Rhode Island Policy Reporter

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Speculation speculation

ANALYSES OF RHODE ISLAND'S real estate market are generally missing some important information. It's easy to see, for example, that around $5 billion of residential real estate was bought, sold, or rented in 2006. What's harder is understanding the many reasons *why* people were buying and selling. People buy property for a number of reasons. Some buy houses to live in them, others buy houses in order to re-sell them at a profit. Still others buy because their parents told them to, and there are undoubtedly sillier reasons out there, too. But does it make a difference why people buy a house? The answer is that yes it does, if you think the market isn't working well.

Rhode Island has a healthy real estate market in one important respect: every seller is able to find a buyer, though they may not be able to find it at the price they want. But the reverse is not true. Every buyer is not able to find a seller at a price they can afford. Depending on how you view the world, this might be a failing of the market to provide a social good (housing for everyone), or it might just be the expected functioning of the market, a necessary hardship. Whatever your economic philosophy, the fact is that the price of real estate in Rhode Island makes finding affordable housing very difficult for many, and even makes it difficult to profit by renting property. Price is an important issue, and people's motivation for buying property is part of it.

The reasons people buy property were the subject of an article in **RIPR** issue 15, a year ago. The conclusion then was that around a quarter of total investment in real estate was speculative investment: purchases made not to provide a home to anyone, but in order to resell at a higher price. The conclusion was based on analysis of Federal Reserve data about investments. But this was indirect data, obtained via gross measures of investment. Better estimates can be obtained by direct measures.

For a new analysis, **RIPR** obtained records of all the real estate sales in Providence in 2003, 2004, 2005 and most of 2006: 14,967 records. Of these, there were only 11,341 distinct properties. Over 3,500 of the sales were resales, on 2,778 different properties: about a quarter of all sales activity, measured in sales or in houses. About 5.5% of all sales were property flips, where the buyer held the property for less than six months.

In many neighborhoods, the number of short-term investors is even higher. In plat 43, which covers part of the West End around Cranston Street, Potters Avenue and Dexter Street, about 40% of sales between 2003 and 2006 were for rapid-fire investment, turning over at a pace 35% faster than in the rest of the city. One hundred and ninety-seven properties there changed hands during that time, but only 87 of them were involved in 220 sales.

Citywide, the average difference between purchase and sales prices for investors who held their properties for less than six months was about $60,000, or a bit more than 50% of the amount invested. From the assessor's data alone, you can't know whether this is all profit, since it's likely that the purchasers put *some* money into these properties, and this gets to the question of whether all these short-term investors are providing a social good or not. There are two common portrayals of these investors. One picture shows a population of earnest citizens, trying to do well by buying and improving pieces of the housing stock in their neighborhoods. The other picture is of rapacious minor-league land barons, making a quick buck by pumping up the value of housing for their personal benefit.

Purchase data provides a way to begin to answer the question of which picture prevails. Counting only the properties purchased and sold after the 2003 revaluation, about 11% of these short-term properties show any change in assessment between their purchase and sale. In other words, only about one investor in nine made any significant improvements to the properties they (re)sold. Others may have cleaned them up, put on a coat of paint or put in new kitchen cabinets, but nothing that shows up in the assessment. As with the other measures, though, this varies by neighborhood. In the West End's plat 43, for example, about one reseller in three made significant improvements to the property they sold.

About one reseller in nine made substantial improvements to their property, city-wide.

The data also show that the property improvers are correspondingly more likely to hold the property longer. Citywide, the difference is small, with improvers tending to hold property a month or so longer (average: 11.7 months) than the non-improvers (10.5 months). In the city's poorer neighborhoods, the long-term improvers hold their property for the same average time as citywide, but the short-term non-improvers are more aggressive, and sell their properties three months sooner, on average.

