Controlling Residential Stakes

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Local communities often suffer when residents have too small a stake in their homes—a point underscored by recent rashes of foreclosures and abandonments, and implicated by longstanding questions about the effects on communities of renters and owner-occupants, respectively. However, homeowners with too great a financial stake in their homes can also cause difficulties for local governance by acting as risk-averse NIMBYs. Local governments should have a strong interest in helping members of their communities move away from problematic forms of stakeholding and toward more desirable intermediate positions. This Article examines how and why governmental entities at the state and local levels might regulate or shape the financial stakes that residents have in their homes. We give particular attention to the role local governments may play in facilitating homeowner and tenant access to index-based financial instruments that adjust residential risk-bearing. More radically, we suggest that local governments, assisted by state law, could formulate shared equity arrangements in which local residents hold stakes, either directly or through their municipalities, in the housing markets of surrounding localities as well as in their own jurisdictions.

INTRODUCTION

Communities suffer when residents lack sufficient monetary stakes in their homes. This point has been underscored by recent rashes of foreclosures and abandonments,[1] and it also underlies longstanding concerns about the relative impacts on neighborhoods of renters and owner-occupants.[2] However, residents who have too large a financial stake in their homes also create grave difficulties for local governance, as exemplified by the NIMBYism of William Fischel's undiversified, risk-averse "homevoters."[3] "Understaked" households are at risk

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1 We use the term "abandonment" here in its colloquial sense, to refer to an owner's decision to cease all payments and upkeep associated with a property and to vacate the premises. The common law does not permit owners to abandon real property in the legal sense of unilaterally terminating ownership. See Lior Jacob Strahilevitz, *The Right to Abandon*, 158 U Pa L Rev 355, 359–60, 399–402 (2010).

2 See notes 30–36 and accompanying text.

3 "NIMBY" is an acronym for "not in my back yard." See William A. Fischel, *Homevoter Hypothesis* 9 (Harvard 2001). Fischel posits that homeowners vote in ways that will protect and enhance the value of their largest assets—their homes. Id at 9–12. Risk aversion plays an impor-

of losing their homes, whether through foreclosure or gentrification, while "overstaked" households narrowly focus on protecting their primary source of financial security—the value stored in their homes.[4] These suboptimal residential stakes generate personal disutility, create conflicts between tenants and homeowners, set neighboring communities against each other, and hobble local improvement efforts at every scale.

Local jurisdictions, ground zero for the fallout from residential "mis-staking," should have an intense interest in helping their residents reach more desirable intermediate stakeholding positions. A community filled with properly staked residents will be less vulnerable to problems of displacement and exclusion because the incentives of renters and homeowners, and of insiders and outsiders, will be more closely aligned. Improved stakeholding could also avoid spillover-generating cycles of foreclosure and abandonment. Yet although local governments may want to control the size and shape of residential stakes, existing stakeholders currently control local government policy.[5] This Article addresses how, under these circumstances, state and local governments might identify and move toward a more productive and cooperative equilibrium.

Many commentators have seized on the ongoing housing meltdown as an apt occasion for rethinking and reworking residential arrangements that have ceased to work well for many households.[6] But

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tant role in Fischel's account, making homeowners into NIMBYs even when a proposed change carries a positive expected value. See id. See also Brendan O'Flaherty, *City Economics* 384 (Harvard 2005) (giving an example illustrating Fischel's point and concluding that homeowners' "stake in the community—the community as it now stands—is too big").

4 The home is the single largest financial asset for most US homeowners. See Brian K. Bucks, Arthur B. Kennickell, and Kevin B. Moore, *Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances*, 92 Fed Reserve Bull A1, A22–23 (2006), online at http://www.federalreserve.gov/pubs/oss/oss2/2004/bull0206.pdf (visited Nov 13, 2009); Fischel, *Homevoter Hypothesis* at 4 (cited in note 3). Because the home is a highly undiversified investment, homeowners tend to be risk averse with respect to changes that might affect its value. See Fischel, *Homevoter Hypothesis* at 9 (cited in note 3); O'Flaherty, *City Economics* at 384 (cited in note 3).

5 See Fischel, *Homevoter Hypothesis* at 15 (cited in note 3) ("In the places where most people live—suburbs, towns, and small cities—homeowners have become the dominant political force."). Consider Richard Thompson Ford, *The Boundaries of Race: Political Geography in Legal Analysis*, 107 Harv L Rev 1841, 1871 & n 74 (1994) (noting the "self-perpetuating quality" of exclusionary zoning and other efforts directed at "community self-definition").

6 The literature reflects a spectrum of views about the appropriate future direction for homeownership. Compare generally, for example, A. Mechele Dickerson, *The Myth of Home Ownership and Why Home Ownership Is Not Always a Good Thing*, 84 Ind L J 189 (2009) (questioning governmental promotion of homeownership for all and recommending that homeownership subsidies be strictly curtailed) with Andrew Caplin, et al, *Facilitating Shared Appreciation Mortgages to Prevent Housing Crashes and Affordability Crises* (Hamilton Project Discussion Paper No 2008-12, Sept 2008), online at http://www.brookings.edu/papers/2008/09_mortgages_caplin.aspx (visited Nov 13, 2009) (urging innovation in home finance through shared appreciation mortgages).

relatively little attention has been paid to the potential role of state and local governments in this process.[7] We seek to fill that gap here by examining how and why governmental entities at the state and local levels might regulate or shape the financial stakes that residents have in their homes.

It is worth noting that many jurisdictions already influence stake-holding through measures that regulate the landlord-tenant relationship[8] or that encourage owner-occupancy;[9] more direct efforts to regulate mortgage arrangements or to encourage long-term tenancies are not difficult to imagine.[10] More promising stake-shaping alternatives, we suggest, would build on innovative financial tools for rearranging housing market risks.[11] Drawing lessons from numerous implemented and proposed approaches, local governments could offer programs that help homeowners offload some of their home's upside appreciation potential and downside property value risk to investors.[12] Similarly, local governments could make financial instruments keyed to local property values available to tenants.[13] More radically, local governments, assisted by state law, could formulate shared equity arrangements in which residents hold stakes in the housing markets of surrounding localities, as well as in their own local communities.[14]

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7 A paper currently under development examines the potential role of local governments in devising and financing innovative new institutional approaches to homeownership. Benito Arruñada and Amnon Lehavi, *Prime Property Institutions for a Subprime Era: Exploring Innovative Models of Residential Development and Finance* (March 2010) (on file with authors). For previous work on the past or potential role of local governmental bodies in altering the stakes of residents, see, for example, the sources cited in notes 58–60, 96.

8 See Part III.A.

9 See note 44 and accompanying text.

10 See Parts II.A and III.A (discussing and critiquing these possibilities).

11 See Parts II.B and III.B.

12 Many approaches to reconfiguring homeownership risk have been proposed. See, for example, Andrew Caplin, et al, *Housing Partnerships: A New Approach to a Market at a Crossroads* 6 (MIT 1997) (proposing a "housing partnership" approach in which an investor contributes to the home's purchase price and shares in the home's sales proceeds); Robert J. Shiller, *Macro Markets: Creating Institutions for Managing Society's Largest Economic Risks* 78–88 (Oxford 1993) (advocating markets in housing futures and options that would permit homeowners to hedge the risk of housing market fluctuations). See generally Lee Anne Fennell, *Homeownership 2.0*, 102 Nw U L Rev 1047 (2008) (discussing literature on these and other homeownership-risk-reallocation approaches, and proposing a new tenure form).

13 See Robert I. Lerman and Signe-Mary McKernan, *Promoting Neighborhood Improvement while Protecting Low-Income Families* *2–3 (Urban Institute Opportunity and Ownership Project No 8, May 2007), online at http://www.urban.org/publications/311457.html (visited Nov 13, 2009) (proposing that instruments indexed to area rents be made available to tenants, whether structured as insurance against rent increases or as tradable options). See also O'Flaherty, *City Economics* at 369 (cited in note 3) ("Tenants could get a long-run stake in the community if they were required to buy some variety of security that was pegged to the town's or neighborhood's total property value."); Part III.B.

14 See Part IV.B.

Our goal in discussing these ideas is not to advocate any particular approach, but rather to draw attention to stake-shaping as an important and underexplored state and local policy lever. We do contend, however, that residential risk-shifting mechanisms have some important advantages over more traditional approaches that implicitly address residential stakes.

The Article proceeds in four parts. Part I explains how stakeholding can present a problem for local governance. Part II considers how local governments might alter the stakes of homeowners. Here, we suggest that voluntary risk-offloading programs are likely to dominate efforts to mandate or regulate homeownership stakes. Part III turns to tenant stakeholding. We argue that offering tenants subsidized stakes in the local housing market through financial options is likely to be more promising than the suite of alternatives—lease regulation, rent subsidies, and rent control—that is typically proposed to address problems of tenant displacement and disengagement. Part IV introduces the idea of regionalized stake-sharing to address interlocal spillovers. We maintain that this sort of synthetic regionalization carries advantages over other proposed approaches, such as resort to regional government, extraterritorial voting schemes, and interlocal bargaining platforms.[15]

I. COSTLY MIS-STAKES

Because residential life is interdependent, communities want members to have a stake in the common enterprise. Stakeholding has often been implicitly managed at the local level through rough proxies like zoning for single-family homes. Changes in lending practices[16] and ownership patterns[17] have put pressure on that model, however. At the same time, local governments (both individually and collectively) have had to grapple with the twin distributive concerns of displacement and

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15 See Part IV.A.

16 See, for example, Christopher Mayer, Karen Pence, and Shane M. Sherlund, *The Rise in Mortgage Defaults*, 23 J Econ Persp 27, 30–33, 36–40, 43–44 (2009) (describing the use of "piggyback loans" (second mortgages) that reduce or eliminate any down payment requirement, low- and no-documentation mortgages, adjustable-rate mortgages with "teasers," and loans with low, zero, or negative amortization of principal); Edward M. Gramlich, *Subprime Mortgages: America's Latest Boom and Bust* 13–22 (Urban Institute 2007) (chronicling changes in mortgage practices from the postwar period onward, including the recent expansion of the subprime lending sector).

17 In 2007, about 7 percent of owner-occupied units were manufactured or mobile homes or trailers while another 6 percent consisted of condominiums or cooperatives. US Census Bureau, *American Housing Survey for the United States: 2007*, table 1A-1, online at http://www.census.gov/prod/2008pubs/h150-07.pdf (visited Nov 13, 2009). By contrast, in 1980, a mere 2.67 percent were condominiums or cooperative apartments. The growth in manufactured homes occurred a decade earlier; they constituted 4.39 percent of owner occupied homes in 1970, 5.79 percent in 1980, and 7 percent in 2007. Id; US Census Bureau, *Annual Housing Survey: 1980* 1 table A-1 (GPO 1982), online at http://www2.census.gov/prod2/ahsscan/h150-80a.pdf (visited Nov 13, 2009).

exclusion. The clashing goals of current and potential residents who are, variously, understaked and overstaked have proven highly problematic for local communities.

A. Understaking

Plummeting housing prices have made communities vulnerable to defaults by understaked homeowners. According to recent estimates, nearly a quarter of US homeowners with mortgages are "underwater," meaning that they owe more than the home is worth,[18] and delinquency rates have reached record levels.[19] Many households' downside exposure is greatly limited by their lack of any significant financial stake in their homes. While this is especially true in nonrecourse states, the fact that few households have significant assets aside from their homes makes recovery of deficiency judgments against them difficult in other states as well.[20] Many understaked homeowners, then, can be viewed as holding an option to default that is "in the money."[21] Despite media coverage of the "jingle mail" phenomenon—

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18 See Ruth Simon and James R. Hagerty, *One in Four Borrowers Is Underwater*, Wall St J A1 (Nov 24, 2009) (reporting that 23 percent of homeowners with mortgages had negative equity in the third quarter of 2009, according to First American CoreLogic). See also Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 2009* 19 (2009), online at http://www.jchs.harvard.edu/publications/markets/son2009/son2009.pdf (visited Nov 13, 2009) ("2009 Housing") (reporting Zillow.com's estimate that 42 percent of existing home sales in 2008 were effected "for a loss," below either the seller's purchase price, the outstanding mortgage balance, or both).

19 See, for example, Mortgage Bankers Association, *Delinquencies Continue to Climb in Latest MBA National Delinquency Survey* (Nov 19, 2009), online at http://www.mortgagebankers.org/NewsandMedia/PressCenter/71112.htm (visited Dec 27, 2009) (reporting, based on records that go back to 1972, that in the third quarter of 2009, "[t]he combined percentage of loans in foreclosure or at least one payment past due was 14.41 percent on a non-seasonally adjusted basis, the highest ever recorded in the MBA delinquency survey").

