Housing in the Seventies

A Report of the National Housing Policy Review

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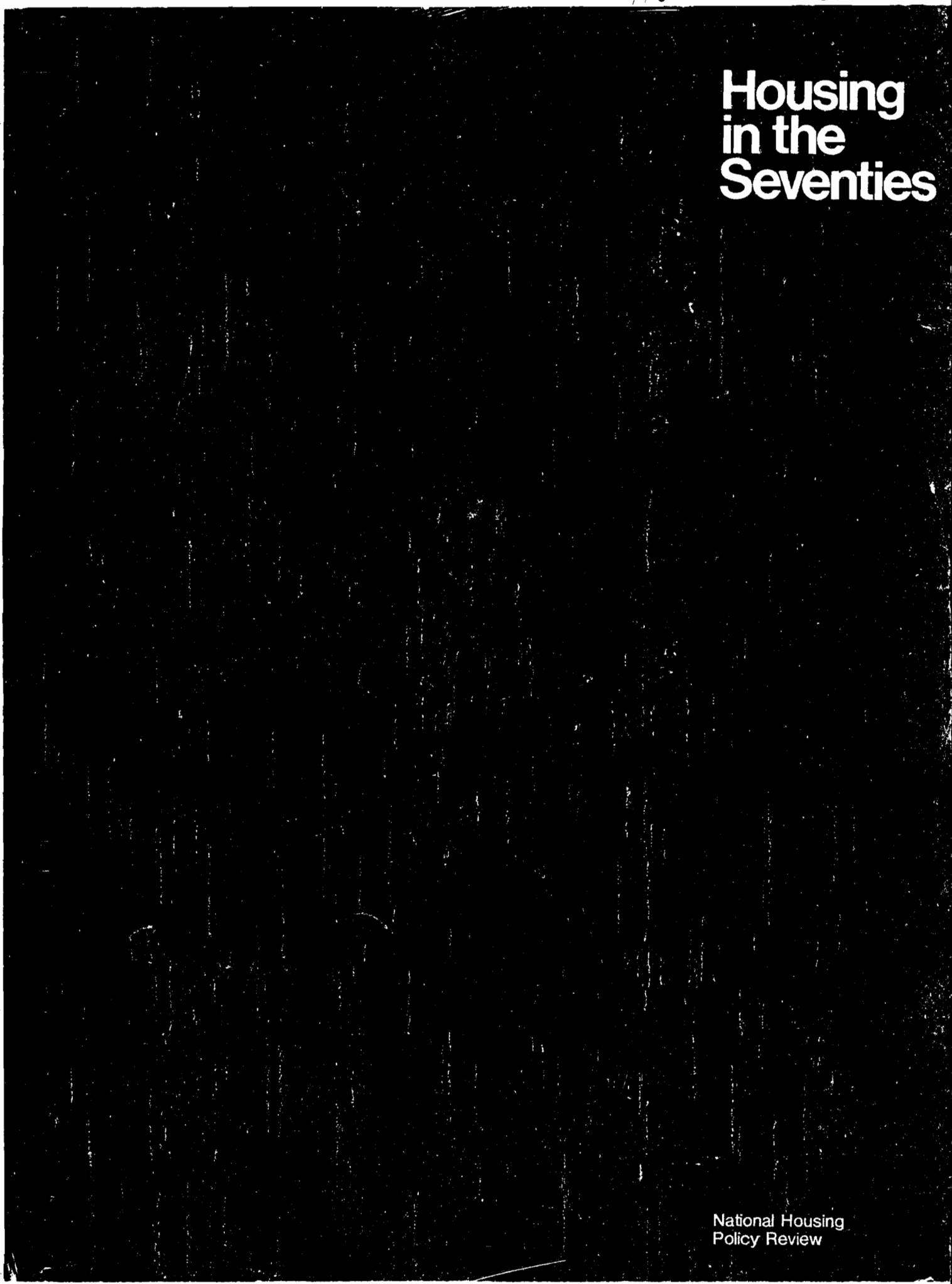