Another question raised by this data is how much money people are earning from these investments. The data don't make it possible to answer this precisely, because there's no way to price the coats of paint applied and because of quirks in the way multi-property sales are reported. Nonetheless, the data does support some broad observations about prices and allows rough estimates about profit. The first finding: it's a lot. From the data available (which doesn't count those coats of paint, remember), a conservative estimate would say that about $65 million in profit is earned each year by selling real estate in Providence that is heldr for four years or less. There are neighborhoods in several other Rhode Island cities and towns that match the characteristics of South Providence and Olneyville, so there is little reason to imagine that these trends aren't matched statewide,

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Duration	Rate
<4 months	60%
4–8 months	35%
8–12 months	30%
1–2 years	25%
2–3 years	20%
3–4 years	15%
4–5 years	10%
5–6 years	5%
>6 years	0%

Table 1: The tax rates in Vermont on the capital gains from land held less than six years. These rates apply if the gains are less than 100% of the purchase price, and there are higer rates if the gains are higher.

which would lead to estimates of $200-250 million per year for the whole state.

We can also see from the data that in dollar terms, approximately 21% of real estate investment in Providence is investment made for short-term gains alone. That is, 21% of the money spent on city real estate in 2003 was spent on property that was sold by 2006, and usually long before. This is a huge proportion, and doesn't count investors with a longer-term outlook. Again, projecting out to the state level, this is almost a billion dollars a year in our $4.6 billion market.[1] This much money can only have an upward effect on prices.

Resale activity is clearly related to the level of prices. Resold property sells for 15-25% more money compared to its assessment than property that was only sold once in the study period. This is a statistically significant difference that survives analysis by the property *and* by the neighborhood. That is, houses in neighborhoods with lots of resold property sell for much more compared to their assessment than calmer neighborhoods and houses that are quickly resold sell for much more compared to their assessment than nearby houses that are not.

Compared to its assessment, quickly resold property sells for 15-25% more than other property.

This analysis doesn't make it clear what is the cause and what is effect. As usual, though, it's neither the case that short-term investors cause high prices, nor is it the case that they are only passive participants, merely taking advantage of market conditions to make some money. Rather, they are an integral part of the way the market functions.

Representative David Segal (D-Providence) is poised to introduce legislation to the General Assembly that would

[1] This agrees well with the estimates made in **RIPR** issue 15 from Federal Reserve statistics.

impose a significant tax on the capital gains from short-term land sales. Modeled after a similar law in Vermont, this would act to discourage a good deal of the short-term investing that is so prevalent recently. The legislation contains exemptions for owner-occupied houses. As of this writing, some important details (like the tax rates) are not settled. The rates in the Vermont law range from 0%, for owners who've held their properties more than six years, to 60%, for owners who sell in under 4 months. In Vermont, this tax is not a big money-maker, and annually only raises between $400,000 and $4 million from a real estate market approximately the same size as ours. It serves their state in a different way, by keeping their real estate market somewhat cooler than ours. Like us, Vermont is also having a crisis in affordable housing, but their housing inflation rate is less than half ours, and this tax is part of the reason why.

Our state government regulates markets in tow trucks, taxicabs, haircuts, electric rates, garbage collection, architects and insurance. The forms of regulation are all different. Some are price regulation, some regulate market entry, and others regulate conduct, or impose taxes. But they have this in common: they were all put in place because some people realized that the unfettered market wasn't serving an important social good. Our shortage of affordable housing is clearly linked to the predictable behavior of the housing market. We can decide that it's "Un-American" to regulate this market, but if we do, we'll have no excuse for wondering why housing costs continue to spiral ever skywards. ■

Iraq Study Group

This issue was going to contain a review of the work of the Baker/Hamilton Iraq Study Group (ISG) report. Suffice it to say that its recommendations for a diplomatic "surge" and careful redeployment have set a new world record for the sprint to irrelevance, rendering our editorial plans somewhat beside the point. Nonetheless, it shouldn't go without note that the ISG report contains important recommendations that the administration probably will support. These appear on page 83, under the heading "Oil Sector," where they essentially call for a surge of US-supplied contractors to restore the oil fields to working order (to be paid for by the government of Iraq) and for the Iraqis to abandon price controls for their domestic gasoline market, and to commercialize their national oil industry. "Until Iraqis pay market prices for oil products, drastic fuel shortages will remain."

So according to the ISG, market regulation remains at the heart of Iraq's problems.