20 See, for example, Todd J. Zywicki and Joseph D. Adamson, *The Law and Economics of Subprime Lending*, 80 U Colo L Rev 1, 30 (2009) (observing that "even if a deficiency judgment is formally available, borrowers may be judgment-proof because of a general lack of other assets"). Compare Andra C. Ghent and Marianna Kudlyak, *Recourse and Residential Mortgage Default: Theory and Evidence from U.S. States* *2 (Federal Reserve Bank of Richmond Working Paper No 09-10, July 2009), online at http://ssrn.com/abstract=1432437 (visited Nov 13, 2009) (finding that the availability of recourse reduces default rates among homeowners likely to have negative equity, with the magnitude of the effect depending on the homeowner's wealth).

21 See, for example, Zywicki and Adamson, 80 U Colo L Rev at 26–27 (cited in note 20) (discussing and comparing support for the "distress model" and the "option model" of foreclosure decisions). Some recent research has suggested that homeowners who put no money down when purchasing a home are disproportionately likely to default, and that those who supply their own down payments are substantially less likely to default than those who receive down payment funds from other sources. See Austin Kelly, *"Skin in the Game": Zero Downpayment Mortgage Default*, 17 J Hous Rsrch 75, 94–95 (2008). See also Stan Liebowitz, *New Evidence on the Foreclosure Crisis*, Wall St J A13 (July 3, 2009) (reporting, based on analysis of loan-level data, "that, by far, the most important factor related to foreclosures is the extent to which the homeowner now has or ever had positive equity in a home").

homeowners walking away from houses that lost value after mailing the keys to their lenders[22]—relatively few underwater homeowners have opted for voluntary default.[23] But waves of involuntary foreclosures that drive down prices may drive up incentives to push losses onto lenders.[24]

Understaked homeowners generate significant costs for local communities. Recent empirical work confirms the intuition that negative spillovers flow from clusters of foreclosures.[25] Untended homes and yards attract vandals, squatters, and even wildlife.[26] From algae in pools to overgrown lawns, signs of decay telegraph the community's deterioration, invite expectations of further declines, and discourage

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22 See, for example, John Leland, *Facing Default, Some Abandon Homes to Banks*, NY Times A1 (Feb 29, 2008). See also Zywicki and Adamson, 80 U Colo L Rev at 29 (cited in note 20) (discussing anecdotal coverage of "jingle mail" defaulters).

23 See Diana Olick, *Treasury: Jingle Mail a Myth*, CNBC (June 26, 2009), online at http://www.cnbc.com/id/31570460 (visited Nov 13, 2009) (quoting Michael Barr, Treasury's Assistant Secretary for Financial Institutions, that "we don't see in the data borrowers who are walking away because they can or because their homes are underwater. We do see borrowers who are unable to make the payment."). See also Christopher L. Foote, Kristopher Gerardi, and Paul S. Willen, *Negative Equity and Foreclosure: Theory and Evidence* *2–3 (Federal Reserve Bank of Boston Public Policy Discussion Paper No 08-3, June 2008), online at http://ssrn.com/abstract=1153413 (visited Nov 13, 2009) (finding default rates of less than 10 percent in a study of 100,000 likely underwater Massachusetts homeowners in the early 1990s).

24 A recent study shows that while households do not voluntarily default when the home's negative equity is less than 10 percent, "[t]he percentage of households willing to default strategically increases to 5% if the shortfall is between 10 and 20% of the value of the house and reaches 17% when the shortfall reaches 50%." Luigi Guiso, Paola Sapienza, and Luigi Zingales, *Moral and Social Constraints to Strategic Default on Mortgages* *5 (NBER Working Paper No 15145, June 2009), online at http://www.nber.org/papers/w15145 (visited Nov 13, 2009). As the number of American homeowners who are deeply underwater has increased, so too has concern about the possibility of strategic defaults. See David Streitfeld, *No Help In Sight, More Homeowners Walk Away*, NY Times A1 (Feb 3, 2010) (reporting that "by the third quarter of 2009, an estimated 4.5 million homeowners had reached the critical threshold, with their home's value dropping below 75 percent of the mortgage balance"—a level at which even owners capable of repayment may begin to consider default, according to recent research); id (describing these homeowners as "stretched, aggrieved and restless" and noting that "[s]uggestions that people would be wise to renege on their home loans . . . are turning into a full-throated barrage").

25 See, for example, Zhenguo Lin, Eric Rosenblatt, and Vincent W. Yao, *Spillover Effects of Foreclosure on Neighborhood Property Values*, 38 J Real Est Fin & Econ 387, 403 (2009) (finding, based on Chicago-area data, significant negative effects of foreclosures on the sales prices of properties within a 0.9 kilometer radius for a five-year period); Jenny Schuetz, Vicki Been, and Ingrid Gould Ellen, *Neighborhood Effects of Concentrated Mortgage Foreclosures*, 17 J Hous Econ 306, 317 (2008) (finding, based on a dataset of sales and foreclosures in New York City from 2000 to 2006, that close proximity to multiple foreclosures depresses sales prices, subject to a "threshold effect" in which very small clusters of foreclosures produce inconsistent results). See also Raphael W. Bostic and Kwan Ok Lee, *Mortgages, Risk, and Homeownership among Low- and Moderate-Income Families*, 98 Am Econ Rev 310, 313–14 (2008) (discussing externalities from foreclosures).

26 See, for example, Sarah Burge, *Lake Elsinore: 4-Legged Squatters Settle on a Foreclosure*, Press-Enterprise C1 (Sept 3, 2008) (reporting the appearance of bobcats on foreclosed property); Nick Miroff, *Shuttered Homes, Thriving Wildlife*, Wash Post B1 (May 27, 2008) (reporting infestations of rats, snakes, and mosquitoes).

buyers. In addition to their effects on local property values, concentrated foreclosures are associated with increased residential turnover and heightened criminal activity; they also contribute to local fiscal difficulties and service shortfalls.[27] These negative impacts have led beleaguered cities to try everything from suing lenders[28] to assessing fines against them.[29]

While the acute problems associated with understaked homeowners are much in the national spotlight, a more chronic form of understaking also deserves attention. Most tenants have little financial stake in their own housing units, a fact that generates three concerns for communities.[30] First is the worry that tenants will do less than homeowners to keep up their homes and contribute to the community. A wide variety of social benefits have been associated with owner-occupancy,[31] although causation is difficult to untangle from selection

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27 For a recent overview of the literature on the community impacts of foreclosures, see G. Thomas Kingsley, Robin Smith, and David Price, *The Impacts of Foreclosures on Families and Communities* 13–21 (Open Society Institute Report, May 2009), online at http://www.urban.org/UploadedPDF/411909_impact_of_forclosures.pdf (visited Nov 13, 2009). See also Stephanie Chen, *As Dues Dry Up, the Neighbors Pay*, Wall St J D1 (May 13, 2008) (noting impacts of foreclosures on common interest communities).

28 A number of cities have filed lawsuits against lenders. See, for example, Creola Johnson, *Fight Blight: Cities Sue to Hold Lenders Responsible for the Rise in Foreclosures and Abandoned Properties*, 2008 Utah L Rev 1169, 1187–1232 (detailing litigation by cities against lenders). Despite dismissals in some of these actions, litigation continues. See, for example, Amos Maki, *Memphis, Shelby County Sue Wells Fargo Over Lending Practices*, The Commercial Appeal (Dec 30, 2009) (reporting on new suit initiated by Memphis and Shelby County and noting dismissal of suits in Birmingham and Cleveland); Andrew Longstreth, *Judge Dismisses Cleveland's Suit against Subprime Lenders*, AmericanLawyer.com (May 18, 2009), online at http://www.law.com/jsp/tal/digestTAL.jsp?id=1202430792417 (visited Dec 27, 2009) (reporting on federal district court's dismissal of Cleveland's suit and noting city's intention to appeal to the Sixth Circuit); Tricia Bishop, *City's Wells Fargo Lawsuit Dismissed*, Baltimore Sun (Jan 7, 2010) (reporting on federal district court's dismissal of Baltimore's lawsuit and noting new cases filed in 2009 by Illinois and Memphis); Brendan Kearney, *City Will Amend Reverse-Redlining Lawsuit*, Maryland Daily Rec (Jan 7, 2010) (reporting on Baltimore's plans to file an amended complaint following federal district court's dismissal of its suit against Wells Fargo).

29 See, for example, Nicholas Casey, *Banker: "What'd I Do Wrong, Officer?" Cop: "You've Got Algae in the Pool, Sir"—Fearing Blight, a California Town Makes It a Crime to Neglect Foreclosed Homes*, Wall St J A1 (May 1, 2009) (reporting that some small towns have passed laws allowing them to charge banks with criminal misdemeanors for failing to maintain foreclosed properties).

30 Although our focus here is on community spillovers stemming from tenant understaking, tenant households also bear understaking costs, including the possibility of displacement.

31 A large literature has examined the social benefits associated with homeownership. See, for example, Robert D. Dietz and Donald R. Haurin, *The Social and Private Micro-level Consequences of Homeownership*, 54 J Urban Econ 401, 438–40 (2003) (evaluating studies on homeownership effects and identifying methodological issues and gaps in the literature); Donald R. Haurin, Robert D. Dietz, and Bruce A. Weinberg, *The Impact of Neighborhood Homeownership Rates: A Review of the Theoretical and Empirical Literature*, 13 J Hous Rsrch 119, 134–40 (2002) (surveying theoretical literature and empirical studies on the neighborhood effects of homeownership); Denise DiPasquale and Edward L. Glaeser, *Incentives and Social Capital: Are Homeowners Better Citizens?*, 45

effects when assessing the significance of tenure form.[32] A second concern is that tenants, fearing displacement as a result of rising rents,[33] will oppose initiatives likely to benefit the community.[34] Not only may tenants be unable to gain from neighborhood improvements, but any resulting displacement would cause them to lose whatever intangible surplus they have built up in their homes. The evidence regarding actual tenant displacement due to gentrification is mixed and hotly contested.[35] Nonetheless, the destabilizing effects of any turnover that does result from community change, as well as the stresses associated

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J Urban Econ 354, 383–84 (1999) (finding that both ownership incentives and tenure length affect social capital investments by homeowners).

32 For cautions about inferring causal relationships from outcomes or behaviors that are correlated with homeownership, see, for example, William G. Gale, Jonathan Gruber, and Seth Stephens-Davidowitz, *Encouraging Homeownership through the Tax Code*, 115 Tax Notes 1171, 1177 (2007); Haurin, Dietz, and Weinberg, 13 J Hous Rsrch at 132–33 (cited in note 31).

33 Although rising rents present tenant households with the most obvious understaking-related displacement threat, tenants can also be displaced when housing units are withdrawn from the rental market. Eminent domain is another potential source of displacement, but it presents issues that are distinct from those we address here, in part because its use does not depend on tenure form or a resident's financial stake. It is, however, possible that some of the mechanisms we discuss below could affect the frequency or impact of localities' resort to condemnation. See text accompanying note 114. Tenants can also be displaced when the property they are occupying is foreclosed upon—a fact that makes them vulnerable to downside market risk. See Mary Shanklin, *Renters Becoming Victims to Home Foreclosures*, Pittsburgh Post-Gazette H11 (June 7, 2009). Recent legislation provides short-run protection against foreclosure-based displacement. See Protecting Tenants at Foreclosure Act of 2009 § 702, Pub L No 111-22, 123 Stat 1632, 1660–61, codified at 12 USC § 5220 note (requiring that the successor in interest provide tenants at least ninety days' notice to vacate, and mandating that the balance of existing lease terms be honored unless a buyer will occupy the unit as a primary residence).

34 See, for example, Lerman and McKernan, *Promoting Neighborhood Improvement* at *1 (cited in note 13) (reporting protests against gentrification by tenants fearful of being priced out of the market); Lance Freeman and Frank Braconi, *Gentrification and Displacement: New York City in the 1990s*, 70 J Am Planning Assoc 39, 39–40 (2004) (describing political effects of gentrification fears).

35 For two different takes on the empirical evidence regarding the displacement effects of gentrification, compare J. Peter Byrne, *Two Cheers for Gentrification*, 46 Howard L J 405, 413–15 (2003) (citing studies that "find no evidence that gentrification causes significant direct displacement") with john a. powell and Marguerite L. Spencer, *Giving Them the Old "One-Two": Gentrification and the K.O. of Impoverished Urban Dwellers of Color*, 46 Howard L J 433, 465–76 (2003) (countering with studies that "document the harmful realities of displacement"). Recent work on this question includes Freeman and Braconi, 70 J Am Planning Assoc at 45 (cited in note 34) (finding that poor households living in gentrifying neighborhoods in New York City in the 1990s were less likely to move than similar households living in nongentrifying New York City neighborhoods); Kathe Newman and Elvin K. Wyly, *The Right to Stay Put, Revisited: Gentrification and Resistance to Displacement in New York City*, 43 Urban Stud 23, 40–42 (2006) (concluding that displacement fears were not unfounded, and noting several factors, including rent regulation, that reduced the amount of observed displacement). See also Lance Freeman, *There Goes the 'Hood: Views of Gentrification from the Ground Up* 127 (Temple 2006) ("[T]he process of neighborhood change in gentrifying neighborhoods is often gradual, driven more by succession or a change in who moves into the neighborhood than rapid and widespread displacement.").

with tenant strategies like "doubling up" with other families,[36] comprise a third set of potential understaking spillovers.