National Housing
Policy Review

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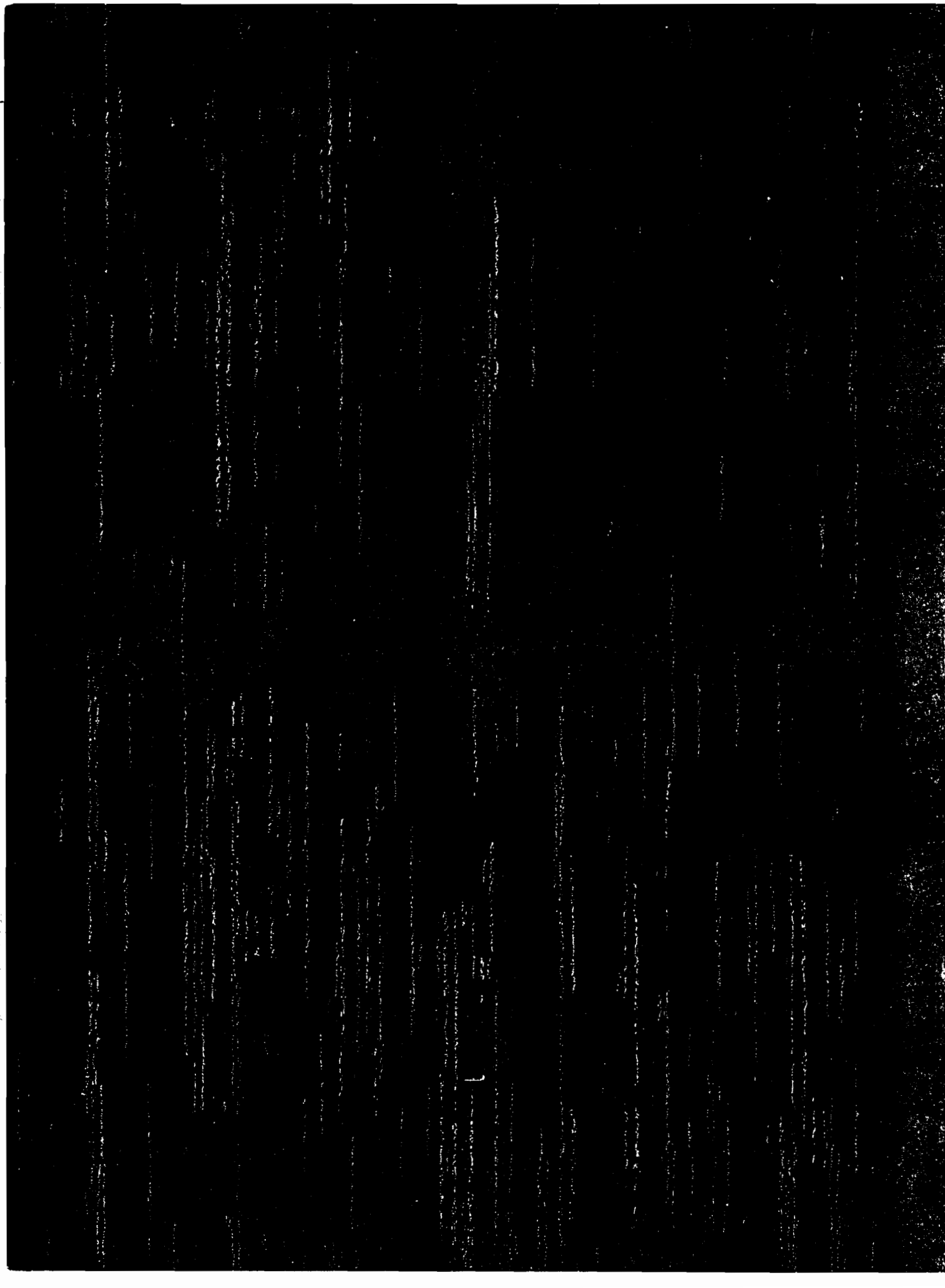
A Report of the National Housing Policy Review

U.S. Department of Housing and Urban Development

Washington : 1974



THE SECRETARY OF HOUSING AND URBAN DEVELOPMENT

WASHINGTON, D. C. 20410

This report—*Housing in the Seventies*—is the product of the National Housing Policy Review, an intensive six-month effort begun in March 1973. The report was the basis for the housing policy recommendations included in President Nixon's message to the Congress of September 19, 1973.

The comprehensive 1973 review undertook to analyze and assess the Federal Government's role—past, present, and future—in meeting the Nation's housing needs. This report recounts the history of Federal involvement in housing; explains the programs that evolved; assesses the cost-effectiveness of those programs; describes the housing activities of State and local governments; and outlines patterns of housing production and finance and the structure and technology of the housing industry. A supplement containing some of the technical and background papers produced for the National Housing Policy Review also is being published.

This is the final version of *Housing in the Seventies*. An interim edition, in draft form, was published in October 1973 and given limited distribution.

James T. Lynn

November 1974

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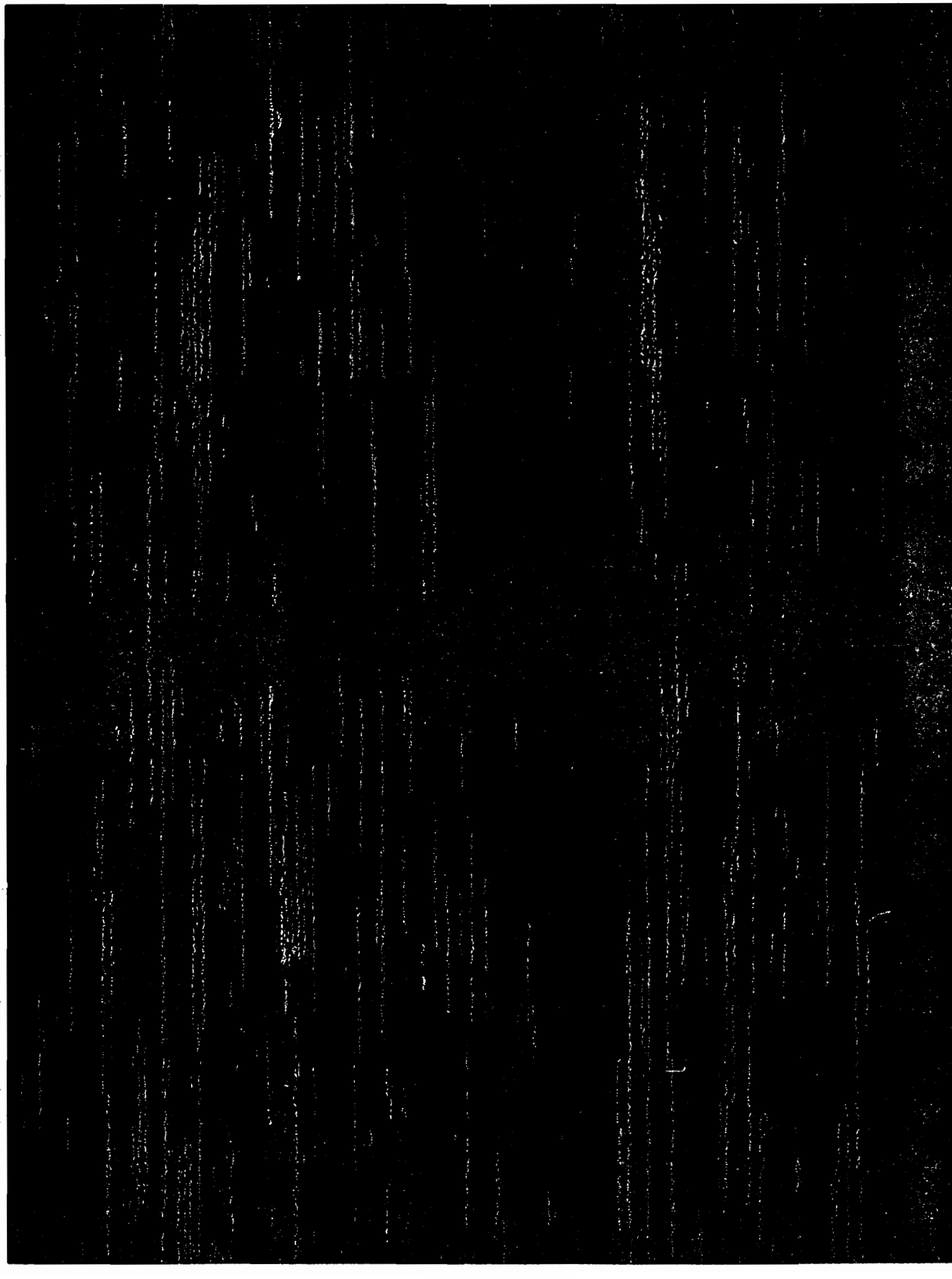