Senator Russell Feingold pointed out that no member of the ISG had had the judgment to oppose the Iraq war in the first place, and further wondered why, with that track record, we should listen to them now. A review of their plan leaves one with little doubt that their only real objective was to convince the President to moderate his plans somewhat, not to promulgate a plan that would actually work. –TS

Promoting Democracy

THE ELECTORAL COLLEGE is an archaic institution, and a fundamentally undemocratic one. What many don't realize is that it is also a hodge-podge. The rules for selecting electors vary from state to state, as they have from the very beginning of our republic. Most states award all their electors (and all their electoral votes) to the winner of the vote in their state. Maine and Nebraska apportion the votes according to the percentage won. Some states used to rely on the votes in different districts, a common method right at first. Virginia used this method in the 1796 election, when Thomas Jefferson lost to John Adams, a Massachusetts candidate whose home state awarded all its electors to him. Chastened, Virginia changed its rules to award all its electors to the winner of its statewide vote. Meanwhile, Massachusetts did the same to protect Adams, due to the inroads the Jeffersonians were making in their state. New Hampshire, whose Federalist-controlled legislature feared losing the 1800 presidential election to the Jeffersonians, did away with their winner-take-all system in favor of letting the legislature appoint their electors.

There's nothing sacrosanct about how we choose electors for a presidential election. States have been tinkering with these rules for partisan reasons from the first. So why not tinker a bit more on behalf of democracy?

For years, plans to abolish the electoral college have come—and gone. Amending the U.S. Constitution is, by design, a cumbersome and long process. More important, proposals suffer from the fundamental conundrum of electoral reform: the current system put the current office-holders into their current offices. Flawed as it is, the system is the source of their power; why would they change it?

A small band of activists and attorneys may have found a solution to the conundrum. They are promoting an interstate compact to award a state's electoral votes to the winner of the national popular vote, rather than to the winner of that state's vote. The "Agreement Among the States to Elect the President by National Popular Vote" must be passed by the different legislatures, but it will not wait for unanimity, but will go into effect when the states that have ratified it constitute a majority of the 538 electoral votes. At that point, a majority of the electoral votes will be awarded to the candidate with the highest popular vote, and we'll have a President elected by the popular vote, without an amendment.

Even after getting enough states to sign on, there are some significant hurdles ahead for the proposal, includ-

ing likely challenges to its constitutionality. None of them seem open-and-shut, though if the proposal gets that far, there will be some tense days in court. The NPV team has prepared a 620-page legal brief on the subject that addresses a number of the objections and legal issues.[2] The issue that may get the most attention around here is the issue of small states.

Several of the seemingly undemocratic features of our nation's government were originally justified as a way to protect small states from the "tyranny of the majority." The allocation of two Senators to every state, regardless of size, the allocation of at least one House member to every state, regardless of size, and the allocation of at least three electoral votes to each state, regardless of size. Rhode Island gets four electoral votes, and California gets 55, even though it's got 36 times as many people.

Does Rhode Island have anything to fear from big ol' New York? Or is it more likely that both states—neither of which have been "battleground" states in years—are routinely ignored in Presidential politics? Our interests are aligned when the substantial majorities in our states are overturned by bare majorities in other states, precisely what happened in 2000. Turnout here is not important to presidential campaigns, since the probability of Democrats losing the electoral votes is very small. Fifty percent plus one will suffice, so campaign funds are better spent elsewhere. If the popular vote is important, then every vote here will be important. Turnout will matter.

As of this writing, the NPV organizers have managed to get the bill introduced in 20 states, and identified sponsors in 25 more. In Colorado, the bill has passed the Senate, and awaits approval in the House. In Rhode Island, the bill will be introduced by Art Handy (D-Cranston) and David Segal (D-Providence) in the House and by Daniel Issa (D-Cumberland, Pawtucket, Central Falls) in the Senate. ■

[2]This can be found at *nationalpopularvote.com*.

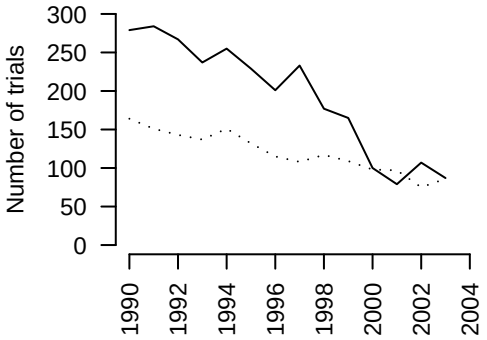

Figure 1: Torts in federal district courts. The solid line is the number of non-asbestos product liability trials heard in all federal courts. The plaintiffs lost in about two out of three cases consistently, and the average award declined from $806,500 in 1990-1993 to $620,500 in 2000-2003. The dashed line is for medical malpractice cases, where only 28% of plaintiffs prevailed, and the average award declined from $1.1 million to $712,000. It's hard to call the trend these lines represents an "explosion" of tort trials. Source: US Department of Justice, "Tort Trials and Verdicts, 2002-2003"

BOOK REVIEW

What don't you learn from the news?

