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PLACE, EXCLUSION, AND MORTGAGE MARKETS

Manuel B. Aalbers

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Series Editors' Preface

The Wiley-Blackwell *Studies in Urban and Social Change* series is published in association with the *International Journal of Urban and Regional Research*. It aims to advance theoretical debates and empirical analyses stimulated by changes in the fortunes of cities and regions across the world. Among topics taken up in past volumes and welcomed for future submissions are:

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Preface and Acknowledgments

When I started investigating redlining in the Netherlands very few people had confidence in the usefulness of the research. "There's no redlining in the Netherlands and even if it were there, you wouldn't find it" pretty much sums up the reactions I encountered. Stubborn as I am, that didn't stop me. In a way, this book is the embodiment of my stubbornness. This book was not supposed to be written; instead I should have been writing a book on urban revitalization policies in continental Europe. Like urban revitalization, redlining is about housing and cities. Yet, redlining has so much more to offer (as I hope to demonstrate in this book). Perhaps most importantly, the subject was new to continental Europe. Contrary to a whole range of contemporary European (urban) thinkers, I did not sit down to explain why Europe and the United States are different, but rather to show how something that Europeans have relegated as a uniquely American phenomenon, is in fact also a European – and perhaps a global – phenomenon. European and US cities may be different – and they certainly are – but that does not mean place-based exclusion is something that only takes places in the ghettos of America and not in the European "*banlieues*," "*quartieri periferici*," and "*achterstandswijken*."

For some, redlining is a story of the past, and although they are right (the history of redlining is a fascinating one!), at the same time they are wrong: redlining is also something of the present and, if I am correct that redlining is of an endemic nature, redlining may very well be something of the future as well. Rather than being foreign to mortgage markets, redlining is and will always be intrinsically part of mortgage lending – it is no coincidence that the birth of modern mortgage markets and the birth of redlining came about together. The history of redlining and structural changes in mortgage markets can teach us a lot about the present and future of redlining and other exclusionary processes.

A great number of people have commented on the draft chapters of this book. In an early stage, Sako Musterd and Robert Kloosterman were most important; at the final stage, it was Kevin Fox Gotham and Patrick Le Galès.

I have drawn heavily on comments of all four. Their insightful suggestions have made this a much better book than it otherwise would have been. I would also like to thank Neil Brenner and Jennifer Robinson who, as editors of the book series, have supported this project critically and enthusiastically. Together with Jacqueline Scott, at Wiley-Blackwell, they have enabled me to write the book that you have just started reading. Besides these seven people, I would like to thank Yuri Kazepov, Enzo Mingione, Elliott Sclar, Neil Smith, Gary Dymski, Sheila Hones, Ewald Engelen, Ashley Terlouw, Chila van der Bas, Els Veldhuizen, Iwona Woźniakowska, Rogier van der Groep, Perry Hoetjes, Bert and Willy Aalbers-Spaans, and finally the interviewees who have made it possible for me to tell the story of redlining.

Manuel B. Aalbers
Amsterdam

Introduction

The summer of 2007 marked the beginning of the subprime mortgage crisis. What started as a subprime mortgage crisis quickly developed into a general mortgage and housing crisis. A few months later it was clear that there was a credit crunch, and one by one commentators suggested this was the worst crisis since the stock market crash of 1929 and the subsequent crisis of the early 1930s. Several of them even claimed that the subprime meltdown of 2007 would soon make the stock market crash of 1929 look like a small crisis. It also became clear that the credit crunch was not limited to the United States; investors and financial institutions around the globe were affected by what seemed at first a very specific and limited problem. Since financial institutions are a crucial cornerstone of the economy, the crisis spread not only from the US to the rest of the world, but also from credit markets to all kinds of markets. Globalization implied a greater interconnectedness not only between different places, but also between different markets.

This book is not about the mortgage crisis, the credit crunch, or subprime loans; this book is about redlining, the identification of an area where no financial services are provided. Subprime lending and redlining, however, share a number of properties. First, they both describe lending patterns in financial markets and are mostly discussed in the context of mortgage markets. Second, both processes played a major role in the two biggest crises of the last 100 years: subprime lending in the financial crisis that started in 2007 and redlining in the Great Depression that started in 1929. Third, both processes disadvantage borrowers: redlining by directly excluding borrowers who live in certain areas, subprime lending by charging higher rates for certain borrowers. Fourth, they disproportionally hit the same social groups: low-income groups and racial minorities. Fifth, both have a clear geographical component. In the case of redlining, this is tautologous as the