Introduction

Historical Perspective

From very modest beginnings barely 40 years ago, the influence of the Federal Government on the ways Americans build, finance, manage, and maintain their housing has grown dramatically. Today there is not a single significant aspect of the vast, diverse, and complex housing market that is not affected by governmental action in one form or another.

This phenomenon is particularly remarkable when one considers that for more than a century and a half—from agrarian times through the transition to an industrialized and increasingly urban society—the Federal Government had left the problem of housing up to the individual and the private market. This attitude changed in the mid-1930's, primarily as a result of the Great Depression. From that point on, hardly a year went by when Congress did not pass some new form of housing legislation.

In the 1930's, Congress made two fundamental policy decisions that remain basically intact to this day. The first was the complete restructuring of the private home financing system through the creation of the Federal Housing Administration (mortgage insurance); the Federal Home Loan Bank Board and Bank System (savings and loan industry); such institutions as the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation (insurance on deposits of commercial banks, mutual savings banks, and savings and loan associations); and, finally, the Federal National Mortgage Association (secondary mortgage market). Creation of these institutions—resulting in the acceptability of the long-term, low downpayment, fully amortizing mortgage and a system to provide a large flow of capital into the mortgage market—are probably the most significant achievements of the Federal Government in the housing area.

The other fundamental policy decision in the same decade was the concept of Government-subsidized housing for low income families. Although the public housing program authorized in 1937 was intended primarily as a means of stimulating employment and clearing slums, it nonetheless marked the first time that Federal funds were used to finance new housing construction for the less fortunate.

In the years that followed, many Federal housing and housing-related programs were added to the statute books, spurred by the 1949 enactment of the national goal of "a decent home and suitable living environment for every American family." A number of mortgage insurance programs were added, conferring special benefits on such groups as veterans, farmers, the elderly, and those displaced by other Government programs. Those programs, in turn, were followed by new subsidized mortgage insurance and subsidized direct loan programs benefiting the elderly and the poor.

In 1968 Congress found "that the supply of the Nation's housing is not increasing rapidly enough to meet the national housing goal, established in the Housing Act of 1949, of the realization as soon as feasible of the goal of a decent home and a suitable living environment for every American family." To meet that goal, Congress established a production schedule "within the next decade of the construction or rehabilitation of 26 million housing units, 6 million of these for low and moderate income families," and enacted a further set of programs to assist in meeting the production schedule for low and moderate income families. These new programs conferred further special benefits—including deeper subsidy assistance for home ownership and rental housing—on residents of

1 The Role of the Federal Government in Housing

Introduction

The complex and many-faceted role of the Federal Government in housing had its origin basically in a single great event: the collapse of the housing economy during the Great Depression of the 1930's. The crisis that resulted from that collapse engendered a series of governmental initiatives that have followed one upon another in the years since.

The history of the Government role from 1932 to 1973 is intricate and tangled. It is possible, however, to construct a somewhat systematic account of the reasons, rationales, or motivating forces behind the various housing initiatives and thereby throw some light on the forms in which those initiatives were cast.

There are three broad areas of concern that have guided Government actions in the housing field: (1) the recognition that it had a responsibility to maintain and promote economic stability, (2) a social obligation to help provide for those in need, and (3) an emerging interest in how the country's communities develop.

These concerns developed gradually as a result of the economic chaos that accompanied the Depression, replacing earlier notions that the proper role of government was minimal interference in the way the marketplace operated. In reacting to the economic crisis, Congress and the executive branch of the Government developed separate strategies that have evolved through the years into a body of policy and programs with specific themes and subthemes that in some cases have lost touch with original objectives.

It is possible nevertheless to recognize several of the different economic objectives or motivations underlying Government actions in the housing field.

First, housing has long been considered by some observers to be an important element of any countercyclical economic strategy. In times of economic recession, special measures designed to stimulate the production of housing have been undertaken to stimulate construction in general, thus reducing unemployment and generating a major multiplier effect through increased demand not only for lumber and other construction materials, but for household furniture and fixtures and similar consumer goods as well. Indeed, such diverse programs as public housing and mortgage insurance originated as parts of a massive Government effort to start up a stalled economy and to get the unemployed back to work. Conversely, in times of prosperity, housing and housing-related industries have been seen by some as a major element of any strategy designed to maintain economic growth and stability. This view has been expressed many times—as, for example, in the declaration of the Housing and Urban Development Act of 1968 of a 10-year housing production goal, which was intended to help stabilize the housing economy at levels of sustained high production.

Second, many observers believe that housing production could not be stablized unless the Government took effective steps to maintain a sufficient and continuous supply of mortgage credit. While this objective has never been successfully sustained over long periods, it has been a factor in such major Government initiatives as the creation of the Federal Home Loan Bank System, insurance of savings in home mortgage lending institutions, and the creation of the Government-backed secondary market system for home mortgage credit.