B. Overstaking

Although the problem of homeowner overstaking has been upstaged by an unprecedented glut of understaked homeowners, it remains significant. Many homeowners continue to hold a substantial equity stake in their homes;[37] although the value of their homes has shrunk, so too has the value of their other assets, such as their retirement accounts and, often, even the marketability of their own human capital.[38] If anything, the current economic crisis has left homeowners more vulnerable to changes that might (further) affect the value of their homes.

The problems of NIMBYism and exclusionary zoning have been recounted at length elsewhere, so a brief mention here will suffice. As Fischel has explained, the political behavior of homeowners is largely driven by their desire to maximize the value of their homes.[39] In some ways, this impulse is functional; if what is good for the community is good for the home's value, then homeowners will vote in ways that make the community better off.[40] A catch, however, is that often one's immediate neighborhood or jurisdiction can be made better off by making other neighborhoods or jurisdictions worse off. If we add a hefty dose of risk aversion, we find homeowners not only all too willing to push locally undesirable land uses elsewhere, but also unwilling to experiment with unproven land uses—or, indeed, to entertain many kinds of change at all.[41] Their reluctance has real bite because, at least outside of central cities, homeowners tend to control the local political process.[42]

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36 See Newman and Wyly, 43 Urban Stud at 49 (cited in note 35) (explaining that overcrowding is the only way for some low-income residents to stay in gentrifying areas).

37 Over twice as many owner-occupied homes are unencumbered by mortgages as are "underwater." See Simon and Hagerty (cited in note 18) (citing Census Bureau data indicating that "nearly 24 million owner-occupied homes don't have any mortgage," compared with 10.7 million households with negative equity in their homes).

38 As of January 2010, the unemployment rate was 9.7 percent, nearly double the rate posted two years earlier. See Bureau of Labor Statistics, *The Employment Situation: January 2010* 1 (Feb 5, 2010), online at http://www.bls.gov/news.release/pdf/empsit.pdf (visited Feb 19, 2010).

39 Fischel, *Homevoter Hypothesis* at 75–76 (cited in note 3).

40 See, for example, id at 268 ("Asset risk is a good thing when it makes homeowners pay attention to the quality of schools and municipal services. It helps overcome the free-rider problem that is otherwise endemic to boring, local political concerns.").

41 See, for example, id at 8–10, 268–69 (noting the downside of asset risk, and observing that homeowners are often frightened by the variance of potential outcomes from neighborhood changes).

42 See, for example, id at 80–81 (noting that homeowners are "[t]he largest and most active group of voters in all but a few cities"). See also William A. Fischel, *Political Structure and Exclusionary Zoning: Are Small Suburbs the Big Problem?*, in Gregory K. Ingram and Yu-Hung Hong, eds, *Fiscal Decentralization and Land Policies* 111, 130–31 (Lincoln Institute of Land Policy 2008)

Local and state governments have an obvious interest in addressing the problems of overstaking and understaking. In the balance of the Article, we identify and critique some directions that such action might take.

II. HOMEOWNER STAKES

A. Mandating and Regulating Stakes

Whether as a direct response to current conditions or to forestall future crises, local governments might undertake coercive efforts to shore up residential stakes. The idea of regulating residential stakeholding is not new. For example, common interest communities often ban or restrict leasing (or subleasing).[43] Similarly, local governments often extend more favorable property tax treatment to owner-occupants than to absentee landlords or vacation home owners.[44] More broadly, de facto regulation of stakeholding has long occurred under the banner of zoning for single-family residences. If zoning for single-family homes or granting tax-preferred treatment to owner-occupants no longer guarantees highly staked residents, local governments might seek to regulate stakeholding more directly, such as by forbidding loan-to-value ratios above a certain level, requiring private mortgage insurance (PMI), or outlawing certain kinds of high-risk products. Small-scale regulation of mortgages is not entirely unprecedented, although some past attempts along these lines have foundered.[45] Local

(examining the effects of jurisdiction size and the degree of metropolitan fragmentation on local political decisions about land use).

43 A number of commentators have noted increased use of such leasing restrictions in common interest communities. See, for example, Zachary M. Rawling, *Reevaluating Leasing Restrictions in Common Interest Developments: Rejecting Reasonableness in Favor of Consent*, 5 J L, Econ, & Pol 223, 224 (2009); David E. Grassmick, Note, *Minding the Neighbor's Business: Just How Far Can Condominium Owners' Associations Go in Deciding Who Can Move into the Building?*, 2002 U Ill L Rev 185, 194; Katharine N. Rosenberry, *Home Businesses, Llamas and Aluminum Siding: Trends in Covenant Enforcement*, 31 John Marshall L Rev 443, 461–65 (1998). Governmental entities have had less success in their efforts to restrict renting through their zoning codes. See Ngai Pindell, *Fear and Loathing: Combating Speculation in Local Communities*, 39 U Mich J Leg Ref 543, 577–81 (2006) (describing litigation over rental restrictions that suggests courts are hostile to categorical owner-occupancy requirements but may allow communities to condition the rental of accessory dwelling units on owner occupancy of the primary dwelling).

44 Many jurisdictions provide tax relief for "homestead" property, defined as property that serves as the owners' primary residence. This relief may be substantial. See, for example, Fla Const Art VII, § 4(d)(1) (imposing a 3 percent cap on annual assessment increases on homestead property); Mich Comp Laws Ann § 380.1211 (West) (limiting application of school district property tax to homestead property).

45 *Roy v Ducote*, 399 So 2d 737 (La App 1981), involved a challenge to a subdivision restriction that prohibited homes financed through certain governmental programs. Id at 738. The defendants stated that they wished to "form a neighborhood that does not look like a 'government program' and to create a quiet, peaceful neighborhood with attractive surroundings and minimal amounts of noise and extraneous intrusions." Id at 741. The restriction was struck down

regulation of mortgages premised on a "spillover control" rationale might be viewed quite favorably in the current economic climate. However, local governments would still face significant legal impediments and normative objections to any policy that mandates an equity stake or regulates the residents' financing arrangements.

1. Legal barriers.

Because local governments have only the powers delegated to them by state legislators and their state constitutions, new programs always raise questions about the scope of those delegated powers. Even jurisdictions accorded "home rule" do not have unlimited freedom, especially when policies run afoul of long-established limits on local power. Though mandating single-family residences, often a rough proxy for highly staked residents, clearly falls within local jurisdictions' zoning power, mandating actual high staking, in the form of maximum loan-to-value ratios or mandatory PMI, may not. After all, mortgage restrictions would not relate to the use of the land per se, as zoning generally does.[46] Further, many states prohibit local governments from enacting laws regulating private or civil law relationships, except as incident to another municipal power.[47] Although it is unclear

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on federal and state constitutional grounds. Id. More recently, Illinois experimented with implementing mortgage counseling requirements at the ZIP-code level in an effort to address subprime lending—a short-lived approach that has since been replaced by consumer protection legislation that applies at the countywide and statewide level. See Sumit Agarwal, et al, *Do Financial Counseling Mandates Improve Mortgage Choice and Performance? Evidence from a Legislative Experiment* *6–9 (Fisher College of Business Working Paper No 2008-03-019, June 2009), online at http://ssrn.com/abstract=1285603 (visited Nov 6, 2009) (describing the Illinois Predatory Lending Database Pilot Program (HB 4050), and its collapse within twenty weeks); Office of the Governor, *Governor Blagojevich Signs Anti-predatory Lending Law, Announces Borrower Outreach Initiative to Help Fight Foreclosures* 1 (Nov 2, 2007), online at http://www.ihda.org/admin/Upload/Files/5f95c2fa-5427-423d-9361-1cc77ba7e831.pdf (visited Nov 13, 2009) (announcing the signing of Senate Bill 1167, which includes statewide consumer lending protections as well as counseling provisions that apply throughout Cook County for first-time homebuyers and certain kinds of loans).

46 See, for example, Edward H. Ziegler, 1A *Rathkopf's The Law of Zoning and Planning* § 1.04 at 1-21 (West 4th ed 1982) ("[A] fundamental principle of zoning [is that] it deals basically with the use, without regard to the ownership, of the property involved."), quoted in *CHR General, Inc v City of Newton*, 439 NE2d 788, 791 (Mass 1982) (finding an ordinance regulating condominium conversions not authorized by the town's zoning power).

47 See Gary T. Schwartz, *The Logic of Home Rule and the Private Law Exception*, 20 UCLA L Rev 671, 689–90 (1973); Howard Lee McBain, *The Law and the Practice of Municipal Home Rule* 673–74 (Columbia 1916) (citing the "common understanding" that "such general subjects as crime, domestic relations, wills and administration, mortgages, trusts, contracts, real and personal property, insurance, banking, corporations, and many others" are matters of state rather than local control). Both of the broadly influential model home rule provisions, one promulgated by the American Municipal Association and the other by the National Municipal League, explicitly provided that home rule powers would not "include the power to enact private or civil law governing civil relationships except as an incident to an exercise of an independent munic-

exactly how far those prohibitions extend,[48] outlawing the use of certain financing schemes within the jurisdiction may be construed as regulating a civil law relationship. Because the prohibitions exempt municipal laws that are "incident to an exercise of an independent municipal power," however, state enabling legislation granting localities the specific power to regulate mortgages would appear sufficient to overcome this obstacle.[49]

Another potential hurdle stems from federal law. Some mortgages are originated by national banks, and state or local regulation relating to such banks raises preemption questions. The measures we have described would protect homeowners and their neighbors rather than bank investors; although this would not necessarily immunize these limits from preemption, the state has a recognized role in protecting consumers.[50] Localities might also emphasize that the regulated parties

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ipal power." See Terrance Sandalow, *The Limits of Municipal Power under Home Rule: A Role for the Courts*, 48 Minn L Rev 643, 675 (1964) (citing language from § 6 of the American Municipal Associations Model Constitutional Provisions for Municipal Home Rule). Judicial enforcement of this exception, however, preceded the appearance of the models. See Sandalow, 48 Minn L Rev at 674–85 (describing early cases recognizing private law limits on home rule powers).

48 See Schwartz, 20 UCLA L Rev at 702 (cited in note 47) ("[C]ase law tells little either way about the supposed private law exception."). For example, one could say that an ordinance preventing the rental of a unit without running water as a residence "interferes" with potential contracts or civil relationships, but it is clear that localities do exactly that when writing and enforcing their building codes. Such regulation, however, can be characterized as falling within the private or civil law exception's own exception of being "incident to an exercise of an independent municipal power"—here, the jurisdiction's zoning or building code authority. See also Sandalow, 48 Minn L Rev at 676–78 (cited in note 47) ("[T]he most likely construction of the model provisions is that private law may be enacted only if it is in aid of some municipal policy or program which is expressed, at least in part, by means other than the regulation of purely civil relationships."). Of course, the bounds of these independent municipal powers are themselves open to question. See *CHR General*, 439 NE2d at 790–92 (finding condominium conversion regulation was not incident to the municipality's exercise of its zoning power, and thus was invalid under the civil relationships exception contained in the Home Rule Amendment of the Massachusetts Constitution).

49 See Schwartz, 20 UCLA L Rev at 694 (cited in note 47). See also notes 47–48.

50 The Supreme Court recently held in *Cuomo v Clearing House Association*, 129 S Ct 2710 (2009), that ordinary enforcement of a state fair lending law was not preempted by the National Bank Act. Id at 2717. Although the issue involved in that case was somewhat different than those that our hypothetical regulation would present, the Court's rejection of a sweeping agency interpretation and its recognition of a role for state law is suggestive. It also may be significant that federal law expressly exempts state usury laws from preemption. See 12 USC § 85 (creating an exception to the federal interest rate limitation "where by the laws of any State a different rate is limited for banks organized under State laws"). Further, in reaching its holding in *Cuomo*, the Court notes that even the Comptroller of the Currency agrees that "the case law *does* recognize [ ] that 'states retain some power to regulate national banks in areas such as contracts, debt collection, acquisition and transfer of property, and taxation, zoning, criminal, and tort law.'" *Cuomo*, 129 S Ct at 2719 (internal citation omitted), quoting the Comptroller's statement of basis and purpose, which appeared in the Federal Register at 69 Fed Reg 1895, 1896 (2004). Maximum loan-to-value regulation and mandatory PMI requirements could be characterized as falling within these areas of residual state power.

would be mortgagors, not financial institutions: banks may continue to write whatever mortgages they want to write, although local purchasers may not avail themselves of those products.[51] However, by eliminating part of the potential market, localities would arguably be placing a regulatory burden on federally chartered banks, which might at least trigger preemption analysis.[52]

2. Normative objections.

Even if these legal barriers could be surmounted, there remain serious normative objections to this line of regulation. Because the ability to obtain mortgages of various types will vary based on wealth, local governmental mortgage regulation could turn into yet another tool for exclusionary zoning.[53] Nor is it clear that such regulation would effectively lower homeowners' overall debt burdens. Since money is fungible, households might substitute other forms of debt for home mortgage debt.[54] They might, for example, keep higher balances on their credit cards, rather than refinance their home mortgage. Or they might borrow to purchase a car rather than pay outright. These other debts may make it as difficult for them to service their mortgage debts (or keep up their property) in times of financial hardship as would the higher mortgage debt they would have incurred in the absence of regulation. Additional regulation of the mortgage relationship might do no more than serve an information function, telling borrowers that the larger community thinks they are behaving in a risky

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51 The Court's opinion in *Cuomo* expressly distinguished between oversight of "corporate affairs" and "the power to enforce the law." 129 S Ct at 2716. Consider *McClellan v Chipman*, 164 US 347, 358–61 (1896) (holding that a state law voiding certain conveyances of real property by insolvent persons was not preempted).