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idea of place-based exclusion is part of the definition of redlining. In the case of subprime lending we see a clear concentration in certain neighborhoods. Subprime lending is either concentrated in formerly redlined areas or in the type of areas that used to be redlined. Sixth, the local impact of redlining and subprime lending are frighteningly similar, not just in who gets hit, but also in what it does to neighborhoods and communities that, in the end, get stripped of equity and opportunities. Indeed, neighborhoods become exploited not for the gain of its residents but rather for the gain of others, like speculators, mortgage brokers and financial institutions. In other words, and this leads us to the final shared characteristic, the agents involved – both the powerful ones and the exploited ones – are essentially the same. The main two differences seem to be exclusion versus overinclusion and the development of these processes. I will return to these differences in Chapter 4, where I argue that the difference in timing is smaller than it seems at first sight and that overinclusion in many cases is a special case of exclusion.

In society, people are excluded not only on the basis of class and race, but also on the basis of place. The mortgage market is no different; in fact, it is exactly highly developed and institutionalized markets like the mortgage market that have a tendency to exclude. Mortgage redlining is the identification of an area, usually a neighborhood or zip code area, where no mortgage loans are to be issued, which is a form of place-based financial and social exclusion. Mortgage applicants are excluded *from* obtaining housing by being denied mortgages in redlined neighborhoods. Current homeowners are excluded *through* housing because they are unable to sell their house, becoming trapped in their neighborhood. In the case of mortgage financing, the supply side (i.e., the lenders) has the power to exclude part of the demand side (i.e., the customers). Financial institutions can provide the essential underpinning for positive social development, but they also have destructive power – the power to deny credit loans. One possible method is to put certain neighborhoods on a black list. A financial institution might blacklist a neighborhood if it is already considered or expected to develop into a "slum" (Jacobs 1961). Almost without exception it is a self-fulfilling prophecy.

According to Robert Merton (1968), who coined the concept of the "self-fulfilling prophecy," perception alone is sufficient for people to act, and prejudices may come into play when certain subjected groups are excluded from mortgage capital. If the exclusion is based on aggregate data, it is a matter of statistical discrimination: individual members of a group are excluded simply by the fact that their group on average has a bad credit profile. The need to rationalize, simplify, and differentiate in the context of inequality leads to the institutionalization of the stereotypical tendencies permeating society (Lipsky 1980: 115; see also Bolan 2000). Because potential homeowners can obtain a mortgage only with great difficulty, and often not at all, in redlined neighborhoods, current homeowners in these neighborhoods cannot sell their houses for a decent price. Consequently, they are unable to move out and a minimum-choice neighborhood is born. Then, real estate prices *will* fall. This is a matter of a self-fulfilling prophecy: because prices are expected to fall, people act accordingly, which in fact causes prices to fall. The principle behind a self-fulfilling prophecy is that people not only react to objective circumstances in a situation, but also, and sometimes primarily, to the meaning that the situation has for them. Public definitions of a situation, like expectations and prophecies, become an integral part of that situation and influence future developments (Merton 1968).

By defining a situation where certain neighborhoods come with a large depreciation risk, and are therefore denied mortgage capital, banks evoke a chain of effects that eventually causes houses in these neighborhoods to actually lose value. Because mortgages are constrained, a majority of the potential homeowners cannot buy a house in these neighborhoods. Drop in demand leads to falling real estate prices. The circle is closed. Real estate prices have dropped because it was impossible to get a residential mortgage in redlined neighborhoods – and not so much because these neighborhoods were high-risk investments. They became high-risk investments because they were *perceived* high-risk investments. Redlining strikes low-income neighborhoods and ethnic neighborhoods in particular. However, redlining affects not only low-income families and ethnic minorities but also everyone applying for a mortgage in a redlined neighborhood. As a consequence of redlining, sale periods are longer and real estate prices are lower. It is not only the ones that are denied a mortgage loan that are excluded, but also those who are unable to sell their house. These exclusions are the result of patterns of stereotyping and labeling, both indirect constraints which are based on the banks' measures of respectability and expectations about behavior (Harrison 1998).

