Book Reviews

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This section contains reviews on textbooks, professional books, and other scholarly books that are appropriate to real estate. Areas of interest include, but are not limited to, mortgage markets, real estate investments, real estate finance, asset and property management, real estate development, corporate real estate, valuation, and other areas related to real estate. If you have an interest in reviewing a book, please contact Thomas Musil.

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Maverick Real Estate Financing:* *The Art of Raising Capital and Owning Properties Like Ross, Sanders, and Carey. Steve Bergsman. 286 pages. Wiley, 2006.

Reviewed by: John F. McDonald, University of Illinois at Chicago.

The real estate journalist Steve Bergsman has written an informative and entertaining book about financing commercial real estate. The book combines descriptions of each of the methods used to finance real estate development or investment with interviews of prominent industry people who have been successful using those techniques. Indeed, the interviewees are a who's who of real estate financiers and include William Sanders (founder of LaSalle Partners, Security Capital Group, ProLogis, and other companies), Jack Cohen of Cohen Financial LP, Michael Mazzei (one of the creators of the commercial mortgage-backed security), Stephen Ross (founder of Related Housing Companies and donor of $100 million to the Ross School of Business at the University of Michigan), William Polk Carey (founder of W. P. Carey & Co. and donor to the W. P. Carey School of Business at Arizona State University), Milton Cooper (REIT entrepreneur), Alfred and Robert Taubman (Taubman Centers), and others.

The chapters cover the basics of the topics below that are roughly of increasing complexity:

- Basic real estate loans (construction, bridge, permanent financing, mezzanine)
- Conduit loans that become part of commercial mortgage-backed securities
- Agency loans for multi-family housing (Fannie Mae and Freddie Mac)
- Equity financing companies
- Low income housing tax credits
- Sale-leasebacks
- Retail site arbitrage (to unlock retail site value)
- Purchase of distressed mortgages
- Commingled capital
- REITs and UPREITs

Each chapter contains the story of an entrepreneur who was successful with the device in question. Each chapter is also chock-full of examples and names of people and companies in each line of business.

If you are not familiar with the basics of all of the topics listed above (as I was not), and if you want to know which prominent real estate financiers are associated with each topic, then you will find this book to be very useful (as I did). This is a book of journalism, not scholarship, but it can be read quickly, easily, and profitably by students, faculty, and professionals. Given that both the methods of real estate finance and the roster of prominent individuals and companies change rapidly, the material in the book may become dated quickly. But for now I recommend the book as

supplemental reading in courses in real estate finance and as ''pleasure'' reading for real estate faculty and real estate professionals alike.

***Discriminating Risk:* The U.S. Mortgage Lending Industry in the Twentieth Century.** Guy Stuart. 248 pages. Cornell University Press, Ithaca, New York, 2003.

Reviewed by: Marcus T. Allen, Florida Atlantic University.

The title of Guy Stuart's book suggests that it would provide an objective summary of the evolution of the lending decisions of the American mortgage lending industry in the twentieth century. Instead, the primary focus of the book is on the way lenders ''construct risk'' in ways that discriminate against racial and ethnic minorities—namely, blacks and Hispanics.

Stuart's book begins with an explanation of his concept of risk construction in which cultural, institutional, and spatial issues affect the lending decision in a manner that discriminates against certain minority groups. He distinguishes [following Keynes (1921) and Knight (1921)] between the concepts of uncertainty and risk by explaining that uncertain decisions are those in which the decision maker is not aware of the probability distribution of future events, whereas risk decisions are made when decision makers attempt to translate uncertainty into risk by evaluating the probability distribution of future events. Cultural, institutional, and spatial issues affect the way lenders construct risk in the face of uncertainty.

Without delving into the quagmire of whether lenders engage in blatant discrimination, as implied by the Federal Reserve Bank of Boston study (Munnell, Browne, McEneaney, and Tootell, 1992), Stuart argues that the ways lenders construct risk result in unfair treatment of minority loan applicants. In particular, he suggests that lenders construct risk in an implicit social context that affects the way they receive and process information and thereby develop lending rules. Furthermore, he suggests that the lending guidelines promulgated by the dominant institutions in the mortgage industry [the Federal Housing Administration (FHA), the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac)] continue to put minority borrowers at a disadvantage in mortgage lending decisions. Lastly, he argues that the manner in which appraisers and lenders identify and delineate neighborhoods makes the conclusions lenders reach regarding changes in property value a self-fulfilling prophecy.

Chapter 1 of the book considers the ''meaning of value'' and the role that appraisers play in the mortgage lending decision. Stuart provides an interesting discussion of the progress made by the appraisal profession (largely at the urging of the Department of Justice) toward reducing explicit racial and ethnic discrimination. He comments on Frederick Babcock's writings in the Federal Housing Administration's *Underwriting Manual* (1936), used for many years after the FHA's inception under the Roosevelt

administration, and concludes (p. 58) that the ". . . (misguided) genius of Babcock's solution" that calls for the careful delineation of "neighborhoods" from which comparables should be chosen in the sales comparison process created a class and race sensitive appraisal process. Eventually in 1976 the Department of Justice and the American Institute of Real Estate Appraisers and the Society of Real Estate Appraisers agreed to strike all racist-like language from their training materials. The passage of the Home Mortgage Disclosure Act of 1975 and the Community Reinvestment Act of 1977 brought transparency to the lending industry, which helped expose explicit racial discrimination in the lending decision process. Today, the dominant players in the mortgage lending industry explicitly prohibit discrimination against neighborhoods based on the race of the inhabitants. But, Stuart (p. 187) argues, ". . . the logic of the appraisal process dictates that segregation [continues to] be tacitly acknowledged in the selection of comparable properties."