52 See, for example, *Watters v Wachovia Bank, NA*, 550 US 1, 13 (2007) ("Beyond genuine dispute, state law may not significantly burden a national bank's own exercise of its real estate lending power, just as it may not curtail or hinder a national bank's efficient exercise of any other power, incidental or enumerated under the NBA."). To forestall preemption concerns, states may exempt national banks from regulatory regimes; state "bank parity laws" may require that exemptions applicable to national banks be extended to cover state-chartered banks as well. See, for example, 765 ILCS 77/70(a) (exempting from coverage mortgage originators exempt from coverage under the Residential Mortgage License Act of 1987, a category including both nationally chartered and state banks under 205 ILCS 635/1-4(d)(1). Obviously, such exemptions would dilute the force of the measure and distort borrower decisions.

53 It is even possible that constitutional challenges might be raised about the power to enact such regulations, if they were viewed as a mere pretext for wealth discrimination. Consider *Roy*, 399 So 2d at 741.

54 Such substitution can occur if (and only if) people are not already at the limit of their capacity to incur nonhousing debt. One alternative would be to limit all credit, as some other countries have done. See Teresa A. Sullivan, Elizabeth Warren, and Jay Lawrence Westbrook, *As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America* 324–25 (Oxford 1989) (noting and critiquing this regulatory approach).

manner and should think twice before taking on so much debt. Thus, it may or may not change behavior.

Moreover, while such an approach would address the problem of understaked homeowners, it would exacerbate the problem of overstaked homeowners. These overstaked homeowners, in turn, have interests that often run directly counter to those of another traditionally understaked group—tenants. This raises the question of whether a more transformative approach to local stakeholding might do a better job at addressing the issues presented by these different constituencies.[55]

B. Facilitating Stake-Shifting

One antidote to NIMBY-generating overstaking is to reduce the degree to which the fortunes of individual homeowners turn on fluctuations in area home values.[56] The idea of home equity insurance has been around for decades.[57] The most well-known local implementation of the concept is Oak Park, Illinois's equity assurance program, adopted in the 1970s in an effort to forestall "white flight"; the plan covered only highly localized price changes that were uncorrelated with larger metropolitan trends.[58] A number of policies along similar lines have since been adopted in other localities.[59] A recent pilot pro-

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55 Given our focus on state and local initiatives and our interest in identifying politically plausible alternatives, we do not discuss another issue relevant to residential stakeholding in the United States—the substantial federal income tax advantages granted to homeowners. These advantages include, subject to some limits, deductions for home mortgage interest and property taxes, as well as an exemption from tax of gains generated from the sale of a primary residence. See 26 USC §§ 121, 163(h), 164(a).

56 See, for example, William A. Fischel, *An Economic History of Zoning and a Cure for Its Exclusionary Effects*, 41 Urban Stud 317, 335 (2004) (proposing "selective home equity insurance" as a way "to make home-owners less anxious about development in their communities while still retaining the desirable incentives that home-ownership provides"); Adam Yarmolinsky, *Reassuring the Small Homeowner*, 22 Pub Interest 106, 106 (Winter 1971) (suggesting that homeowners may "become less resistant to mixed housing" if protected against loss on their housing investment).

57 See, for example, Matityahu Marcus and Michael K. Taussig, *A Proposal for Government Insurance of Home Values against Locational Risks*, 46 Land Econ 404, 408–12 (1970) (outlining a proposal for a Home Owners' Insurance Corporation designed to insure homeowners against "locational risks" to home values); Yarmolinsky, 22 Pub Interest at 106 (cited in note 56) (advocating "a simple and quite inexpensive public insurance scheme" to protect homeowners against loss on sale attributable to factors other than "physical deterioration or damage to the home itself").

58 See, for example, Maureen A. McNamara, Comment, *The Legality and Efficacy of Homeowner's Equity Assurance: A Study of Oak Park, Illinois*, 78 Nw U L Rev 1463, 1468–69 (1984) (noting program does not protect against declines in value attributable to a decline in the prices of homes in the larger Chicago-Cook County area). A variety of other conditions and limitations applied. For example, the plan covered only 80 percent of qualifying losses and also excluded from coverage declines in value attributable to damage to the property in question. See id.

59 See, for example, Robert J. Shiller, *Radical Financial Innovation*, in Eytan Sheshinski, Robert J. Strom, and William J. Baumol, eds, *Entrepreneurship, Innovation, and the Growth Mechanism of the Free-Enterprise Economies* 306, 316 (Princeton 2007) (noting that programs similar to Oak Park's

gram in Syracuse, New York extended downside market protection to a broader spectrum of housing market risks by keying payouts to a ZIP-code–based home price index.[60] Such programs have not attracted widespread participation,[61] but they may have had a positive impact in reassuring residents.[62] In addition to programs that address downside market risk, a wide spectrum of affordable housing programs have featured "limited equity" or "shared equity" arrangements that leave some percentage of the home's upside appreciation potential with the local government or with a community group.[63] Private variations on these programs, including shared equity mortgages, attempt to deliver a form of equity financing to homeowners instead of requiring them to rely exclusively on debt.[64]

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were created in a number of localities in Illinios and other states); Liz Hersh, *Profile of Existing Home Equity Assurance Programs* 1–2 (Summary Report on Home Equity Assurance to the Urban Issues Task Force of 10,000 Friends of Pennsylvania, Fall 2001), online at http://www.pauljsentner.com/no_wehav/referenc.all/homeqcha.rts/heqchts_.doc (visited Nov 13, 2009) (reporting data from nine programs located in four states).

60 Andrew Caplin, et al, *Home Equity Insurance: A Pilot Project* *12–17 (Yale International Center for Finance Working Paper No 03-12, May 2003), online at http://ssrn.com/abstract_id=410141 (visited Nov 7, 2009).

61 See, for example, Sarah Max, *Selling L.A., Buying Chicago*, CNNMoney.com (Aug 9, 2004), online at http://money.cnn.com/2004/08/06/real_estate/investment_prop/hedging/index.htm (visited Nov 13, 2009) ("Since the [Syracuse] program was launched in August 2002, [ ] only 76 homeowners have signed up, according to its director[,] Virginia Smith."); Hersh, *Profile of Existing Programs* at 1–2 (cited in note 59) (showing relatively low participation rates for nine surveyed programs, although a few programs in Chicago have attracted hundreds or thousands of households and at least two of them appear to be growing).

62 See, for example, Caplin, *Home Equity Insurance* at *28 (cited in note 60) (suggesting that even where participation in a home equity insurance program is low, there might be positive effects for the community such as increased confidence). Paid claims have been low to nonexistent in such programs. See, for example, Hersh, *Profile of Existing Programs* at 1–2 (cited in note 59).

63 See, for example, J. Peter Byrne and Michael Diamond, *Affordable Housing, Land Tenure, and Urban Policy: The Matrix Revealed*, 34 Fordham Urban L J 527, 541–51 (2007) (describing how resale limits involve tradeoffs between the wealth creation and housing goals of subsidized homeownership programs); John Emmeus Davis, *Shared Equity Homeownership: The Changing Landscape of Resale-Restricted, Owner-Occupied Housing* 65 (National Housing Institute 2006) (describing resale restrictions applicable to shared equity housing and identifying a variety of formulas for capping the portion of the sales proceeds the homeowner can receive); Duncan Kennedy, *The Limited Equity Coop as a Vehicle for Affordable Housing in a Race and Class Divided Society*, 46 Howard L J 85, 87 (2002) (advocating the development of "limited equity coops" which would allow owners to recoup only their initial investment plus the value of their improvements, along with an inflation adjustment and perhaps a limited share of appreciation, on resale); Rick Jacobus and Jeffrey Lubell, *Preservation of Affordable Homeownership: A Continuum of Strategies* *5–6 (Center for Housing Policy, Policy Brief, Apr 2007), online at http://www.ncbcapitalimpact.org/uploadedFiles/downloads/JacobusLubelloptions4-07.pdf (visited Nov 13, 2009) (describing a spectrum of ways to structure affordable homeownership through equity sharing and subsidy repayment alternatives, with choices among them framed in terms of the tradeoff between the goals of wealth creation and the preservation of affordable housing).

64 See, for example, Andrew Caplin, et al, *Shared-Equity Mortgages, Housing Affordability, and Homeownership*, 18 Hous Pol Debate 209, 217 (2007) (noting the affordability advantages of "more innovative mortgages that bridge the gap between debt and equity"); Andrew Caplin, et al,

These two approaches (offloading downside risk, and selling off upside potential) could be combined in a single product or policy package.[65] A simple example will convey how such a program for reducing homeownership risk would work. Suppose Holly Homebuyer wishes to purchase a home in Maroon Meadows that costs $200,000. Ivan Investor makes the following two-part deal with her: First, he will give her a lump sum now, and when Holly sells, she will pay him an amount that represents the portion of her home's appreciation (if any) attributable to housing market changes (that is, screening out appreciation attributable to changes made on-site to the home and grounds).[66] Second, he will collect a lump sum premium from her now, and when she sells, he will pay her the portion of the home's loss in value (if any) attributable to housing market changes (again, screening out losses caused by changes to the property itself). When all is said and done, Holly gets some money upfront[67] and Ivan bears most of the home's upside and downside risk.[68] If the home later sells for $250,000 due to a

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Innovative Approaches to Reducing the Cost of Home Ownership 7–8 (Menzies Research Centre, June 2003), online at http://www.mrcltd.org.au/research/home-ownership/volume_1.pdf (visited Nov 7, 2009) (proposing the development of equity financing techniques).

65 One of us has elsewhere suggested that the offloading of upside and downside risk associated with off-site factors could be combined in a new default tenure form. Fennell, 102 Nw U L Rev at 1071–73 (cited in note 12) (outlining a "Homeownership 2.0" tenure form where homeowners bear the risk for the consumption and on-site investment components of homeownership while outside investors bear the investment risk associated with off-site factors, including local changes in housing values).

66 There are a variety of ways to accomplish this disaggregation, albeit imperfectly, including the use of housing price indexes. See, for example, id at 1073–78 (describing methods for disaggregating neighborhood and on-site effects); Robert J. Shiller and Allan N. Weiss, *Home Equity Insurance*, 19 J Real Est Fin & Econ 21, 25–26 (1999) (explaining how the use of housing indexes overcomes moral hazard and selection bias problems that would otherwise afflict homeownership insurance schemes).

67 We assume here that the proceeds from alienating upside potential would be larger than the premium required to insure against downside loss.

68 When effectuated with respect to marketable stocks, securities, or commodities, this arrangement is denominated a "collar." See Jeffrey L. Rubinger, *Tax Planning Strategies with Equity Derivatives*, 76 Fla Bar J 45, 45 (Apr 2002) (explaining that a collar is a combination of a put option and a call option on the underlying shares of stock). Typically businesses and investors enter into collars to lower the cost of hedging against unfavorable price movements, as collars have a lower cash price than one-way options. The cash discount comes from the sale of the rights to the gains generated by favorable price movements. See Fred D. Arditti, *Derivatives: A Comprehensive Resource for Options, Futures, Interest Rate Swaps, and Mortgage Securities* 135 (Harvard 1996) (describing an interest rate collar as "a trade-off of the lower cost of insuring against higher rates in exchange for parting with the reduced borrowing costs to be realized if rates are lower"). However, most collar arrangements cover explicit—and relatively short—time periods, rather than being open-ended. That is, prices, gains, and losses are determined and paid at the end of six months or a year, rather than (as envisioned in this Article) waiting until the sale of the underlying property. Settling options based on sales rather than at specific temporal intervals introduces complications in pricing that have received some attention in the literature. See, for example, Shiller and Weiss, 19 J Real Est Fin & Econ at 41–43 (cited in note 66) (noting the potential for policyholders to strategically time their moves to maximize their returns if payouts were

general rise in home values in the area, Ivan collects $50,000 of the proceeds. If the home later sells for $150,000 due to a general decline in home values in the area, Ivan pays Holly $50,000 to cover her loss.[69]

Because it is hard to imagine ordinary homebuyers making deals with investors in this fashion, an intermediary institution would be necessary to bring about the changes just described.[70] That institution would arrange the cash transfers incident to the risk shift and seamlessly (from Holly's perspective) move the upside and downside risk associated with the home to Ivan and his ilk. While private entities could take on a risk-shifting role (and have done so to some extent),[71] local governments might be especially well positioned—and well motivated—to spearhead a move to a new homeownership paradigm. With the increasing availability of financial instruments tied to local housing prices, local governments would not have to engineer these risk shifts from scratch, but rather could serve as a user-friendly conduit for matching homeowners with investors. Program options could range from mere information provision[72] to policies that encourage or even require the use of risk-shifting tools.[73]

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temporally unconstrained, and discussing the potential for using "life event" triggers to restrain opportunism); Caplin, 18 Housing Pol Debate at 218–19 (cited in note 64) (explaining how the borrower's costs for shared equity mortgages vary depending on the holding period and noting that "[t]he long and unpredictable nature of the payoff period appears to have been the chief reason that the Bank of Scotland withdrew its shared-equity mortgages from the market").