The two extremes of geographical disparities are, on the one hand, areas where full mortgages (100 percent loan-to-value) or low down-payment mortgages are granted on advantageous conditions (greenlining) and, on the other hand, areas where no mortgages are granted whatsoever (redlining). Greenlining can be defined as the provision of mortgage loans under normal, advantageous conditions; it constitutes the provision of loans to areas to which mortgage lenders are eager to provide mortgage loans because the area is considered low-risk (of course loan applications can still be rejected because the lender considers either the collateral (the property) or the applicant high-risk). Redlining can be defined as the rejection of mortgage loan applications solely on the basis of place; that is, lenders consider certain areas high-risk, which implies that even low-risk applicants would be rejected. Some authors have included disadvantageous loan conditions based on place in their definition of redlining, but in this book we use the term "yellowlining" for such conditions. Yellowlining includes higher down-payment requirements and higher interest rates, if these are based on place; for example, if lenders normally charge a 5 percent interest rate, but raise it to 8 percent only in certain neighborhoods, these neighborhoods can be considered yellowlined. Redlining, yellowlining, and greenlining do not refer to the total volume of credit supplied to neighborhoods, but to spatial variations in terms on which credit is (not) offered.

Discussions on redlining have taken place primarily in the US and have been connected to debates on the causes of segregation and on forms of racial discrimination. Massey and Denton (1993) distinguish between three factors that cause segregation: prejudice, discrimination, and discriminatory institutionalized government policies including "public" redlining. In addition to discrimination and redlining, Kaufman (1998) names the transformation of the economy and fragmented government policies as causes of segregation. Galster (1992) explicitly names redlining as a discriminatory practice leading to segregation. Redlining practices constitute a *landscape of power* (see Zukin 1991), and demonstrate not only how "private investment shapes cities" but also how "social ideas (and laws) shape private investment. First comes the image of what we want, then the machinery is adapted to turn out that image" (Jacobs 1961: 313). According to Jane Jacobs these are often not diametrical opposites, but scaringly similar images: "Credit-blacklist maps are identical, both in conception and in most results, with municipal slum-clearance maps" (Jacobs 1961: 300). In the US literature, redlining is mainly a form of (institutionalized) discrimination and a cause of segregation. Gratz's example of the decline of the Bronx illustrates well how redlining takes shape and place:

> The Bronx survived the Depression, but not post-war prosperity. After World War II, all the policies that began to erode cities across the country began wounding the Bronx as well. Government policies encouraged the mass exodus to the suburbs where low down-payment homes with large government-insured mortgages enabled many families to fulfill their dreams of a freestanding house in the suburbs. No comparable financing opportunities were available for those who preferred to pursue the American dream in the city. The decline of the Bronx was not an accidental consequence of local residents moving to the suburbs in pursuit of the American dream, nor was it the *unintended* consequence of federal housing and transportation planning policies. Mortgage money and business investments moved out of the city, following the routes of new federally financed highways and new federally financed infrastructures, leaving behind the tax base, job opportunities, mass-transit facilities and the middle-income population in steady decline. Redlining – withdrawal of private resources – and the diminishment of public services and resources contributed significantly to decline. The message of the government's loans programs was that the future was in the

> suburbs. City residents who stayed were mostly on their own in the search for mortgages and loans. (Gratz 1989: 89–90)

Gratz claims that the federal government through its financial support to the suburbs directly and indirectly encourages redlining. R. Walker (1981), Mollenkopf (1983), Jackson (1985), Detlefsen (1997), Rusk (1999: 82–100), and many others have demonstrated how the Federal Housing Administration (FHA) stimulated suburban homeownership and disadvantaged prospective homebuyers in the cities. William Julius Wilson (1996) highlights the interaction between public and private actors, and shows how black households are hit twice: through both place-based and race-based exclusion (see also Harvey 1977: 132; Massey and Denton 1993; Kasinitz 2000).

The first part of this book opens up the present framing of redlining in at least three ways. First, it argues for a conceptual repositioning of redlining in the realm of social and financial exclusion. Second, it argues for a (re-)spatialization of redlining practices and therefore of redlining research. And third, it argues for a re-socialization of redlining processes. Part I (Chapters 1, 2, and 3) sets the stage for reframing the conceptualization of redlining and redlining research; Part II (Chapters 4, 5, and 6) presents historical and empirical evidence. Part III (Chapter 7) connects the debates and the research results, and relates both to recent developments in the mortgage market.