Third, it was believed that without Government intervention it was unlikely that housing production would reach and maintain levels high enough to meet the needs of new family formations and to replace slums and substandard housing. The Government therefore has sought—through many devices such as mortgage insurance, extension of its own credit, and technological research—to stimulate and expand housing production. These actions were taken not solely for economic reasons but also for the social purpose of providing more and better housing.

The Government's recognition of its obligations to the social needs of the Nation, and especially to the disadvantaged, has expressed itself in a variety of ways in Federal housing policies. One example is the belief displayed in Government policy since the inception of its housing activities that homeownership is a valid objective of public policy in itself. Thus, making homeownership available to the widest range of family incomes has been a continuing goal of Government policy. In addition, where the poor

are concerned, it has long been recognized that shelter is as basic a need as food. Many efforts have flowed from this recognition—public housing, rent supplements, the rental and homeownership interest subsidy programs, and others. Out of these programs has arisen a certain ambiguity as to whether these efforts serve essentially social ends, or economic objectives, or both.

Another example of how Federal housing policies have taken on social objectives as well as economic objectives is in the area of civil rights. With the abandonment of the "separate-but-equal" doctrine in public education and the emergence of a new national consciousness in the area of civil rights and equal opportunity, the Government has moved from a posture of noninvolvement where housing was concerned to one of positive action designed to end racial discrimination in housing and assure equal access to the housing market by all, without regard to race or national origin. And, most recently, through project site selection policies, the Government has attempted through its subsidized housing programs to reduce racial concentrations in center city slums.

Still other areas of Government social concern can be cited. For example, the Government has sought to provide aid for such special groups as veterans, the elderly, the handicapped, and students; it has assumed a moral obligation to those who were involuntarily displaced by its power of eminent domain in pursuit of certain public objectives. In recognition of this obligation, a variety of housing programs has been used by the Government to relocate those who have been displaced.

Finally, permeating the thinking of Congress and the executive branch about housing has been concern over community growth and development and the cumulative effects of growth patterns on the welfare of the Nation as a whole. This concern has been expressed many times and in many forms.

Public housing originated in 1937 as an effort to clear slums as much as to increase employment and assist the poor. Then, in 1949, Congress authorized a major program apart from the public housing program to deal with slum clearance as such. Starting in 1954 and continuing in the 1960's and early 1970's, the same thrust was steadily expanded to embrace ever-larger areas: first, entire neighborhoods, then whole sections of cities, and finally entire cities and counties and preplanned new communities.

The multiplicity of Federal housing policy goals helps explain why there has never been unity and coherence, either in housing and community development programs or in administrative organization, for carrying the goals into effect. The manifold objectives imply, and to some extent result from, a similar number of constituencies to be listened to and served. These constituencies are both local and national, public and private. They represent public interest groups or private interest groups, industries or parts of industries, labor or the various affected professions, and many, more varied segments.

Thus, what has emerged is an enormously complex and confusing aggregation of special purpose programs—some very broad in concept and some very narrow, but all categorized within federally predetermined limits—being carried out to a major extent by the United States Department of Housing and Urban Development (HUD), but also to a significant extent by several other departments and agencies. Correspondingly, the substance of these programs is evaluated within the Congress by primarily one set of House and Senate committees, but important elements also fall within the jurisdiction and interest of a half dozen other sets of committees.

Furthermore, all of this Federal involvement in activities that are local in impact—even if national in import—has led inevitably to considerable confusion and controversy over the appropriateness of the respective roles of the various levels of government involved: Federal, State, and local. These issues, difficult enough in themselves, are made even more so by the enormous number and variety of existing local government jurisdictions.

The basic control over federally assisted housing activities has tended to stay in the hands of the Federal Government—primarily because it had first identified and attacked the problems, and to a large extent because it has provided most of the money. Over the years, the presence and endurance of Federal control have contributed to the development of a multiplicity of programs with differing and some-

times conflicting and overlapping requirements and procedures. The balancing of roles of the various levels of government is an ever-continuing process, with no final resolution of how they should be balanced yet in sight.

The history of the development of the Federal Government's present role in housing matters and some of the complexities and other features of existing legislative authorizations for Federal housing programs are described in broad outline in the pages that follow.

Preliminary Federal Housing Efforts

Since President Theodore Roosevelt appointed the first Presidential Commission to evaluate slum conditions in 1908, Presidential panels have developed into a prime source of housing recommendations and policies.

The Roosevelt Commission in its report to the President recommended:

> A little government aid extended to these unfortunates (District of Columbia slum inhabitants) in the form of a loan to build them habitable dwellings would tend immensely toward their uplifting and improvement . . . All unsightly and insanitary property should be condemned and purchased by the government, improved in a uniform manner and inexpensive and healthful habitations erected for the poor, who could rent or purchase their homes on installment plans at low rates of interest.[1]

However, it took another 10 years before the Federal Government approved the Nation's first housing program. It was not until World War I that Congress, acting on the recommendation of the Council of National Defense, approved legislation aimed at providing adequate housing for defense workers. It authorized the United States Shipping Board and Emergency Fleet Corporation to provide housing for shipyard workers through loans to subsidiaries of shipbuilding firms.

Congress also authorized $100 million for direct construction of housing by a newly created United States Housing Corporation. The Corporation spent some $52 million in the production of about 6,000 dwellings and 7,000 dormitory accommodations near defense industries for families and individuals. After the war, housing under both programs was either sold or demolished, and there was no further direct Federal activity in the housing area until the 1930's.

[1] U.S. Congress, Senate, *Reports of the President's House Commission*, 60th Cong., 2nd sess., 1909.

Response to the Great Depression

President Hoover's Conference on Home Building and Homeownership provided, in December 1931, the first impetus for the basic home financing legislation that evolved during the 1930's.

In his opening statement to the Conference, President Hoover said:

> I am confident that the sentiment for homeownership is so embedded in the American heart that millions of people who dwell in tenements, apartments and rented rows of solid brick have the aspirations for wider opportunity in ownership of their houses.

