urban Policy Research, p. 132.

¹⁰ One incentive for the change was the desire to reduce the appaent budget deficit caused by the war in Vietnam, but not showing the full Fannie Mae exposure.

¹¹ Hendershott and Villani comment: “The secondary market facility [FNMA] was made private because it served and benefited private financial nstituins, particularly mortgage bankers. There was no lonng-term need for federal involvement, because the users of the secondary market service have always been willing to pay for the service.” P. 129. For a detailed description of how this system functions, see Roger Starr, 1975. Housing and the Money Market. New ork, Basic Books, chpters 13 and 14.

¹² See Mitchell, supra, p. 131. After scandals in 199- some level of government oversight was however provided.

What underlies this push for expansion of homeownership for lower income households, and the ensuing crisis of foreclosures? Most obviously, everyone in the private housing industry made money on it. Even when the mortgages given could not be repaid, the fees charged and the commissions paid rewarded real estate brokers and mortgage finance companies with generous profits on each transaction. And politicians could happily claim they were helping more and more families achieve the American Dream.¹³

Beneath this crisis lies something deeper. The underlying economic system is built on the drive for the steady accumulation of profit and the necessity of constant growth to provide that profit. That requires a constantly expanding market. Globalization of production and distribution is one answer; the markets in countries like China and India seem a fertile source of new demand. But some industries cannot enter markets abroad. Individual home builders, for instance, are largely confined to the domestic market; only the very largest can operate internationally. And speculative land owners holding property in the United States need to find a profitable use of that land in the United States. As the economic surplus that growth produces increases, the pressure to find new markets increases. Thus, both Lord Keynes and Karl Marx would agree, the pressure to expand markets is constant and pervasive. But, Marx would point out, it is inherent in the system that profits grow by holding down wages, and thus the ability to pay for everything that is produced lags behind the ability to produce it. A surplus is produced that needs to find an outlet for its investment. Letting those needing housing borrow the money to pay for it, since they are not able to pay for it out of wages, is one solution. The development of the subprime housing market is one result: A whole new stratum of home buyers is created, the market for homes is increased dramatically, and as long as prices continue to rise that fact that the increase is based on calls for buying by those that cannot afford to buy is suppressed. Until prices start to fall. Then you have a crisis, as we have today.

¹³ In May of 2007, Bernanke concluded that despite a 14.4% rate of 30-day delinquency rate among subprime loans, the virtues of subprime loans should not be overlooked:

“The expansion of subprime mortgage lending has made homeownership possible for households that in the past might not have qualified for a mortgage and has thereby contributed to the rise in the homeownership rate since the mid-1990s. In 2006, 69 percent of households owned their homes; in 1995, 56 percent did. The increase in homeownership has been broadly based, but minority households and households in lower-income census tracts have recorded some of the largest gains in percentage terms. Not only the new homeowners but also their communities have benefited from these trends. Studies point to various ways in which homeownership helps strengthen neighborhoods. For example, homeowners are more likely than renters to maintain their properties and to participate in civic organizations.” (Bernanke, May 17, 2007)

So what's the solution? There are a number of proposals, some partially incorporated in the Dodd bill already passed, which in effect make it possible to for home "owners" in or near default to extend the term of their mortgages. Other proposals address how new mortgages should be regulated in the future: lenders should be required to tell their prospective borrowers of the lowest-cost mortgages available., they should be forced to disclose all costs and fees up front, there should be more opportunity to evaluate the operation of mortgage markets.¹⁴ They are all worth doing, but they only deal with the fringe of the problem There is a history of stabs at regulation of specific problems, in the Fair Housing Act of 19The Equal Credit Opportunity Act of 1974, the Home Mortgage Disclosure Act of 1975, as well as the broader community Reinvestment Act of 1977.. In the end, deregulation is not the problem; the existence of what needs to be regulated is the problem.

So what is really the problem¹⁵? It is both ideological and economic, and its name is the same in both: The private supply of one of life's necessities through the private market, the provision of housing for profit not for people. In more classical terms, the handling of housing for its exchange value rather than for its use value, the commodification of housing.¹⁶

The ideological problem lies in the belief in the goal of private single-family home "ownership" with the American Dream, visualized as a single-family home on a suburban lot,¹⁷ and the coupling of that belief with the conviction that the private market is the best way to achieve that goal. Underlying the widespread acceptance of the goal are some facts of life in the dominant housing system:

The beliefs on which the "American Dream" is based include:

1. that rental tenure is insecure and always subject to the danger of eviction;
2. that the only alternative to insecure rental is ownership in fee simple;
3. that "ownership" in fee simple guarantees unrestricted use and secure occupancy and ultimately the ability to sell at a profit;
4. that housing prices seem to be steadily rising, and thus occupancy seems secure;
5. that "ownership" should be seen as a way of accumulating assets for households;¹⁸

¹⁴ See, for instance, xxKpmatjam Ss[ader. 2008, "Subprime's Footprine," Shelterforce, summer , #154, p. 38ff..