69 In this simple example, we ignore the effects of interest and inflation, and also make the simplifying assumption that Holly would alienate 100 percent of the upside and downside risk associated with off-site factors. Many homeowners would wish to retain at least some portion of the upside, and, for affordability reasons, would likely keep part of the downside as well.

70 See, for example, Shiller and Weiss, 19 J Real Est Fin & Econ at 33–34 (cited in note 66) (discussing the potential for insurance companies to offer "pass-through futures and options"). See also Juerg Syz, Paolo Vanini, and Marco Salvi, *Property Derivatives and Index-Linked Mortgages*, 36 J Real Est Fin & Econ 23, 24 (2008) (proposing that index-based risk-shifting be built into mortgages).

71 A number of private enterprises have offered products for rearranging homeownership risk. For recent examples, see EquityRock, formerly known as REX & Co, http://www.rexagreement.com (visited Jan 3, 2010) (providing information on agreements that deliver funds in exchange for a share of home equity, which the company plans to resume originating soon); Equity Finance Mortgage, online at http://www.efm.info (visited Nov 13, 2009) (describing shared equity mortgage product offered by Rismark International through Australia's Adelaide Bank); Advanced e-Financial Technologies, Inc, SwapRent, online at http://www.swaprent.com (visited Nov 13, 2009) (offering a product that would let homeowners toggle to and from an "economic renting" mode that offloads upside and downside home price risk). See also notes 57–64 and accompanying text (describing several models for shifting homeownership risk through public or private mechanisms).

72 At the very least, local governments could inform residents of the existence of products for hedging homeownership risk. Many are undoubtedly unaware, for example, that futures and options based on local housing indexes exist. Financial instruments keyed to home prices in a number of cities, developed by Robert Shiller and Karl E. Case, became tradable on the Chicago Mercantile Exchange (now CME Group) in the spring of 2006. See Robert J. Shiller, *Derivatives Markets for Home Prices* *4–24 (NBER Working Paper No 13962, Apr 2008), online at

Increased use of markets in housing risk would help protect against both understaking and overstaking. Selling off upside appreciation potential makes homes more affordable and, other things being equal, reduces the need for mortgage debt and hence the likelihood of default.[74] Buffering downside housing market risk reduces the mortgage default risk and increases liquidity in housing markets. Homeowners protected against market downturns will be better able to sell or refinance in a down market, both because the payment they will receive from the program will enable them to meet their existing mortgage obligation, and because potential buyers will not be frightened away from purchasing by the prospect of losing money.[75] The homeowner's reduced stake in both upside and downside price changes would also be expected to dampen the impulse toward risk-averse, NIMBY-like behavior.[76]

Though we have sketched the broad parameters of a risk-shifting program, many operational details remain to be worked out. While space does not permit us to address these design issues here, others have already devoted detailed attention to many of the relevant issues.[77] The many past and existing entrepreneurial efforts along these lines also offer useful case studies.[78]

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http://www.nber.org/papers/w13962.pdf (visited Nov 13, 2009) (discussing history and future prospects of these derivative markets).

73 Encouragement might take the form of subsidies, tax preferences, or regulation. While mandating a particular level of risk shifting seems implausible and even unwise, local governments could require a reduced-risk version of homeownership to be the default option for residents, so that purchasers would have to affirmatively opt into the traditional level of homeownership risk. See Fennell, 102 Nw U L Rev at 1094–95 (cited in note 12) (explaining how a new default package for homeownership could reframe choices and influence decisionmaking). For another proposed use of defaults in the home-buying context, see Michael S. Barr, Sendhil Mullainathan, and Eldar Shafir, *An Opt-Out Home Mortgage System* *22–25 (Hamilton Project Discussion Paper No 2008-14, Sept 2008), online at http://www.brookings.edu/papers/2008/09_mortgage_system_barr.aspx (visited Nov 13, 2009) (proposing that lenders be required to offer borrowers a certain set of standard terms as a default matter).

74 Some homebuyers may instead opt for more expensive homes, retaining traditional levels of debt, just as they might undermine the goals of mortgage regulation by increasing their levels of nonmortgage debt. See text accompanying note 54. Tightening credit standards may limit access to debt financing, however. See Caplin, *Facilitating Shared Appreciation Mortgages* at *5 (cited in note 6).

75 As it is, falling prices may discourage rather than encourage sales—as Ian Ayres and Barry Nalebuff put it, buyers do not want to "catch a falling knife." Ian Ayres and Barry Nalebuff, *Price-Protect Your Home*, Forbes 101 (Sept 16, 2002). Further, getting bank approval for "short sales" is a difficult and lengthy process that can chase away buyers. With option money in hand, a seller should be able to afford to pay off the mortgage in full even if the sales price is less than the amount of the outstanding mortgage.

76 See note 56 and accompanying text. See also Fennell, 102 Nw U L Rev at 1100–03 (cited in note 12) (explaining how offloading homeownership risk might improve homeowner incentives, but noting some qualifications).

77 Technical issues include the appropriate construction and use of indexes, the treatment of inflation, the timing for exercising an option, the structure and timing of payments and

Voluntary municipal programs offering homeowners risk-shifting options would confront fewer legal obstacles than would the direct regulation of mortgages; at most, state enabling legislation would be required.[79] Such legislation could either authorize specific programs[80] or grant local governments broader authority by explicitly including within "general welfare" and "home rule" powers the right to develop risk-shifting mechanisms aimed at improving housing security. Given the nascent state of knowledge, the latter approach would carry distinct advantages.[81]

Beyond mere enabling, state governments could help by providing administrative support for these innovative programs. Although local governments may work together and share information in the normal course of events, a state agency or commission charged with oversight of housing programs may provide resources or simply facilitate coordination. Resulting exchanges of information and ideas could hasten the development of valuable programs and perhaps avoid replicating the mistakes that will undoubtedly arise in the course of what will be a trial and error process. Moreover, some localities may be too small to create these types of programs; a state coordinating entity could provide a platform for joint ventures.

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payouts, and other details affecting price. For discussion of these issues, see, for example, Shiller and Weiss, 19 J Real Est Fin & Econ at 31–32 (cited in note 66); Shiller, *Macro Markets* at 96–98, 116–200 (cited in note 12). Regulatory oversight would need to address, among other issues, concerns about consumer mistakes and confusion, investor "capture" of local governance, and discrimination in the pricing or availability of risk-shifting mechanisms. See Fennell, 102 Nw U L Rev at 1095–98, 1104–07, 1115–17 (cited in note 12) (noting these issues and discussing how they might be addressed). The new program's interface with existing regulatory structures, including those governing lending, securities, and insurance, as well as with federal, state, and local taxation mechanisms, would also require attention. See, for example, Andrew Caplin, Noël Cunningham, and Mitchell Engler, *Rectifying the Tax Treatment of Shared Appreciation Mortgages*, 62 Tax L Rev 505, 514–29 (2009) (explaining how existing tax law impedes the use of shared appreciation mortgages); Fennell, 102 Nw U L Rev at 1007–09 (cited in note 12) (noting issues raised by property tax increases attributable to appreciation after homeowners have alienated upside potential); Caplin, *Home Equity Insurance* at *24–28 (cited in note 60) (describing regulatory issues encountered in launching a home equity pilot program in New York state).

78 For examples, see notes 58–64 and accompanying text.

79 The underlying financial instruments would be subject to federal regulation, however; thus, the legal treatment of derivatives would affect the availability and structuring of those instruments.

80 In some cases, state authorization may be necessary more as a matter of politics than of law. The State of Illinois, for example, specifically authorized groups of voters within cities with populations of more than one million (a category that includes only Chicago) to create sublocal homeowner equity assurance programs of the type pioneered by Oak Park. See Home Equity Insurance Act, 65 ILCS 95/1–95/14. Even before this legislation was enacted, Chicago, like other Illinois cities, had the power to charter an assurance program like Oak Park's. The legislation enabled neighborhoods within Chicago to create and fund their own assurance programs without interference from the central city government. See Caplin, *Home Equity Insurance* at *6 (cited in note 60).

81 See Caplin, *Home Equity Insurance* at *7–9 (cited in note 60) (detailing shortfalls in programs enacted pursuant to Illinois's statutory scheme).

The development of such programs raises normative as well as legal concerns. One primary worry relates directly to stakeholding itself—will homeowners who have offloaded risk care too little about their communities? Two factors would be expected to constrain this effect. First, homeowners will still live in the community,[82] and thus will continue to have a direct consumption interest in the community's fortunes.[83] Second, the risk that is offloaded to investors relates to area housing price trends; homeowners will still enjoy (or suffer) the results of any maintenance, renovation, or decorating choices that they make. If homeowners primarily contribute to the community through behaviors like maintaining their homes and forming robust ties to others in the community, reductions in home value risk would not be expected to have a significantly negative behavioral effect. When the salutary effects of reducing exclusionary homeowner behavior are taken into account, net gains appear likely.[84]

Another concern is that reconfiguring homeownership would work all too well—for homeowners. Even if homeownership is made more affordable through risk-shifting, many households will choose to rent for at least some portion of the life cycle. When communities flourish and property values rise, concerns emerge about gentrifica-

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82 Although the program may make it easier for residents to leave a declining area, moving would remain a disruptive and costly transaction. Perhaps more important, these programs would greatly reduce the risks of staying by providing protection against additional property value decreases; homeowners would no longer have to worry about selling before others do. See, for example, Yarmolinsky, 22 Pub Interest at 109 (cited in note 56); Thomas C. Schelling, *A Process of Residential Segregation: Neighborhood Tipping*, in Anthony H. Pascal, ed, *Racial Discrimination in Economic Life* 157, 174 (Lexington 1972). Homeowners also should be reluctant to leave improving areas, since the benefits of that improvement are not portable.

83 While that same consumption interest might also drive NIMBY-like behaviors (rendering them less responsive to risk reduction), it is possible that the latter are driven primarily by risk aversion about home values rather than a belief that the changes in question would actually reduce quality of life. See, for example, Fischel, *Homevoter Hypothesis* at 9–11 (cited in note 3) (noting that the absence of insurance causes homeowners to worry "about the *variance* (statistical, not legal) in the outcome" of even those local projects with "benign . . . *expected* effect[s]"). Significantly, with the risk of property value declines out of the picture, homeowners would have to justify their objections in terms of the housing consumption experience rather than rely on the assertion that the change would harm property values. See Yarmolinsky, 22 Pub Interest at 106 (cited in note 56) ("Even where economic concerns are pure rationalization by white racists there is something to be said for calling their bluff."); see also Fennell, 102 Nw U L Rev at 1101 (cited in note 12) (observing that homeowners who were shielded from home value risk could no longer rely on the justification of "preserving property values").

84 The investors holding the risk will have incentives of their own, of course, introducing additional complications. Tracing the full political implications of the shift in risk-bearing arrangements is beyond the scope of this Article, but the analysis one of us has undertaken elsewhere suggests cause for cautious optimism that the rearrangement of risk could produce gains and that the largest concerns could be successfully addressed through policy design. See Fennell, 102 Nw U L Rev at 1098–1109 (cited in note 12).

tion and tenant displacement.[85] Addressing these concerns requires reconfiguring the stakes of tenants as well as homeowners.

III. TENANT STAKES

Perhaps the most important drawback of leasing rather than owning is that tenants lack the option to remain in their homes for as long as they wish.[86] There are many ways to deliver this option to tenants, including familiar devices like rent control, rent subsidies, and longer leases. We discuss these traditional responses briefly before turning to a more innovative approach to reconfiguring tenant stakes.