Essentially, the Conference was a factfinding body that identified the weaknesses and inadequacies of home financing, rather than an instrument for developing specific legislative recommendations. Although the recommendations made by the Conference did not directly call for increased or new Federal involvement in the national housing credit market, the fact was that the President's initiative in calling such a conference, and the impact of its discussions, had much to do with the pioneering legislation that was shortly to follow. The Conference highlighted for the Nation the existing inadequacies of home construction and rehabilitation, the need for further research and distribution of information on the subject, the crucial problems of building and loan associations and other lenders arising from the Great Depression, and the flaws in foreclosure, zoning, and other State and local laws. Its findings reflected the drastic impact of the Depression upon homeowners: some 50 percent of all home mortgages in the Nation were in default; foreclosures neared the astronomical rate of 1,000 per working day in late 1931 and 1932; and new mortgage lending and new homebuilding were sharply reduced, dropping still further in the year following.

In response to this crisis, Congress acted in broad and sweeping ways that permanently changed the nature of housing credit markets. It created three emergency and four permanent

never considered to be a housing program as such because its major thrust was toward encouragement of ownership of adequate-sized farms and of equipment. In this context housing was treated merely as an adjunct of the physical plant of the entire farm.

Impact of World War II

President Franklin D. Roosevelt, using his emergency war powers, created the National Housing Agency in 1942. The new agency centralized all Federal housing authorities under a single administrator for war needs. Through the auspices of the National Housing Agency, nearly 853,000 units of defense and war housing were provided by direct Federal construction under the Lanham Act of 1940 and related acts of the early 1940's. Subsequently, lacking the stimulus of the war effort, the Federal Government abandoned its role of directly supplying housing; it demolished two-thirds of the wartime-constructed units and sold the remainder.

The construction of private housing for defense and war purposes was assisted by the first special purpose FHA programs, enacted in 1941 and 1942 as Sections 603 and 608, respectively. These programs provided mortgage insurance on liberal terms to builders providing housing in "critical defense areas;" they were reenacted and made available to veterans after the war ended.

The wartime shortage of housing, due to shutdown of nearly all residential construction except in defense areas, and the low level of production in the 1930's, was compounded by the number of returning veterans in 1945. As part of a broad package of benefits in the G.I. Bill of Rights (Servicemen's Readjustment Act of 1944), a new homeownership program was enacted for veterans. To date, it constitutes the largest program ever enacted for a single target group. All other programs for the poor, the elderly, the handicapped, minority groups, and college housing, are dwarfed by the scale of the Veterans Administration (VA) housing program.

By 1973, 8.7 million veterans' loans had been placed, totaling close to $100 billion. Of these, about 3.9 million loans, with a balance of $45.5 billion, are still outstanding. Only the cumulative outstanding balance of FHA mortgages insured under its basic Section 203 single-family home mortgage insurance program of $51.1 billion exceeds the total loans guaranteed by the VA.

Postwar Enactment of National Housing Policy

The Housing Act of 1949 represented the culmination of a lengthy series of companion or rival bills, which continuously received the attention of three Congresses.

Throughout most of the 1940's, both the executive branch and Congress considered numerous proposals for programs to eliminate the slum housing in the Nation's cities.

Legislation introduced in 1943 led to a 1945 congressional report, *Postwar Housing*, which proposed:

> The establishment, on a provisional basis, of a new form of assistance to cities in ridding themselves of unhealthful housing conditions and of restoring blighted areas to productive use by private enterprise.

Subsequently, from 1945 to 1949, Congress debated the details of new housing and slum clearance legislation. During that 4-year period, strong support for legislation came from the general public, stimulated by the severe nationwide housing shortage following the war, and from President Harry S. Truman, who called for enactment of comprehensive housing legislation in several strongly worded statements. Many Members of Congress, led by Senator Robert Taft of Ohio, also were prominently identified with the development and enactment of the new legislation.

The Housing Act of 1949, which was enacted with broad support from both political parties, contained the clearest statement to that time of a national commitment to housing and reaffirmed the use of private resources, local governmental initiatives, and Federal financial assistance in achieving housing goals. Section 2 of the act states:

> The Congress hereby declares that the general welfare and security of the Nation and the health and living

standards of its people require housing production and related community development sufficient to remedy the serious housing shortage, through the clearance of slums and blighted areas, and the realization as soon as feasible of the *goal of a decent home and a suitable living environment for every American family*, thus contributing to the development and redevelopment of communities and to the advancement of the growth, wealth and security of the Nation. (Emphasis added.)

It was a commitment to provide decent housing for all citizens and to remove slum conditions, but it was a commitment without a timetable and without adequate means for accomplishment.

Beyond the statement of policy, the act created the Urban Redevelopment Program (Title I), which later became the urban renewal program; greatly increased the funds available for public housing (Title III); and established new programs for rural housing (Title V).

Urban redevelopment was seen as an expansion of the related programs of low income housing and slum clearance established by the Housing Act of 1937. Basically, Title I provided Federal assistance to local public agencies for projects consisting of the assembly, clearance, site-preparation, and sale or lease of land at its fair value for uses described in a redevelopment plan for project costs. The Federal grants generally could not exceed two-thirds of net project costs, and the local agency was required to furnish the remaining one-third, which could be in the form of cash, donation of land, or public facilities such as schools to support or serve the new uses of land in the project area. The Housing Act of 1949 also required that the redevelopment plan be approved by the governing body of the locality.

In Title III, the act of 1949 authorized 135,000 new public housing units for each of the next 5 years—a number far in excess of the previous low rent housing efforts and far in excess also of the amounts Congress subsequently voted to fund each year.

Under the provisions of Title V, the Farmers Home Administration (FmHA), established by the Farmers Home Administration Act of 1946, was authorized to establish a program of grants and loans for the construction or reconstruction of farm dwellings. The rural housing program was established after a congressional finding that the scarcity of credit resources in rural areas made the use of then existing FHA programs difficult. The program was extended to nonfarm rural housing by the Housing Act of 1961 and has been expanded considerably over its 24-year life.