¹⁵ "The Causes of the Housing Problem", with Emily Paradise Achtenberg, in in Critical Perspectives on Housing, Rachel Bratt, Chester Hartman, and Ann Meyerson, eds., Philadelphia: Temple University Press, 1986, pp. 4-11.

¹⁶ Marcuse, Peter. 1983. "Towards the Decommodification of Housing: A Political Analysis and a Progressive Program," with Emily Achtenberg, in Chester Hartman (ed.), America's Housing Crisis: What is to be done?, Institute for Policy Studies, Routledge & Kegan Paul, Boston; reprinted in Critical Perspectives on Housing, Rachel Bratt, Chester Hartman, and Ann Meyerson, eds., Philadelphia: Temple University Press, 1986.

¹⁷ See "The Ideologies of Ownership and Property Rights," in Housing Form and Public Policy in the United States, Columbia Monographs on Architecture, Preservation and Planning, Praeger Publishers, 1980.

¹⁸ See above quote from Bernake, but also the polemics of Hernando de Soto, a trend in the policy of the Ford foundation, and countless politicians' speeches.

6. that the economic value of owning a home is one created by the owners hard work and is proof of his (much more often than her) personal achievement and moral worth public policy has provided substantial economic incentives for homeownership through the mansion tax subsidy, the deduction from income taxes of mortgage interest and real property taxes¹⁹
7. that the experience of any kind of supportive collective or communal ownership and residential facilities is minimal.

So the ideology is rooted in real world experience,²⁰ but a limited experience, more extremely limited in the United States than in many other countries. Knowledge of the way the housing system functions in the real world in fact contradicts the conclusions drawn from this limited experience.

1. Rental tenure could in fact be made at least as secure of “ownership” by appropriate lease provision and selection of appropriate landlords, e.g. non-profits or government,²¹
2. A wide variety of tenures is available: cooperative, condominium, limited equity co-ownership, mutual housing association, land trust, each of which combines various attributes in the bundle of rights that is “ownership.”
3. Clearly wrong, as hundreds of thousands are now finding.
4. Clearly wrong, as millions are now finding, Some 9 million households today have negative equity in their homes.
5. Putting the above two points together, wrong; treating housing for its exchange value runs contrary to optimizing its use value, and by and large does not even increase asset value for many.²²
6. The value of a home is in fact largely socially created, through provision of infrastructure, tax benefits, but most importantly by the economic activities of others that gives a location, and thus the its land, its value. That is not a product of the individual owner’s activity. It also means that the advantage of homeownership is subject to the fluctuations in the general level of economic activity,²³ as well as of public policy,. subject to technically easy congressional and local community change, as in setting local property tax rates.
7. True, but countless examples do exist, here and abroad.

¹⁹ And the non-taxation of the imputed income from the personal use of what is owned, which is the equivalent of income from the ownership of an asset but is not taxed as income in the United States.

²⁰ The question of how real world experience affects ideology is a complex one. One pending study suggests even those experiencing foreclosure hold to a neoliberal ideology in which not the system but their own weakness or some evil individuals are responsible for their problems. [Devaluing the Dream, forthcoming.]

²¹ See the model lease drawn up for the Urban Institute by Peter Marcuse and Richard Clark, 1974.. The arrangements in the state socialist states in the post-World War II period, provide an example. See Marcuse, Peter. 1996. “Privatization and its Discontents: Property Rights in Land and Housing in Eastern Europe.” in Andrusz, Gregory, Michael Harloe and Ivan Szelenyi, eds. Cities After Socialism: Urban and Regional Change and Conflict in Post-Socialist Societies. London: Blackwell, pp. 119-191.

²² See Elliott Sclar, Chaky Palaces, a study of changes in house values in the Boston area compared to changes in stock prices, and Marcuse, Peter. 1972. "Homeownership for Low Income Families: Financial Implications" Land Economics, Volume 48, Number 2, May, 1972, pp. 134-143. And see Rohe and Wateon, 2007, and Di, 2005, and Rohe, McCarthy & van Sandt, 2000. Hernando de Soto’s attempt to sell home ownership as a policy for the poor in developing countries to accumulate “wealth” with which to become entrepreneurs has also been devastatingly critiqued.

²³ See the comparison of investment in a home with investment in stocks in Elliott Sclar and Mathew Edel, Shaky Palaces.

The conclusion at the ideological level then is that an educational campaign to illuminate the limits of home “ownership” and the range of available alternatives is needed.