A. The Usual Suspects

Rent control is typically proffered as the solution to concerns about tenant displacement. The pros and cons of rent control have received considerable scholarly attention, which we will not attempt to summarize here. Instead, we wish to focus on two features of rent control that make it less than ideal for addressing the problem of understaked tenants. First, rent control concentrates the costs of avoiding tenant displacement on landlords and their current and future tenants, leaving open only the question of how costs will be distributed among and between those groups.[87] Controls that suppress rents below market levels deliver benefits to current tenants, but the associated costs are absorbed within the rental housing market. Either landlords chisel on maintenance and services to the detriment of their current tenants,[88]

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85 Interestingly, rising property values could present difficulties not only for tenants, but also for homeowners who have alienated their upside appreciation rights under the scheme discussed above; without rights to the increasing equity, rising property taxes would become problematic. See Fennell, 102 Nw U L Rev at 1107–09 (cited in note 12) (discussing this problem and some possible approaches to it). Politically, such difficulties may lead to support for "welcome stranger" property tax assessment rules or other tax caps. See *Nordlinger v Hahn*, 505 US 1, 6 (1992) (describing "welcome stranger" assessments).

86 For discussions of the significance of security of tenure, see, for example, Florence Wagman Roisman, *The Right to Remain: Common Law Protections for Security of Tenure: An Essay in Honor of John Otis Calmore*, 86 NC L Rev 817, 820–29 (2008); Richard Arnott, *Tenancy Rent Control*, 10 Swed Econ Pol Rev 89, 111–12 (2003); Margaret Jane Radin, *Residential Rent Control*, 15 Phil & Pub Aff 350, 359–63, 368–70 (1986).

87 See Anthony Downs, *A Reevaluation of Residential Rent Controls* 3 (Urban Land Institute 1996) ("Much evidence indicates that all rent controls, even temperate ones, transfer income from owners to tenants or between various classes of tenants."); William Tucker, *Zoning, Rent Control and Affordable Housing* 37–41 (Cato Institute 1991) (describing effects of rent control as "war between tenants and landlords").

88 For empirical work on this question, see Choon-Geol Moon and Janet G. Stotsky, *The Effect of Rent Control on Housing Quality Change: A Longitudinal Analysis*, 101 J Polit Econ 1114, 1143–44 (1993) (studying how housing quality in New York City varied over time depending on the magnitude of the implicit subsidy delivered to tenants through rent control). While Moon and Stotsky found that units with proportionately larger rent control subsidies were

or their profits decline. Reduced landlord profits can translate into a diminished stock of rental housing,[89] making it more difficult for newcomers to find accommodations.[90] Second, rent control tends to lock existing tenants into particular units.[91] While it might seem that keeping people in the community is the point of rent control,[92] an option to

less likely to experience quality improvements, their evidence on quality declines was mixed. See id at 1139. See also Downs, *A Reevaluation* at 12, 55–58 (cited in note 87) (noting that although empirical studies suggest that "stringent" rent controls lead to more deterioration in housing units, the evidence is mixed on whether "temperate" controls have that effect). The picture is complicated by the fact that tenants receiving large subsidies under rent control tend to stay in their units for a long time, and hence have greater incentives to engage in maintenance on their own. See Moon and Stotsky, 101 J Polit Econ at 1125, 1139.

89 See, for example, Lerman and McKernan, *Promoting Neighborhood Improvement* at *1 (cited in note 13) (noting the tendency of rent control to "induc[e] shortages and higher prices for uncontrolled units"). As Anthony Downs explains, controls that keep rents below market levels suppress price signals that would otherwise induce entry when demand increases; to the extent profits are diminished below "normal" returns, controls send an erroneous signal that induces exit. See Downs, *A Reevaluation* at 21–26, 45–48 (cited in note 87). Rent control is viewed as a major reason for the decline in private rental markets in Europe. See, for example, Gavin McCrone and Mark Stephens, *Housing Policy in Britain and Europe* 20 (UCL 1995) (observing, based on data from European countries, that "[t]he size of the private rented sector has been greatly affected by rent control, wherever it has been applied"). See also Downs, *A Reevaluation* at 48 (cited in note 87) ("The experience of the United Kingdom strikingly confirms that stringent rent controls reduce new construction of rental units in the long run."); E. Jay Howenstine, *Attacking Housing Costs: Foreign Policies and Strategies* 74–81 (Center for Urban Policy Research 1983) (explaining how rent control in a number of countries undermined the profitability of private rental housing, leading to a decline in its economic significance). Where rent control ordinances have avoided supply problems, it may be because their price caps are so relaxed as to have had little binding effect. See Margery A. Turner, *Housing Market Impacts of Rent Control: The Washington, D.C. Experience* 95–96 (Urban Institute 1990) (discussing evidence indicating that a moderate rent control program in the District of Columbia—one "that explicitly [sought] to maintain the profitability of investment in rental housing"—had a small to nonexistent supply effect); id at 97 (noting that "[i]t is possible that the reason rent control has had no impact on supply is that its impact on price has been negligible" but finding that rent control in Washington, DC suppressed rents by an average of $50 per month); John I. Gilderbloom and Richard P. Appelbaum, *Rethinking Rental Housing* 134 (Temple 1988) (reviewing studies that suggest that "neither moderate nor strong [as distinguished from restrictive] forms of control have caused a decline in either the quality or supply of the rental stock"); id at 220 ("[B]oth the positive and negative economic effects of moderate rent control (its most widespread form) . . . [are] limited.").

90 The prevalence of long-time tenants in controlled units is consistent with rent control's effect on newcomers. See Tucker, *Zoning* at 48 (cited in note 87) (observing in 1991 publication that "[m]ost rent-controlled apartments [in NYC] are occupied by people who have been in continuous residence since 1971—and some have been occupied by the same people (or their friends or relatives) since 1943"). Another concern is that shortages of rental housing will lead landlords to screen based on improper criteria. See Downs, *A Reevaluation* at 61 (cited in note 87).

91 This lock-in effect follows most clearly if stricter limits on rent increases apply within a given tenancy than between tenancies, as with "vacancy decontrol." See Arnott, 10 Swed Econ Pol Rev at 95–96 (cited in note 86); Downs, *A Reevaluation* at 58–59 (cited in note 87). But any controls that produce scarcity in rental housing will contribute to lock-in; no tenant wants to give up her place if she will have difficulty finding another. See Downs, *A Reevaluation* at 59–60 (cited in note 87).

92 See Radin, 15 Phil & Pub Aff at 368–71 (cited in note 86) (discussing a communitarian justification for rent control). Rent control might solve a collective action problem in keeping a

remain is different than a distortive pressure to remain, which can, among other things, reduce the responsiveness of labor supply[93] and keep tenants in larger or smaller units than desirable given their current family configurations.[94]

Rent subsidies funded by local taxation would avoid the cost concentration of rent control but, depending on program design, may still have a lock-in effect. They are also likely to be politically vulnerable, and any uncertainty about the program's continuing viability will erode tenants' time horizons, and accordingly, the social benefit of such programs.

Requiring landlords to offer prospective tenants longer lease terms might seem to offer another solution. We might first ask why the market does not already produce lengthy residential leases. One possible reason is that they tend to be asymmetrically binding on the parties. Most landlords could be compelled to comply with longer lease terms, but few would be able to collect anything beyond the security deposits of low-income tenants who break their leases. Pricing a one-way option into the rental amount is certainly possible, but would run counter to the goal of housing affordability.[95] Forcing landlords to offer longer leases at the same price as shorter leases would raise landlord costs and produce the same dynamics as rent control.

B. Giving Tenants Options

Robert Lerman and Signe-Mary McKernan have proposed another way to confer on tenants the right to remain in place: financial options that are keyed to local rent levels.[96] The basic outlines of an

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community that is highly valued by all of its members from unraveling as a result of households' individual actions to move to cheaper markets. See id at 369. A fully portable tenant benefit, even one that enables households to stay if they wish, would lack this advantage. See text accompanying notes 110–11.

93 See Arnott, 10 Swed Econ Pol Rev at 111 (cited in note 86) (noting that rent control "has a lock-in effect that reduces not only housing mobility but also labor mobility"). Related points have been made in the context of homeownership: owners facing a difficult market tend to become stuck in place, potentially reducing their ability to take advantage of job opportunities elsewhere. For discussion of this issue and how downside home equity protection would remove obstacles to mobility during market downturns, see, for example, Fennell, 102 Nw U L Rev at 1109–10 (cited in note 12); Yarmolinsky, 22 Pub Interest at 107 (cited in note 56).

94 See Downs, *A Reevaluation* at 59–60 (cited in note 87) ("Rent controls tend to lock in tenants in controlled units regardless of how suitable those units are to the households' real space needs.").

95 This point is analogous to the "front-end load[ing]" associated with forms of rent control that apply only within, and not between, tenancies. See Arnott, 10 Swed Econ Pol Rev at 94 (cited in note 86) (explaining that a rational landlord "will set the initial rent above what he would charge in the absence of controls in an attempt to compensate for the 'loss' (relative to the free market rent) he will make on his unit in the later years of a tenancy").

96 Lerman and McKernan, *Promoting Neighborhood Improvement* at *2 (cited in note 13) (explaining how tenants could "offset rent increases" with gains from their options). See Robert

option-based approach can be illustrated with a simple example.[97] Suppose Tara Tenant, who is on a fixed income, leases a unit for one year at $1,000 per month. She could expect her rent to go up by about $10 a month or $120 a year for every 1 percent increase in area rents. Suppose she obtains a one-year call option that is indexed to rental values within her ZIP code, at a value that corresponds to her lease's rental amount. If, in a year, prices have shot up 20 percent, her option would be worth $2,400 ($120 x 20).[98] Assuming her unit tracks the area trend, the payment she receives under the option would cover the cost of any rental increases associated with renewing the lease for another year at her present location. Alternatively, Tara might take the cash and rent (or buy) elsewhere, having benefited from the general improvement in her community.[99] If, instead, area rental prices stayed the same or fell, the option would have no value.[100]

I. Lerman, *Promoting Neighborhood Improvement while Protecting Low-Income Families* (unpublished presentation, 29th Research Conference, Association for Public Policy Analysis and Management, Nov 2008) (on file with authors) (expanding on the ideas in Lerman and McKernan, cited in note 13, and including options pricing estimates). The idea of such a financial instrument is also raised in O'Flaherty, *City Economics* at 369 (cited in note 3).

97 In the interest of providing an intuitive illustration of how tenant options could work, this example ignores some important refinements that will be discussed below; accordingly, it should not be viewed as an operational template. More generally, because Lerman and McKernan have provided relatively few details about their proposal, our description may diverge in some respects from the options regime they envision.

98 Although this example suggests that tenants would receive complete protection against area rent increases, options would likely be structured to provide somewhat less protection. For example, the tenant's option might begin to gain value only after increases in area rents have outpaced inflation by a certain amount. In options terminology, the "strike price" would be adjusted upward, constricting the circumstances in which the option is "in the money" (valuable to exercise), and thereby reducing the price of the option itself. See Lerman, *Promoting Neighborhood Improvement* at *10 (cited in note 96) (suggesting that the strike price be set to meet the objective of protecting tenants against "unusually high rent increases" rather than all rent increases). Similarly, rent control programs generally permit annual percentage adjustments of some sort. See Downs, *A Reevaluation* at 34 (cited in note 87).

99 See Lerman and McKernan, *Promoting Neighborhood Improvement* at *2 (cited in note 13). If, for example, Tara's landlord does not keep up the unit in a fashion that reflects the overall improvement in the area but nonetheless raises the rent in accordance with local price trends, Tara may decide to use the money to move to a nicer unit. If her landlord instead opts for a smaller (or no) rental increase, Tara might stay and spend the cash on non-rental needs.

100 Tenants could also conceivably use financial instruments to accept exposure to the risk of downward market fluctuations. Thus, Tara could collect a premium for selling a "put" requiring her to pay out an amount corresponding to the decline in area rents. For example, suppose the area's property values went down in value by 10 percent, reducing the rent demand by Tara's landlord from $1,000 per month to $900 per month. Tara would have to pay the holder of the put $100 per month, or $1,200 per year, leaving her in the same position (from a cash perspective) as if her rent had stayed at $1,000. Builders or landlords with an interest in buffering the risk of falling rents might wish to hedge against that eventuality, and, in theory, tenants could take the other side of those transactions. See Lerman, *Promoting Neighborhood Improvement* at *5, 8 (cited in note 96). Although the sale of the put would allow tenants like Tara to partially offset the cost of obtaining protection against upward rent movements, we assume such ar-

In effect, such a call option would insure tenants against area rent increases.[101] A tenant holding such an instrument would have a stake in the community's improvement that she currently lacks.[102] By lengthening the tenant's time horizon and protecting against displacement, the program would be expected to foster the development of social capital and reduce opposition to community changes that are likely to have positive effects on property values.[103]

Here too, many additional design details would have to be worked through. Chief among them is the issue of who would pay for the option. Tenants, especially those most at risk of displacement through gentrification, are unlikely to have the ability or desire to spend money on complex financial instruments. Local governments, who have much to gain from tenant stability[104] (and who may find it necessary to spend money on affordable housing in any event) might purchase such instruments and give them to low-income tenants living within their

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rangements would be too risky to interest many tenants. Tenants would find it hard to make the necessary payments if falling area rents correlated with labor market declines or if their particular units failed to experience a rent decrease.