Chapter 2, "Rules for Assessing the Borrower and Managing Behavioral Risk" considers how loan-to-value (LTV) ratios, debt-to-income ratios, and credit records help lenders construct risk. While it might seem hard-pressed to conclude that LTV and debt-to-income ratios are inherently discriminatory, Stuart reviews the history of how FHA, VA, and secondary mortgage market participants developed these "rules of thumb" to construct risk in mortgage lending and concludes that some minority applicants might be entitled to exceptions from these rules. For example, a minority loan applicant who has successfully been meeting her housing costs by renting her residence at 45% of her gross monthly income should be able to continue paying that amount for a mortgage payment. Yet, the debt-to-income ratios used by lenders to construct risk would prevent her from doing so unless an exception was made. Stuart's discussion of the development of the credit reporting industry and modern credit scoring models in this chapter is clear and enlightening.

Perhaps the most convincing arguments in support of Stuart's contention that the mortgage lending industry is discriminatory appear in Chapter 3, "The Loan Application Process." In particular, the relationship between the mortgage applicant and the loan officer may lead to discrimination if the two are from different social/racial classes. Stuart suggests that a loan officer who shares a cultural affinity with a loan applicant will work more diligently to successfully shepherd the application through the underwriting process. (Stuart spends little effort addressing the other side of this coin; the possibility that truly unqualified borrowers might benefit from the relationship between loan officer and applicant if the applicant and officer are from the same social/racial class.) The development of automated underwriting during the 1990s reduces some, but not all, of the potential ambiguity in the loan approval process. While the lending criteria are carefully defined in Fannie Mae's Desktop Underwriter and Freddie Mac's Loan Prospector software programs, the recommendations of these programs can be legitimately manipulated by loan officers who can provide additional documentation to override the basic decisions from the programs. Interestingly, Stuart is a strong proponent of risk-based pricing and persuasively argues that the increase in sub-prime loans at higher yields for lenders is a step toward tying loan approval to actual risk in ways that will reduce discrimination.

Stuart returns to the issue of neighborhood demarcation and identification in Chapter 4, ''Constructing Housing Markets.'' This chapter might be better named as ''Delineating Housing Markets.'' As real estate brokers and appraisers define and delineate neighborhoods, to help them serve their clients' interests and correctly choose comparable properties in the sales comparison approach, respectively, they may implicitly create racial and/or ethnic boundaries. These demarcations need not be wrongfully motivated, but they could retard the gentrification process or at least encourage ethnic succession as neighborhoods age. Therefore, according to Stuart, brokers and appraisers play an active role in the in the spatial structure of real estate markets as they explore it to understand what is happening in it.

In Chapter 5, ''Lending Discrimination,'' Stuart presents proposed evidence of lending discrimination in greater Chicago. He provides a sketch showing distinct geographic areas within the city that are dominated by certain races of inhabitants. He then discusses the lending activity (applications, approvals and denials) by area and concludes that discrimination varies for blacks, whites, and Hispanics, with black applicants suffering the most inequitable treatment, followed by Hispanics. Because the predominant race or ethnic group is slow to change in these neighborhoods, Stuart argues that application denials reduce effective demand for housing in these areas and that reduced demand depresses value growth in the neighborhood. As this process cycles through, spatial discrimination against blacks and Hispanics becomes a self-fulfilling prophecy.

In the final chapters of the book, Stuart reviews the practical methods lenders use to construct risk (appraisals, credit reports, and debt-to-income and LTV ratios). He then offers some specific ''constructivist'' policy approaches that he thinks will reduce mortgage lending discrimination. First, he recommends that the results and data from ''fair lending examinations'' performed by federal regulators of lending institutions be made public. In the event disparity of loan applications is found in these examinations, the lenders should be required to fix the problem even if the regulators do not conclude that discrimination is explicit. Second, he recommends that sub-prime lending be encouraged so that high-risk borrowers can obtain financing, albeit at a higher cost. Mainstreaming sub-prime lending can be made more palatable by the existence of a mutual insurance pool that will protect lenders who use risk-based pricing and engage in sub-prime lending. Third, Stuart suggests that appraisers should no longer be called upon by lenders to evaluate neighborhood-level house price stability. Instead, these evaluations should be made directly by the lender from objective data collected and maintained by the lender. This change will presumably put the onus of spatial discrimination fully on the lender and remove the appraiser's subjective definitions of ''neighborhood'' from the lending decision. Finally, Stuart concludes that the zoning rules and planning processes used by municipal governments to create artificial neighborhoods need to be addressed in order to minimize spatial segregation. Due to his objections to exclusionary zoning, he calls for the overturning of the 1926 U.S. Supreme Court decision in the *Euclid v. Ambler* case that originally interpreted zoning as a constitutional act.

In summary, Stuart's book provides an interesting consideration of the causes of racial and ethnic discrimination in today's mortgage lending industry. He makes the case

that discrimination results from the ways mortgage lenders construct risk (convert uncertainty about future events by considering the probability distributions of those events) based on cultural, institutional, and spatial issues. While the policy recommendations he makes may or may not solve the problems he identifies, his explanation of his position on these issues is a welcome addition to the debate over racial and ethnic discrimination in the mortgage lending process. This text has proven to be a suitable addition to the reading lists and an impetus for some lively debate in graduate and undergraduate real estate finance courses taught by this reviewer.

References

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