Refining and Broadening Housing Laws for Special Groups

In the 1950's Federal housing policies became increasingly directed toward meeting the needs of special interest groups. It was a period characterized by refining the operations of the Federal Government's secondary financial market structure to eliminate the risk of fraud while at the same time liberalizing standards to permit reaching the housing needs of newly identified target groups, such as the elderly and servicemen. It was additionally an era in which the housing goals outlined in previous years were broadened to include not only the removal of slums but also the rehabilitation of existing structures to provide housing for a wider range of people. The basic approach in achieving the emerging goals was through modification of the Government's existing financial and insuring mechanisms rather than by direct outlays, although some new major programs did rely on direct outlays.

President Eisenhower's Advisory Committee on Government Housing Policies and Programs

President Dwight D. Eisenhower's Committee on Government Housing Policies and Programs was established in 1953 to review broadly the housing and urban development programs and make recommendations for changing and eliminating programs or establishing new ones. The Eisenhower Committee met over a period of months and issued its comprehensive report in December 1953, recommending retention of some programs without change, substantial modification of others, and enactment of additional ones.

The most significant subjects considered by the Eisenhower Committee grew out of the urban development program authorized in 1949, which was just then getting into full

operation in cities and was precipitating some serious community problems.

The Eisenhower Administration was principally concerned with accommodating public objections to the large expenditures for "bulldozing" slum areas, which often remained vacant for long periods because of problems in getting housing or other redevelopment underway. In response to that problem, the Eisenhower Committee recommended a redirection and broadening of the scope of urban redevelopment projects to include the rehabilitation of existing structures. This change was enacted in the Housing Act of 1954 and eliminated the need to "bulldoze" areas where rehabilitation work was being done.

Subsequently, the name of the program was changed to "Urban Renewal." Urban rehabilitation efforts were not as extensive as contemplated because of problems related to the sponsorship and financing of housing rehabilitation. Nevertheless, there was a general application of urban renewal powers in rehabilitation areas; this often involved code enforcement or other municipal efforts and expenditures for improvement of streets, public utilities, parks, and other facilities. Also, the 1954 act required a community to have a "workable program" for solving its overall development problems as a condition for receiving urban renewal and related Federal aid.

The 1954 act addressed another major problem under the 1949 Housing Act: the difficulty of initiating housing construction on a cleared site. To qualify under the program, a redevelopment project site either had to be "predominantly residential" before clearance, or to be redeveloped for predominantly residential purposes after clearance. The existing FHA insurance programs were wholly inadequate to attract credit and sponsors.

Accordingly, Congress included in the 1954 act a new mortgage insurance program, known as Section 220, to generate housing credit and production in urban renewal areas. Traditional insurance terms were liberalized in several respects and purchase of the mortgages by the Federal National Mortgage Association was authorized. The program has been one of the major special purpose programs of FHA. Criticism of it in later years stemmed from the fact that it produced housing for high income families and not for those displaced from the area. It never was intended for low income or displaced families as such, however, but to provide housing needed in the community and housing that would add to the city's tax base.

By 1953, experience had begun to show the magnitude of the urban renewal problems resulting from the displacement of families from project sites to be cleared. This problem became the chief basis for lack of project approvals by local governing bodies. The lack of adequate housing for the displaced was critical, and there was growing concern for the plight of those affected, who were generally minority families.

Accordingly, the Eisenhower Committee recommended a special liberalized mortgage insurance program for housing displaced families; it was enacted in the 1954 act as Section 221. This new authority required that the housing involved be "programed" for each area on the basis of the number and income of families displaced by Federal, State, or local governmental action, and that these families receive priority of opportunity to purchase or rent the completed dwellings.

This mortgage insurance program to assist displaced families marked the beginning of concern for adequate and prompt relocation of those displaced by slum clearance and other governmental housing actions.

Another important recommendation by the Eisenhower Committee that was enacted by the Congress in the 1954 act was a complete reform of the Government's secondary market structure, both as to the role of the Federal Government and that of the private financial community. It conformed with a basic element of the Eisenhower Committee's approach, which involved an effort to design a secondary market facility that would derive capital from participating lending institutions and would eventually finance itself in the private capital markets, rather than relying upon the Federal Treasury as had been done in the past.

The Federal National Mortgage Association statutory authority was rewritten completely in a new Federal National Mortgage Charter Act, which was part of the 1954 act. It divided Federal National Mortgage Association operations into three parts: "secondary market opera-

tions," "special assistance functions," and "management and liquidation functions." The chief result of this division was to isolate the special assistance functions (which need Government financial aid) from other Federal National Mortgage Association operations. The special assistance functions continued primarily for special FHA mortgage insurance or the VA guaranty loan program requiring Government purchase of mortgages.

The 1954 act contained other important provisions, including consumer protection measures specifically designed to avoid further frauds and abuses such as those revealed in 1953, which were known at the time as "the FHA scandal." These frauds occurred under the Title I Repairs and Rehabilitation Loan Insurance program and the Section 608 War and Veterans Housing program of the Housing Act of 1949.

Under the Title I program, FHA insures approved financial institutions against losses they might sustain as a result of certain loans for financing repairs and improvements to real property. These loans are not individually insured or processed; FHA insures against losses up to 10 percent of an individual lending institution's total loans. Because the loans are not processed individually, the FHA relies on the lending institution for their validity and soundness. Before the 1954 act, the program was abused by fraudulent repair salesmen who generated negotiable paper on the basis of shoddy work or inadequate or worthless material. The 1954 act attempted to correct this situation by requiring, among other items, a real coinsurance feature so that not more than 90 percent of each individual loan would be covered by insurance (in addition to earlier limitations).

The frauds under the Section 608 War and Veterans Housing program consisted primarily of "mortgaging out" on the basis of greatly excessive estimated costs that determined the mortgage amount. The sponsor simply kept the money under the mortgage to the extent it was not needed for the development. This was prevented in future programs by the "cost certification" requirement, which obligates the sponsor to certify costs after development, and requires FHA to limit the mortgage amount accordingly.