101 A tenant protection policy might be explicitly structured as an insurance policy against rent increases rather than as a tradable option. See Lerman and McKernan, *Promoting Neighborhood Improvement* at *2 (cited in note 13); Lerman, *Promoting Neighborhood Improvement* at *7–8 (cited in note 96).

102 See Lerman, *Promoting Neighborhood Improvement* at *12 (cited in note 96) (observing that the tenant option proposal "would provide low-income renters with a financial stake in improving their neighborhood").

103 See id ("[T]hese financial instruments would limit or even prevent the downsides of gentrification for low-income residents, help to maintain diversity in neighborhoods, and thereby remove some of the opposition to development."). We do not mean to suggest that a tenant stakeholder program will—or should—make all tenants support every change with a positive expected impact on property values. Both tenants and homeowners might rationally oppose changes that would increase property values but alter the character of the neighborhood in ways that would reduce their desire to remain. See, for example, Eduardo Peñalver, *Land Virtues*, 94 Cornell L Rev 821, 842–44 (2009). As Lance Freeman makes clear in his book, *There Goes the 'Hood*, although gentrification often brings desired amenities to an area, such as increased retail and improvements in city services, it also often brings conflict regarding the use of public space, Freeman, *There Goes the 'Hood* at 137 (cited in note 35), and can evoke "feelings of anger and racially based disrespect," id at 111. Homeowners seek to maximize the sum of their consumption flow and their investment returns, and may rationally forgo some of the latter in favor of more of the former, especially if they plan to stay for a long time. See, for example, Fischel, *Homevoter Hypothesis* at 150 (cited in note 3) ("If you plan to stay a long time, you are more inclined to suit yourself; if you plan to move soon, you suit the market."). Tenants given the equivalent of an investment stake would be expected to make similar tradeoffs.

104 Research suggests that the typically longer tenure length of homeowners explains part of the correlation between homeownership and socially valuable behaviors and outcomes. See, for example, DiPasquale and Glaeser, 45 J Urban Econ at 356 (cited in note 31) (finding that "the impact of homeownership on our citizenship variables is working substantially through community tenure"). Given this, we might expect increased tenant stability to provide at least some of the benefits that have been traditionally associated with homeownership.

jurisdictions or make them available to tenants on a sliding-scale basis.[105] To the extent funding comes from general property tax revenues, such a program would partially redistribute gentrification gains from landowners to tenants.[106] Unlike rent control, the costs of this redistribution would be borne by the entire class of landowners, rather than the smaller subset of rent-controlled landlords. The possibility that the costs would be shifted back onto tenants would diminish accordingly.

Once local government funding enters the picture, however, additional complications arise. To prevent distortion in housing choice, subsidized options would have to be pegged to median rents in the area, adjusted for family size, rather than to a household's actual rental costs;[107] tenants choosing relatively more expensive accommodations could then purchase additional protection at market rates if they so desired. Subsidized programs could also encounter state law impediments. In addition to generalized attacks on such programs on "public purpose" grounds,[108] some jurisdictions may lack the authority to provide tenants with rent subsidies taking the form of financial instruments offering cash-out options. A broader normative concern that would be exacerbated by the liquid nature of the subsidy (relative, say, to rent control) is that tenant households could cash out their option gains only to later suffer displacement or even homelessness. To avoid these prob-

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105 One possibility would be for the local government to provide the hedge itself (rather than merely act as a conduit for passing risk to investors). See Lerman and McKernan, *Promoting Neighborhood Improvement* at *3 (cited in note 13) (explaining that the local government would only make payouts when property values have risen; the rise in property values could increase property tax receipts by enough to fund the required payouts). A locality taking this approach could achieve the same economic result by executing a contractual rent subsidy agreement with selected tenants that made payouts contingent on changes in local rental values. In either case, the informational and risk diversification advantages of an options market would be lost.

106 Alternatively, one might characterize the program as compensating tenants for the harm of gentrification. See Barbara Bezdek, *Putting Community Equity in Community Development: Resident Equity Participation in Urban Redevelopment*, in Nestor M. Davidson and Robin Paul Malloy, eds, *Affordable Housing and Public-Private Partnerships* 93, 101–04 (Ashgate 2009) (enumerating harms inflicted by gentrification).

107 Lerman and McKernan note that under their proposal, "[t]he benefit paid would not depend on the price of the renter's own unit, as this could create incentives for abuse by renters and landlords." Lerman and McKernan, *Promoting Neighborhood Improvement* at *2 (cited in note 13).

108 Most states have constitutional, if not legislative, prohibitions against spending governmental money for anything other than "public purposes." See Lynn A. Baker and Clayton P. Gillette, *Local Government Law: Cases and Materials* 393 (Foundation 3d ed 2004) ("Virtually every state constitution restricts governmental spending to those activities that serve a 'public purpose.'"). Historically, subsidized housing programs have been attacked as diversions of public money for the "private" gain of the subsidized tenants, although most courts now accept that subsidized housing confers a public benefit. See, for example, *Martin v North Carolina Housing Corp*, 175 SE2d 665, 672–77 (NC 1970) (finding that an act establishing a public housing corporation to provide housing assistance to low-income families served a public purpose). However, the new forms of subsidies discussed in this Article—particularly the multiyear cash-out option—may reinvigorate this issue. See text accompanying notes 115–16.

lems, communities might place limits on how payouts from subsidized options could be used.[109]

Two additional design decisions—the degree of mobility that these tenant options would facilitate, and the timing and structure of option payouts—raise a bevy of issues. Although one advantage of the call option structure is that it grants tenants the ability to move to other accommodations,[110] unlimited tenant mobility may decrease the social value of the program by reducing continuity. At least in some jurisdictions, the point of offering a housing subsidy (whether in the form of an option or otherwise) is to maintain an economically diverse community. If the option follows the tenant rather than the rental unit, such diversity will be lost whenever the tenant prefers cash and residence in a cheaper jurisdiction to continued residence in the community.[111] Other jurisdictions, however, may be seeking another type of diversity, such as the introduction of wealthier members to the community[112] or the creation (or preservation) of job opportunities, both of which may require the displacement of some members of the existing community.[113] Options that enable tenants to move as community con-

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109 See Lerman and McKernan, *Promoting Neighborhood Improvement* at *3 (cited in note 13) (suggesting that "[s]ome limitations might be placed on those assets purchased with government subsidies").

110 Absent this ability, landlords might treat their tenants as a captive audience, skimping on maintenance and other services, essentially overcharging those tenants (and the subsidizing government) for the accommodations provided.

111 Though sympathetic scholars such as Bezdek, *Putting Community Equity in Community Development* at 101–04 (cited in note 106), assume that tenants would want to stay in gentrifying areas if they could afford to, and recent studies suggest that most in fact stay, see Freeman and Braconi, 70 J Am Planning Assoc at 48 (cited in note 34), some might prefer to move. Even long-time residents may feel out of place as their neighborhood changes around them. Their friends may die or leave, new stores catering to a different clientele may replace the establishments they used to patronize, and community organizations may develop a different focus. See Freeman, *There Goes the 'Hood* at 83 (cited in note 35) (citing literature decrying changes brought by gentrification "loathed by long-term residents").

112 For discussion of the potential advantages of income mixing, see, for example, Alex F. Schwartz, *Housing Policy in the United States: An Introduction* 263 (Routledge 2006); Alastair Smith, *Mixed-Income Housing Developments: Promise and Reality* 1 (Joint Center for Housing Studies of Harvard University, Oct 2002), online at http://www.jchs.harvard.edu/publications/W02-10_Smith.pdf (visited Nov 8, 2009); Harry J. Wexler, *HOPE VI: Market Means/Public Ends—The Goals, Strategies, and Midterm Lessons of HUD's Urban Revitalization Demonstration Program*, 10 J Affordable Hous & Comm Dev L 195, 204–06 (2001). But see Freeman, *There Goes the 'Hood* at 204 (cited in note 35) ("[T]here seems to be little reason to expect gentrification to significantly affect the class trajectories of residents indigenous to gentrifying neighborhoods—at least in the short run.").

113 Perhaps the most infamous example of resident displacement in the name of job preservation was Detroit's use of eminent domain to displace the residents of Poletown in order to facilitate the construction of an automobile assembly plant. See *Poletown Neighborhood Council v City of Detroit*, 304 NW2d 455, 457–59 (Mich 1981), overruled by *County of Wayne v Hathcock*, 684 NW2d 765 (Mich 2004).

ditions change could diminish the need for more invasive displacement actions, notably the exercise of eminent domain.[114]

A related question is how the cash-out option ought to be structured. If the option covers only a year's worth of rental increases at a time with subsequent payouts linked to continued residence in a jurisdiction, tenants may be loathe to move; such a call option mechanism could end up working much like a place-based rental subsidy. On the other hand, if tenants are granted a spatially unrestricted call option offering a stream of payments over a multiyear period that could be sold for its lump sum equivalent,[115] a series of tenants could cash in (and move out) in sequence, causing the costs of the program to balloon.[116] A third alternative would be to provide multiyear options to only those tenants who happen to live in a jurisdiction at the time such a program is enacted. This may be appropriate, or at least no worse from a social justice standpoint, than the one-time bonus (in the form of price appreciation) enjoyed by area landowners at the time such appreciation occurs. But if gentrification is a lengthy and unpredictable process, the program's failure to cover incoming tenants could prove problematic.[117] While new tenants would initially lack the sorts of social or economic networks that would be disrupted by gentrification (or the need to move) and might come in at rent levels that at least partially accounted for anticipated property value increases, their incentives to invest in the community could be clouded by their uncertainty about future rent increases.

The answer may be that different communities should adopt different programs. Those interested in maintaining diversity should

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114 We do not mean to suggest that tenant options would always make eminent domain unnecessary, nor that voluntary moves prompted by community changes are necessarily free from negative normative implications. Nonetheless, eminent domain is often thought to constitute a particularly damaging form of displacement.

115 See Lerman and McKernan, *Promoting Neighborhood Improvement* at *2 (cited in note 13) (discussing plans guaranteeing tenants ten years of expected future benefits, regardless of whether they move).

116 For example, if the call option generates cash representing the value of ten years of rental increases, one tenant may move out at the end of year one, entitled to receive a further nine years of payments, while another tenant moves in at the start of year two, moving out at the end of the year and becoming entitled to a further nine years of payment; a third may take up residence in year three and move out in year four, and so on. Thus, multiple tenants could become entitled to payments for each year's increase in rental costs with respect to a single apartment. And, of course, former tenants may be entitled to collect similar payments under similar plans offered in their new places of residence.

117 This dilemma—the conflict between subsidizing existing tenants and preserving assets for future tenants—is similar to the choice faced by designers of shared equity programs for low-income homeowners. See Jacobus and Lubell, *Preservation of Affordable Homeownership* at *19 (cited in note 63) (examining the tradeoff between maintaining permanent affordability of a housing unit and effectuating housing choices of current occupants).

enact programs tied to, if not particular rental units, a specified number of units located within the community. This might be accomplished by providing payouts in the form of rental vouchers valid only within the community. Communities seeking to compensate likely-to-be displaced residents might opt for programs providing longer-term, cash basis options or rental insurance policies available to a specific group of current residents. Although designing workable programs will be challenging, we think there is considerable room for experimentation with this suite of alternatives.

Putting these ideas together with the homeowner option proposals from the previous Part would give local governments an interesting and powerful new role in managing resident stakeholding. Local governments could educate, facilitate, subsidize, and coordinate programs that shift local housing market risk away from homeowners and (as to the upside potential) toward tenants. Differences in the time horizons of the two groups—homeowners need to wait until sale to settle their options, while tenants will need payouts timed to cover annual rental increases—may prevent them from directly trading risk with each other. But local governments would be well positioned to broker trades with investors who can take the other side of both kinds of transactions.

IV. Regional Stakes

The devices described above are aimed at changing stakeholding arrangements within a given jurisdiction. But a central dilemma of local governance, exacerbated by the phenomenon of overstaked homeowners, is that of interlocal spillovers. Exclusionary zoning presents one example of an oft-noted problem created by territorial boundaries within metropolitan areas: the ability of some jurisdictions to reap the general agglomeration benefits of the metropolitan area without fully sharing in the costs of that agglomeration, and indeed, by failing to share, increasing overall costs.[118] Even if deconcentrating poverty would produce large net gains throughout the region, few communities are sufficiently altruistic to attract households likely to be a net financial burden.