While research on redlining is widespread in the US, it is not in Europe. There is, however, a sizeable literature on financial and social exclusion in Europe. Chapter 1 argues that redlining is a form of financial exclusion and that financial exclusion is a specific type of social exclusion. It discusses the literatures on financial and social exclusion, which have developed entirely separately from one another, the one originating in British economic geography and consumer credit studies, the other in French sociology and popularized by the European Union. It argues that exclusion is a more fruitful way of looking at redlining than discrimination and segregation. It is not the case that references to discrimination and segregation are irrelevant; rather, they limit the conceptual scope of redlining. The concept of social exclusion, which can include processes of discrimination and segregation, presents a constructive alternative – despite the critiques that it has endured since its birth. The last section of this chapter is devoted to spatializing exclusion, that is, to discussing how place and space play a significant role in exclusion processes such as redlining. This final section of Chapter 1 prepares the stage for Chapter 2 which, on the one hand, argues for a re-spatialization of redlining and, on the other hand, presents an analytical approach to researching redlining practices.

In this book, I will show that redlining is not an American phenomenon of the past, but a wider and also a continuing phenomenon. I demonstrate the existence of redlining in the Netherlands and Italy in the late 1990s and early 2000s, in particular in the City of Rotterdam. The book will also demonstrate a strong correlation between redlined neighborhoods and neighborhoods predominantly accommodating ethnic minority groups. In this case, place-based exclusion implies indirect race-based exclusion, as ethnic minority groups are hit disproportionately hard by redlining practices. Even though the key factor in exclusion is clearly place, the underlying cause may be race, as mortgage lenders may use zip code as a proxy for race, in particular since race is a more controversial variable for exclusion than place.

In the US context, race and place shape the opportunity structure of people, neighborhoods, and cities (Squires and Kubrin 2005); race and place are so intertwined that it is hard, and in some cases impossible, to disentangle them empirically. Hence, theoretically one has to see race and place in a dialectic relationship. Race-based and place-based exclusion intersect, as the places hit by exclusion are often inhabited predominately by ethnic minority groups. Holloway (1998) even argues that both race and place are insufficient to explain lending discrimination; it is the interaction of race-based discrimination and the neighborhood's racial composition that shapes lending discrimination. The work of Wilson and of Massey and Denton, and the literature on "neighborhood effects," focus on this question. US studies have demonstrated that place matters – that is, the neighborhood has an independent influence on exclusion outcomes; for example, in job search, social mobility, and social behavior (e.g., *Housing Policy Debate* 1995; *Housing Studies* 1997; Briggs 2005). Research in EU countries has been much more cautious in singling out the neighborhood as a causal factor in exclusionary processes (e.g., *Housing Studies* 1997; Friedrichs 1998; Musterd, Ostendorf, and De Vos 2003; Pinkster 2009). One reason for this is the intermediating role played by the welfare state. It provides not only for lower segregation in EU welfare regimes than in the US liberal welfare regime (Musterd and Ostendorf 1998), but also for a smaller significance of place in EU countries than in the US, as poverty neighborhoods in most European cities are not such deprived areas as US ghettos (Wacquant 1996). Do the differences between the US and Europe imply no redlining takes place in Europe? This book argues that this is not the case: redlining is not an exclusively American phenomenon. This does not imply that redlining in the US and in Europe are exactly the same – place does make a difference. While earlier neighborhood effects studies have focused primarily on employment and social mobility, it could be argued that redlining – that is, place-based exclusion in the mortgage market – could be conceptualized as another type of neighborhood effect. If the existence of any form of place-based exclusion can be demonstrated, it can be concluded that the neighborhood matters. Then, the neighborhood would make a difference for the individual mortgage loan applicant because it can either enable someone to reach a better position in life or constrain them from doing so. This book focuses on the mechanism fostering exclusion.

Redlining has many dimensions; in order to explain and understand it, one should also consider its multi-dimensional character. The point is not to delineate a general process, occurring at all times in all places, but rather to understand the mix of general and specific factors that create redlining in different contexts (see Fainstein 2001: 26). Redlining is not only *multi-dimensional*, but, like most other social phenomena, it also has a *multi-scalar* aspect. The concept of redlining cannot exist without the notion of internally differentiated geographical space; without internal differentiation – that is, without submarkets – there is no redlining. Rather than making the argument that the existing literature misunderstands redlining, this book argues that different frameworks for understanding redlining only explain part of what redlining is. Most of the existing approaches are, in other words, not so much misguided as limited and limiting in explaining redlining.