The 1954 Housing Act, in hindsight, was a watershed for subsequent housing programs to meet the needs of specifically designated groups that followed in increasing number throughout the remainder of the 1950's and into the 1960's.

Separate FHA Mortgage Insurance Program for Groups Having Special Needs

The growth of the scope of FHA mortgage insurance programs through the years has resulted primarily from the gradual liberalization of mortgage terms under FHA's regular insurance operations and the enactment of special insurance progams—especially during the 1950's—to meet the emerging housing needs of specific groups or in response to the new forms of cooperative and condominium ownership. It was in this way that the overall character of FHA was changed from an agency concerned almost entirely with increasing the supply of adequate housing to an agency widely concerned with serving special public purposes in the housing field.

This expansion was initiated by the 1954 Housing Act, which, under Section 220, attempted to generate credit for urban renewal projects and under Section 221, to provide for families displaced by these projects, as well as by the creation of the new Federal National Mortgage Charter Act in 1954, which established the first special assistance functions to be carried out by the Federal National Mortgage Association.

Outside criticism of the special purpose programs developed around the argument that they diverted FHA efforts from volume production and resulted in high-risk insurance. This was based on the liberalized underwriting standards of the special purpose programs, and the FHA time and effort invested in encouraging operations under them when they presented obstacles to sponsors because of financing problems or problems inherent in servicing the special groups to be benefited.

Generally, each of these new special programs was established as an almost independent operation with its own statutory provisions and insurance fund, in order to prevent the original FHA mortgage insurance fund support-

ing FHA's basic programs—enacted in 1934 for Section 203 single-family home mortgage insurance and Section 207 multifamily apartment mortgage insurance—from being adversely affected by the liberal underwriting terms of each new program. The essence of each new program was a liberalization of mortgage terms beyond those in effect at the time under the regular insurance programs. Usually, mortgage terms were liberalized in three ways: the "economic soundness" test for the proposed construction was replaced with an "acceptable risk" test; the maximum insurable mortgage loan was based on "replacement cost" rather than on the more conservative estimate of long-range "value"; the maximum percentage or ratio of loan to "replacement cost" was made higher than the earlier percentage of loan to value (and, in some cases, the maximum term of the mortgage was lengthened, thereby permitting lower monthly payments).

A continuation of the liberalizing approach initiated in the 1954 Housing Act by Sections 220 and 221 came with the enactment of Section 231, in 1959, which granted generous insurance terms for housing of the elderly. This program was approved in an era of growing recognition of the problems of the elderly by Congress.

Separate mortgage insurance programs were enacted to give special insurance advantages to several designated groups in special areas.[10]

In 1961, further focusing on special interest groups, the Congress enacted the Section 234 program, which did not actually involve liberalized insurance terms but was an adaptation of regular mortgage insurance to conform to the special characteristics of condominium ownership and obligations.

Other special nonhousing or fringe FHA mortgage insurance programs were enacted to assist the construction or purchase of nursing homes, hospitals, group practice facilities, recreational homes, trailer courts, mobile homes, and housing in Alaska.

In addition to special mortgage insurance programs, the direct loan program to assist the construction of college dormitories for students and faculties was enacted in 1950 to meet the rapidly increasing enrollments starting in the post-World War II era and to assist returning veterans.

The trend established under the 1954 act expanded from liberalized lower cost insurance to indirect subsidy without insurance with enactment of Section 202 in the 1959 Housing Act. Under this new and separate program, direct loans were to be made through the device of Government-subsidized low interest rates to provide housing for the elderly. Under the program a loan could cover 98 percent of development cost and have an interest rate as low as 3 percent.

The Subsidy Initiatives of the 1960's

Housing legislation in the 1960's took an evolutionary approach toward meeting the Nation's housing needs. New emphasis was placed on providing housing to groups such as the poor. Instead of relying upon revising the financial mechanisms, as in the 1950's, the Government embarked on direct and indirect subsidies. It also added new emphasis to the goal spelled out in the 1949 Housing Act of providing a "decent home and a suitable living environment" for all Americans.

The indirect subsidy initiated through the Section 202 program of the 1959 Housing Act, providing low cost loans to developers of private housing for the elderly, can be said to be the forerunner of later subsidy programs.

The principal feature of the Housing Act of 1961 was the subsidized, below-market interest rate mortgage insurance program to assist rental housing for moderate income families, known as Section 221(d)(3). Not only was the new program an interest subsidy program, it also was a direct loan program. Since private lenders would not make mortgage loans at below-market interest rates, the funds were provided through the purchase of the originator's mortgage by the Federal National Mortgage Association under its special assistance functions. The chief beneficiaries of this program were those families whose incomes were

[10] World War II defense and veterans, 1941; Korean War defense areas, 1951; urban renewal areas, 1954; displaced families, 1954; non-World War II servicemen, 1954; and military rental housing, 1955.

above public housing limits set by local housing authorities but were below the amounts necessary to meet rental requirements in decent, new, unsubsidized private housing.[11]

After the trends of the 1960's toward subsidies for private housing and liberalized programs, HUD mortgage insurance programs continued to proliferate, as illustrated by Chart 1.

The 1961 act further expanded the subsidy concept by authorizing payments of up to $120 per year on housing units occupied by the elderly poor in public housing projects. The subsidy was based on the belief that the elderly's housing needs could not otherwise be met without endangering the solvency of the project, despite the Federal Government's annual contribution.

The subsidy was the first ever given to finance the operating costs of housing projects, along with capital costs.

The Housing Act of 1964 extended the subsidy treatment given for housing the elderly to families displaced by urban renewal projects. In 1968, the subsidy was made available for large families with unusually low incomes who were living in housing projects and could not afford to remain without the additional subsidy.