Blocking the Courthouse Door
How the Republican Party and Its Corporate Allies are Taking Away Your Right to Sue
Stephanie Mencimer, Free Press, 2006, 291pp

LENNY BRUCE USED TO SAY that the many stories of dolphins pushing drowning sailors to shore had nothing to them. He said that dolphins just like to push people around, and you never hear from the ones they push *away* from shore. Sample bias is what happens when you base your judgments on a sample of events that have some sort of systematic tilt: only the sailors who survive tell their stories, and all the stories sound the same, so we conclude something about dolphins that may be completely bonkers because all the opposing evidence was gathered by people who drowned before they could report it.

Something similar has happened over the past thirty years with stories about "out-of-control" jury awards: the egregious cases with the million-dollar judgments get the headlines, and the subsequent award reductions or the routine dismissals of almost all lawsuits get completely ignored. If you only read the news, you might be forgiven for believing that trial lawyers and juries were ruining our society. But as usual, a close look at what's really going on shows something very different. In fact, news about jury awards is usually promoted (if not created) by an alliance of insurance companies, large corporations, doctors and Republicans, and usually with the aim of restricting rights that you'll likely never even know were in jeopardy unless you're injured as a result of some corporation's idiocy.

The need for tort reform is found in headlines, not in data.

Beyond the headlines, the evidence for a runaway tort system is pretty thin. The figure above shows personal injury and malpractice awards from federal courts between 1990 and 2003. There are interesting features to the graph, but it's hard to characterize it as anything but a decline. The average award has declined, too, from $806,500 to $620,500 in 2003. The same trend is apparent in medical malpractice suits. People will say the problem isn't in federal courts, but in state courts. But there again, the evidence is thin. According to the National Center for

State Courts[3] Tort claims have declined in state courts, too, from 543,393 in 1992 to 508,927, a decrease of about 6%. Of course they haven't declined in some states, but it's hard, while perusing the NCSC statistics, to find a state where the increase is worrisome. New York, Florida and Puerto Rico all saw substantial increases, but all other states saw either minor increases, or decreases. Rhode Island has only been reporting statistics to the NCSC since 1996, when there were 3,923 tort cases heard. In 2001, there were 3,516, a 10% drop.

So if the data don't show that there is a problem, why are there so many calls for "tort reform?" Here in Rhode Island, the Governor and several legislators have pushed for several changes in the conduct of liability suits over the past few years, especially concentrating on medical malpractice suits. But nationally, there is even more noise about reform. Texas is a pioneer in the field, with limits on non-economic damages ("pain and suffering"), punitive damages, the kinds of testimony that can be presented, and limits to shareholder suits against corporations (passed at the behest of the late Ken Lay, of Enron). And Texas is also where we can find part of the reason tort reform is so high on the agenda: campaigning on this issue is what got George W. Bush elected Governor in 1994. Karl Rove developed and honed his bare-knuckle style of campaign in high-profile Supreme Court election campaigns in Alabama and Texas (they elect judges there) on exactly this issue, and when he met a candidate willing to run for Governor on it, well, you know the rest.

Tort reform has been a magic issue for Republicans. It gave us our President.

For Republicans, the issue is magic: it attract bags of corporate money, hampers Democrats, for whom trial lawyers are an important source of funds, and allows them to spend all their time on the campaign trail bashing lawyers and telling tall tales about crazy juries.