The nature of the economic problem is similarly clear. It results from the simple fact that the overwhelming majority of housing, both units and services, are privately provided for profit. Yet the simple fact is that, given the level of rents required to produce the profit that is sought, a major part of the population cannot afford adequate housing, and will either pay a disproportionate part of their incomes for housing, neglecting food or clothing or health care or education. There are two answers to this problem:

One is a mild one: extend control over the level of profits that is permitted in the provision of housing. The tools for this purpose are at ha: rent control; anti-speculation and excess profits taxes; criminalization of discrimination and unfair practices; eviction controls and building code improvement and enforcement. Such measures are more than lipstick on a pig, but fall short of reshaping the animal: providing an alternative.

The alternative is radical, but very simple: until adequate incomes are guaranteed, providing adequate public financing to cover the gap between even regulated housing costs and ability to pay. Where that financing is to come from can be debated; measures such as the military budget and raising progressive income taxes are surely obvious possibilities.

On the immediate question of what to do about the current crisis, separate it into the immediate crisis and the prevention of its recurrence in the future:

Included in the current package of reforms is \$4 billion of grants to state and local governments to use in rescuing borrowers. Let it be used to buy the homes that are in foreclosure, possible in many cases at bargain prices, and let those units remain publicly owned units with their residents remaining in occupancy and control. Let there be experiments to see if those units should be handled as an expansion of public housing along existing models, which can be adapted to provide the security and individual control that the “owners” wish. But let there also be a wide range of experimentation with other forms of non-private-profit oriented ownership models. Many existing ideas are already on the table.²⁴ Other physical forms of housing can also be explored; for instance, Dolores Hayden has argued from a feminist perspective that a non-sexist housing program would include the possibility of common cooking and eating facilities, shared recreational space, etc.²⁵

²⁴ One of the most promising is Shared Equity Home Ownership. See John Emmeus Davis’ study of that title, published by the National Housing Institute, Montclair, New Jersey, 2006.

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Importantly, let the \$4 billion be vastly augmented. The treasury, in its current bail-out policies, is criticized for socializing the risk but letting the profits remain private. Use the \$4 billion plus to socialize the profit in the housing supply system. The balance between private for-profit “ownership” of housing and social “ownership” should be shifted dramatically in favor of the latter.²⁶ Likewise, development and construction and management should shift to the public sector; there is plenty of good experience in each area.²⁷

A strong argument can be made that public housing, in its traditional or democratized (in the direction of tenant involvement) form, play a major role in this solution—for two reasons. First, a legal envelope and management structure exists through which public housing authorities can handle large numbers of units for low income households, and would only need to be modified, not replaced and started from scratch, to handle the accession of a large number of acquired foreclosure-impacted properties. Second, had there not been so large a curtailment of subsidies in all forms, but particularly for public housing, the pressure for lower-income households to seek home ownership as the cheapest way of improving their housing conditions would have been reduced. In a sense, it was the cut-back in public housing subsidies that forced people to take up subprime mortgage. The mistake should be corrected to avoid a continuation of the pressure for “ownership” by those who should be well served if decently funded public housing were available to them.²⁸

As to the future: accept the fact of on-going major public investment in the housing of its people. It clearly has the resources to do so; if it can make a \$4b to the \$29 b commitment to back Bear Stearn’s counterparties, provide \$85 billion for AIG, the \$5.2 trillion liability taken on with GSEs, etc. bring the investment in housing from \$4 to \$40 billion is a drop in the bucket of federal expenditures.²⁹ For those still in a position to buy privately and willing to do so, let the government help by playing the technical role of bundler, as GNMA now does, for a fee, but leave the risks of default with the originating bank, as it had been before FNMA began selling securities for a profit. Let Fannie Mae and Freddie Mac go bust. Deal with the impact on shareholders who invested, not to speculate, but to provide income on retirement through pension funds, by public assistance to those pension funds, not by bailing out the institutions that permitted the crisis to happen and had been profiting on the system for many years before its collapse.

²⁶ Marcuse, Peter. 1994. “Mainstreaming Public Housing: For a Comprehensive Approach to Housing Policy.” Preiser, Wolfgang F. E., David Varady, and Francis Russell, eds. *Future Visions of Urban Public Housing*. Cincinnati, University of Cincinnati, College of Design, pp. 45-58., makes this argument, although not exploring public alternatives to existing public housing.

²⁷ For a comprehensive view of what such a policy might look like, see the Institute of Policy Studies’ study, and Hartman, Chester, and Michael Stone. 1986. “Towards a Socialist Housing Program for America.” in Bratt et al., eds, *Critical Perspectives on Housing*, Philadelphia, Temple University Press.

²⁸ I owe the suggestion to Nicholas _____, whose study of the public housing program in New York City is persuasive on the positive contributions the program has made and could make in the future if properly funded.

²⁹ Kathe Newman also makes this point.