Therefore, this book builds on different literatures or, if one prefers, different theoretical schools. The focus in Chapter 1 is on the following question: how are the concepts of social exclusion and financial exclusion defined and how does redlining relate to other forms of exclusion? Chapter 2 discusses the theoretical importance of mortgage markets and real estate more generally, speaking to broader debates in urban theory. I discuss the "socio-spatial approach," which was developed in reaction to the Chicago School and has its roots in urban sociology, human geography, and political economy. One of the most important sources of inspiration to the socio-spatial approach, David Harvey, receives a great deal of attention in this chapter. A socio-spatial approach looks at the structuration of redlining by emphasizing the power of agents/actors, linking the structure of the real estate industry to the development of places (neighborhoods, cities, etc.).

Mortgage lenders are not merely automata of the price mechanism who steer the *natural* operation of the market, but should be seen as intentionally and unintentionally restructuring the market, and thus possibly producing, or contributing to, processes of redlining and neighborhood decline. In effect, I present a critique of the conceptualization of redlining in empirical work. This is not a completely new critique: redlining research has been widely criticized. The existing critique, in many ways, is a critique on the foundations of mainstream, neoclassical economics (it is here that Chapter 2 connects to Chapter 3). To this I add a critique of the a-spatial character of most redlining research. I propose a different operationalization of redlining (Chapter 2), based on the socio-spatial approach, and a different conceptualization of markets (Chapter 3).

Chapter 3 first introduces an approach to markets and economic action, and second discusses the use of credit scoring and other forms of profiling in mortgage markets. For the first goal of this chapter, I discuss an approach to markets that refutes the neoclassical approach and suggests an alternative approach that builds on both economic sociology and institutional economics. It argues that redlining practices have rational motives behind them, but that does not mean rational action theory provides an adequate explanation. Context-bound rationality guides the exclusion of high-risk areas; the social and institutional environment is important in explaining when redlining occurs and which form it takes. As lenders watch one another and act in response to signals, they may adjust their policies up to the point where a market leader's actions may be copied by other mortgage lenders.

Chapter 3 also includes a description of the loan application process. In presenting the actors involved, I show how redlining can be rooted in this process and what the roles of credit scoring and gatekeepers are in shaping redlining. This is essentially an application of the institutional approach sketched in the first part of this chapter. It also takes redlining out of the realm of econometric analysis and into the realm of agency and structure; that is, the realm of sociology. Indeed, together with the earlier argument for re-spatializing redlining, this book makes a case for reclaiming redlining as an inherently sociological and geographical phenomenon.

The second part of this book discusses three country case studies. These three chapters are, however, quite different from one another. Chapter 4 is an analysis of a century of redlining in the US. After describing the origins and evolution of mortgage markets, it traces the origins of redlining in the 1930s, discusses the community response to redlining in the 1970s and 1980s, and pays attention to current debates on subprime and predatory lending and how they relate to redlining, yellowlining, reversed redlining, and the new redlining.

Redlining research is common practice in the US, but not in other countries. Does this imply redlining does not take place elsewhere? Chapter 5 discusses the case of Milan, Italy. The Italian and Dutch mortgage markets are in many ways contrasting cases, whether we look at the relative size of the mortgage market, the role of homeownership in society, or the role of the family in connection to both mortgage loans and homeownership. This chapter continues by explaining how the Italian mortgage market has changed tremendously in the past decades and how this has influenced place-based exclusion in the City of Milan. Empirical research is presented on redlining and yellowlining in Milan.

Chapter 6, the longest empirical chapter, discusses the case of the Netherlands and argues that redlining did take place. Empirical research on redlining in the City of Rotterdam is presented in detail and compared more briefly to empirical research in the cities of Amsterdam, The Hague, and Arnhem. This chapter maps and explains redlining patterns in Rotterdam during the last 20 years, and by comparing the changing patterns not just to developments in Rotterdam, but also to national changes and to redlining patterns in the other three Dutch cities, I am able to come to a fuller understanding of why, how and when redlining takes place.

The Photo Essay revisits the City of Rotterdam, and shows how redlining interacts with other processes at the neighborhood level. The Tarwewijk district is taken as an example to show how the retreat of "formal" actors, such as banks and bona fide landlords, stimulates the rise of the underworld in the housing market.

The comparison between the US, Italian, and Dutch cases is handled in the third and final part of this book; that is, Chapter 7. This concluding chapter also summarizes the main argument of this book and draws the most important conclusions. It integrates the multi-scalar approach followed in this book, in light of the argument that any explanation of redlining should necessarily involve processes at different spatial levels and not just at the level at which the phenomenon manifests itself. Such an approach also allows me to abstract from the cases of this book and explain why redlining and exclusion manifest themselves differently across space.

Part I

The Exclusion, Urban, and Market Lenses