For example, who doesn't know the tale of the elderly woman who sued McDonald's for millions of dollars for serving her coffee too hot? And this is where Stephanie Mencimer's *Blocking the Courthouse Door* comes in handy. In it, you can learn that the woman's name was Stella Liebeck, she was a lifelong Republican, and she suffered third-degree burns, was disabled for two years after the spill, and wound up with medical costs of around $20,000. You also learn that during the trial, it came out that McDonalds had received more than 700 similar complaints, but had done nothing to change their company policy, which was to keep the coffee just short of boiling. Stella Liebeck was awarded $2.7 million in punitive damages, which made her a poster child for tort reform, but you may not have ever heard that the judge thought the jury's award too high, and cut it by 82%.[4]

The book itself is a trove of interesting information about the tort wars. You hear about Frank Cornelius, an Indiana lobbyist for malpractice insurance reform, who wound up trying to sue his doctors after botched arthroscopic surgery nearly killed him and eventually cost him the use of his leg. The Indiana laws he helped pass in 1975 wound up preventing him from receiving more than a small fraction of his medical costs fifteen years later. Driven by debt, despair and declining health, Cornelius left some anti-tort-reform testimony for the state legislature after his suicide shortly after.

You know about the McDonald's coffee case. Do you know how it ended? Why not?

The corporations behind tort reform—and the politicians who benefit from it—don't need the lasting allegiance of people like Frank Cornelius. They only need them for a little while. By now, the agenda encompasses several fronts. The obvious fronts are limits on damages, of the kind that caught Cornelius. But legislated limits on tort claims take other, even more sinister shapes. For example, new rules about scientific evidence have been introduced as ways to protect juries from "junk" science. Unhappily, these rules can also be used to cloud the

[3]Links to supporting documents are available at *whatcheer.net*.

[4]Nor did you probably hear that the jury had already reduced the award 20% because they found that Stella did have some fault: she spilled the coffee.

value of real science, and give judges wide discretion to disallow testimony by scientists for arbitrary grounds.

Another attack comes in the form of "pre-emption." The idea here is that if a product is under federal regulation, then it is immune from court challenges to its safety or efficacy, since that safety is presumably already a matter of public record. Michigan, for example, has a law that explicitly forbids suits against drug manufacturers if the drug in question was approved by the FDA. People in Michigan who suffered injuries as a result of Vioxx or Fen-Phen, two drugs the FDA requested be withdrawn from the market, have no recourse because those drugs were approved at the time that they had their strokes, or their heart attacks. In other states, similar precedents have been created by FDA briefs and by court decisions.

Wild tales of tort cases mostly serve to let insurance companies off the hook for their premium increases.

There are more. Moving tort cases from state courts to federal courts only sounds benign if you aren't aware that the federal courts have many fewer resources than most states', and that relegation to federal jurisdiction is tantamount to saying "will not be heard." And so on.

None of this is to say that there aren't serious issues with personal injury law. Medical malpractice premiums continue to shoot up and up, and lawsuits are the usual scapegoat. Other kinds of insurance see the same escalation. But where it's been tried, tort reform seems unable to keep the premiums down. But this isn't surprising. Insurance company accounting rules are designed to keep companies solvent, not to keep premiums down, and they have morphed over the last century into an amalgam of Alice-down-the-rabbit-hole rules and definitions. Among many others, here are three examples. Insurance companies routinely count among their losses claims they have never received and may never receive. They are allowed to count a claim you make as evidence of an increase in risk, even if it's the first one you ever made. Most important, they are allowed to claim as "lost" money that they still have and on which they are still earning investment income. Reforming these practices might be more effective in limiting premium hikes than limiting lawsuits, most of which lose.

Amid all the pointed fingers, it's worth stepping back to look at the larger picture. The whole tort issue is fueled by our refusal to provide basic care for our citizens. People are regularly forced into suing because there is no other way to pay for their care, or because someone else's negligence means a lifetime of poverty ahead. When you have to choose between penury and filing a suit, most people find it an easy choice. After her coffee accident, Stella Liebeck found herself deep in debt as well as deep in pain, and our society gave her little choice except to follow the path she took. If we want people to choose other paths, we should give them other choices. That is, anger may have made her *want* to sue McDonald's, but medical bills drove her to it.

Mencimer's book is a good one. The style is fairly straight-ahead, but it's a long list of offenses she has to describe, and they are dealt with briskly and well. She is especially compelling in describing the various ways in which the 21st century Republican party has been shaped by the issue. The trail of corporate money and influence is long and winding, and it weaves through the whole issue. You couldn't ask for a better guide. ■

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