One impetus for altering stakes, then, is to foster a style of local governance that responds more cooperatively and efficiently to problems that are regional in nature. While permitting homeowners to reduce their exposure to housing market fluctuations in the manner suggested above should help to curb NIMBY tendencies, metropolitan

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[118] See Richard Briffault, *The Local Government Boundary Problem in Metropolitan Areas*, 48 Stan L Rev 1115, 1136–37 (1996) (describing how “affluent localities can [ ] use their regulatory authority to maintain their preferred fiscal position”).

areas might want or need to do more to align the interests of residents of different jurisdictions.

A. Regionalization, Extraterritoriality, and Bargaining

Some existing doctrines, such as the requirement that annexed areas be "contiguous," help to address some of the most egregious efforts to offload costs on other jurisdictions.[119] Revenue sharing can also spread costs and benefits interlocally, although it often generates significant political backlash.[120] Legal restraints and post hoc redistribution can only go so far. What is needed is a mechanism for affirmatively knitting together the interests of different jurisdictions within a metropolitan area.

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119 For discussion of the contiguity requirement, see Clayton P. Gillette, *Expropriation and Institutional Design in State and Local Government Law*, 80 Va L Rev 625, 672–86 (1994). While the contiguity requirement can prevent cities from annexing far-flung wealthy communities while ignoring intermediate poor ones, it cannot prevent communities from refraining from all annexation in order to avoid the annexation of poor areas. Remedying that situation requires changes in state annexation rules. Scholars advocating such changes have come up with different suggestions based on differing assumptions about the location of needy individuals. Compare Michelle Wilde Anderson, *Cities Inside Out: Race, Poverty, and Exclusion at the Urban Fringe*, 55 UCLA L Rev 1095, 1159 (2008) (advocating "state legal reforms that increase territorial outsiders' ability to initiate annexation") with Laurie Reynolds, *Rethinking Municipal Annexation Powers*, 24 Urban Lawyer 247, 253–54 (1992) (advocating allowing municipalities greater power to annex nonresidents on "the fringe").

120 There is an ongoing scholarly debate over whether the California Supreme Court's decision in *Serrano v Priest*, 487 P2d 1241 (Cal 1971), striking down California's reliance on local property taxes for financing public schools, id at 1244, was responsible for the later success of Proposition 13, a constitutional amendment enacted by referendum that rolled back the property tax assessments of some residents and strictly limited future increases in property tax assessments and rates. The leading proponent for causality, William Fischel, argued that by delinking local taxes from local service provision, *Serrano* turned local taxes into a "deadweight loss" for most voters, making them more likely to vote for Proposition 13. See, for example, William A. Fischel, *Did* Serrano *Cause Proposition 13?*, 42 Natl Tax J 465, 469 (1989). Others have challenged the empirical basis for Fischel's claim. See Kirk Stark and Jonathan Zasloff, *Tiebout and Tax Revolts: Did* Serrano Really *Cause Proposition 13?*, 50 UCLA L Rev 801, 853–54 (2003). See generally Isaac Martin, *Does School Finance Litigation Cause Taxpayer Revolt?* Serrano *and Proposition 13*, 40 Law & Soc Rev 525 (2006). Fischel stands by his original position. See William A. Fischel, *Did John Serrano Vote for Proposition 13? A Reply to Stark and Zasloff's "Tiebout and Tax Revolts: Did* Serrano Really *Cause Proposition 13?*,*"* 51 UCLA L Rev 887, 888 (2004); William A. Fischel, Serrano *and Proposition 13: Comment on Isaac Martin, "Does School Finance Litigation Cause Taxpayer Revolt?"* *13 (Dartmouth College Working Paper, Feb 2009), online at http://www.dartmouth.edu/~wfischel/Papers/Martin%20comment%20feb09.pdf (visited Feb 4, 2010). Other state plans that have reallocated local property tax revenues to equalize school funding have encountered serious political resistance. See, for example, Laurie Reynolds, *Uniformity of Taxation and the Preservation of Local Control in School Finance Reform*, 40 UC Davis L Rev 1835, 1883–84 (2007) (stating that the Texas and Vermont experiences with "recapture" mechanisms "leave no doubt about the political volatility of this school funding system"); Maurice Dyson, *The Death of Robin Hood? Proposals for Overhauling Public School Finance*, 11 Georgetown J Poverty L & Pol 1, 4–18 (2004) (detailing challenges to the Texas system).

One response that has attracted some scholarly adherents involves changing the size of the decisionmaking unit through regionalization.[121] The disadvantage of this approach is that it undercuts local control that might be scaled appropriately for a variety of other problems, and diminishes the potential for useful interlocal variation and competition along the lines suggested by the Tiebout hypothesis.[122] At the other end of the spectrum, metropolitan areas might simply rely on interlocal bargaining, buttressed by repeat play among neighboring jurisdictions.[123] Yet interlocal bargains often fail to emerge, generating conflicts among jurisdictions.[124] In between these extremes lie a variety of possible approaches, including multitiered governmental structures,[125] cross-border voting,[126] and interlocal liability rules designed to

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121 For some views on how regional or metropolitan-area governance might be approached, see Myron Orfield, *Metropolitics: A Regional Agenda for Community and Stability* (Brookings 1997); Scott A. Bollens, *Concentrated Poverty and Metropolitan Equity Strategies*, 8 Stan L & Pol Rev 11, 14–15 (1997); Briffault, 48 Stan L Rev at 1164–68 (cited in note 118). Some examples of regional governance exist. See Baker and Gillette, *Local Government Law* at 725–31 (cited in note 108) (describing existing regional governments and discussing the issues that gave rise to them). However, most believe the political support necessary for the establishment of comprehensive forms of metropolitan government is absent. See, for example, Amnon Lehavi, *Intergovernmental Liability Rules*, 92 Va L Rev 929, 981 (2006) (citing political obstacles to regionalization); Briffault, 48 Stan L Rev at 1171 (cited in note 118) (finding "little reason to be optimistic about the prospects for metropolitan governance" given that "[h]ostility to metropolitan government is intertwined with a commitment to local autonomy that is deeply rooted in both law and politics"); Anthony Downs, *New Visions for Metropolitan America* 170 (Brookings 1994) ("Metropolitan government has almost no political support.").

122 See Clayton P. Gillette, *The Conditions of Interlocal Cooperation*, 21 J L & Polit 365, 365 (2005) (listing arguments against regionalism); Richard Briffault, *Localism and Regionalism*, 48 Buff L Rev 1, 15–17 (2000) (stating arguments of "advocates of [ ] decentralization"); Robert P. Inman and Daniel L. Rubinfeld, *Rethinking Federalism*, 11 J Econ Persp 43, 47 (Fall 1997) (identifying studies "offer[ing] empirical support for the proposition that competitive local governments do provide citizens the public services they want at the lowest cost"); Briffault, 48 Stan L Rev at 1124 (cited in note 118) (noting that in Tiebout's model, a "multiplicity of localities" in a given area "enhance[es] the likelihood that one locality will approximate the mobile 'consumer-voter's' preferences").

123 Fischel suggests that municipalities have disincentives to engage in "beggar thy neighbor" tactics, arguing that neighboring jurisdictions "are locked into a web of mutually beneficial exchanges at both the political and the personal levels." Fischel, *Homevoter Hypothesis* at 184 (cited in note 3). But see Lehavi, 92 Va L Rev at 942–46 (cited in note 121) (discussing Fischel's account and suggesting he "may have been overly optimistic"); Briffault, 48 Stan L Rev at 1149 (cited in note 118) (describing how local decisions can create "a 'tragedy' of the regional 'commons'").

124 See, for example, Lehavi, 92 Va L Rev at 943–44 (cited in note 121) (observing prevalence of uncoordinated local land use policies that produce externalities); Gillette, 21 J L & Polit at 373–82 (cited in note 122) (describing "contracting cost" barriers to interlocal cooperation); Briffault, 48 Stan L Rev at 1147 (cited in note 118) (finding agreement-based solutions unpromising due to "the inability of metropolitan area localities to come to grips with the regional prisoners' dilemma caused by local land use decision making, local fiscal autonomy, and local responsibility for the costs of local public services").

125 See Briffault, 48 Stan L Rev at 1165–66 (cited in note 118) (advocating a "rule of subsidiarity": "only those functions necessary for metropolitan governance should be shifted to regional institutions").

sidestep bargaining impediments.[127] We cannot do justice to these proposals here, but it is worth noting that each would require either a significant political restructuring, a difficult set of normative determinations about the magnitude and direction of spillovers, or both. The conflicting interests that motivate these proposals would also likely impede the formulation of the solutions themselves.

B. Synthetic Stake-Sharing

It is possible that some of the instruments and strategies described in Parts II and III for offloading and reallocating risks within a community could be reconfigured to accomplish analogous risk reallocations between communities. Such approaches could reduce political resistance to measures and mechanisms designed to promote regional objectives like socio-economic integration. The idea would be to explicitly link the financial and social fortunes of politically distinct entities within a metropolitan area.

Creating such a linkage would, in a sense, replicate the strategy-proofing advantages that Henry Smith has attributed to the medieval common field arrangement.[128] Medieval common fields comprised what Smith has termed a "semicommons."[129] Each individual farmer owned a number of strips of land scattered throughout a larger grazing commons rather than owning one consolidated parcel.[130] This physical interspersing of land made it harder for participants to selectively burden others; actions that degraded one area of the field were likely to affect everyone and not just a disfavored few.[131] Although the idea of discontinuously interspersed local jurisdictions (or even jurisdictions that are contiguous but intricately interlocked) seems both fanciful and deeply problematic, a virtual (or synthetic) interspersing could be accomplished through community-indexed investments reciprocally held by residents of different localities.

While space does not permit a detailed exploration of this idea here, the basic building blocks would be the area-indexed investment

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126 For discussions of possible ways cross-boundary voting might be structured, see, for example, Ford, 107 Harv L Rev at 1909 (cited in note 5); Jerry Frug, *Decentering Decentralization*, 60 U Chi L Rev 253, 329–34 (1993). See also Aaron J. Saiger, *Local Government without Tiebout*, 41 Urban Lawyer 93, 120–37 (2009) (proposing a redistricting scheme for local governance that would employ periodically shifting boundaries).

127 See Lehavi, 92 Va L Rev at 988 (cited in note 121) (explaining how a system of liability rules might address conflicts among jurisdictions).

128 See generally Henry E. Smith, *Semicommon Property Rights and Scattering in the Open Fields*, 29 J Legal Stud 131 (2000).

129 See id at 132.

130 See id at 135; Robert C. Ellickson, *Property in Land*, 102 Yale L J 1315, 1388–90 & fig 3 (1993) (describing and depicting this arrangement).

131 See Smith, 29 J Legal Stud at 144–54 (cited in note 128).

instruments discussed above, which could allow homeowners to shed the risk associated with local housing markets and tenants to share in the gains of the community. The earlier discussion suggested that (aside from tenants), most of those accepting risk from homeowners would be investors with well-diversified portfolios and no particular ties to the community. But housing risk could be shifted around much more selectively, so that residents (either directly or through their local government institutions) acquire home equity stakes in jurisdictions neighboring their own. While this approach would do little to relieve the problem of inadequate diversification that has been associated with homeownership (a region's housing markets are likely to be at least somewhat correlated), it would help to address the misalignment of incentives that causes local governments to impose negative externalities on other parts of the larger metropolitan system.

To illustrate how the concept might be applied (without endorsing this particular approach), suppose a state legislature passes a Stakeholding Enabling Act granting local governments the power to buy and sell securities indexed to local property values and to subsidize the provision of options to tenants, on condition that the local government agrees to participate in a regional risk-sharing arrangement and to adopt a residential stakeholding plan that meets certain state standards. Each jurisdiction could then set up residential stakeholding programs offering homeowners the ability to shed local market risk and tenants the ability to accept local (upside) market risk. Jurisdictions would be required to buy a certain number of locally indexed options from each other, pursuant to regional risk-sharing requirements, and to either hold onto them for a given period or to sell them to residents within their own communities. In addition, or alternatively, each locality could set up tax preference schemes or other incentives to encourage those local homeowners who wish to bear housing market risk to trade in some of the appreciation rights associated with their own local area for an option indexed to a compilation of surrounding jurisdictions.

The resulting cross-investment would mean that jurisdictions' investment losses would (at least partially) offset any gains from adopting "beggar thy neighbor" policies that produce negative externalities. This rewiring of the economic interests of residents should induce localities to act more cooperatively.

CONCLUSION

The problem of suboptimal residential stakeholding is nothing new, but the present financial crisis has thrown it into bold relief. In this Article, we have tried to suggest that this crisis offers an opportunity to rethink in a more comprehensive manner the way in which

residential risk is held and shared. While our discussion here has been brief and tentative, we hope that it will help to spark interest in residential stake management as an important policy instrument for state and local governments. We think it is one that might be creatively wielded in ways that would not only respond to current realities, but also help to address longstanding conflicts of interest between homeowners and tenants, and between residents of different localities in the same metropolitan area.