In the Housing Act of 1964, the Urban Renewal statute, Section 312, was amended to authorize a new program of 20 year, 3 percent loans to property owners or tenants in urban renewal areas to finance rehabilitation required to make the property conform to the local housing code or to carry out the objectives of the urban renewal plan.

Two additional subsidy programs were enacted by the Housing Act of 1965 to provide housing for families eligible for regular public housing through the utilization of privately owned housing. These programs also served to avoid a growing stigma communities had begun to attach to the concentrations of public housing. Both programs permitted broader dispersal of the very poor among varied income groups.

One of these programs was the rent supplement program under which Federal payments are made to meet a portion of the rent of certain low income families[12] in privately owned housing built with FHA mortgage insurance assistance. Each tenant must pay one-fourth of his income for rent. The program was originally proposed for middle income families but the

[11] However, it should be noted that the new trend toward interest subsidies did not replace the earlier trend toward liberalized albeit unsubsidized, mortgage programs. The Housing Act of 1961 amended the Section 221 mortgage insurance program, which to that time had been directed only to those families displaced by Governmental action such as urban renewal, to provide more liberal terms and to broaden the program to apply to low and moderate income families generally. In addition to authorizing the Section 221(d)(3) Below-Market Interest Rate Progam, the act authorized or continued the following programs:

A. Section 221(d)(2): provides mortgage insurance for the acquisition, construction or rehabilitation of one- to four-family homes by low and moderate income families. Eligible owner/occupant mortgagors are enabled under this program to obtain financing with a downpayment as low as 3 percent of acquisition cost; those mortgagors who in addition have been displaced may arrange financing with a downpayment as low as $200 on a single family property. The mortgagor is permitted to reduce further his cash downpayment requirement by being allowed the maximum feasible opportunity to contribute the value of his labor as equity in the property.

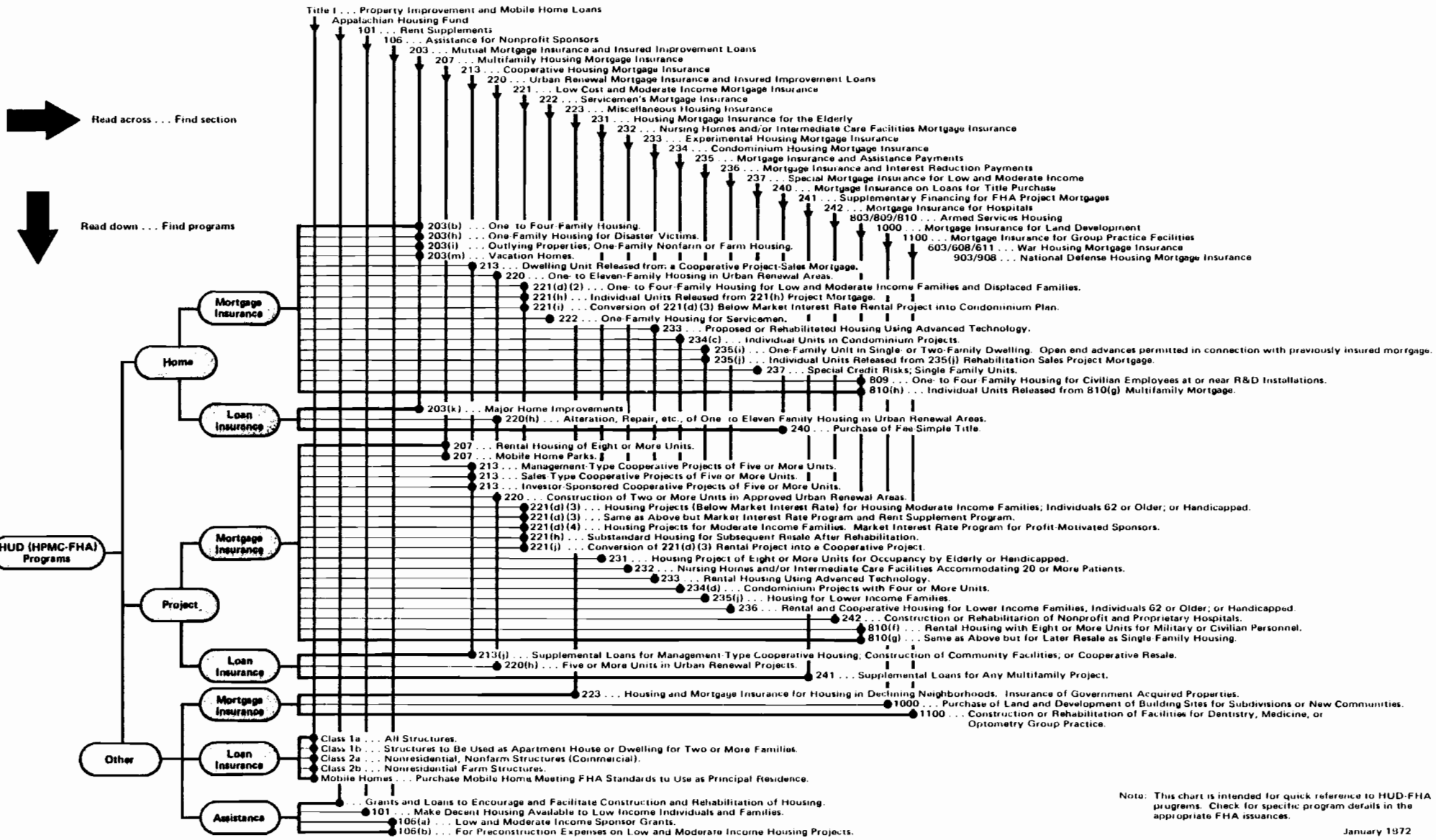
B. Section 221(d)(3) Market Interest Rate Program: designed to help finance construction or rehabilitation of projects by public agencies, investor-sponsors, nonprofit groups and limited dividend corporations; provides rental or cooperative housing within a price range appropriate to the resources of displacees and other low and moderate income households. The cooperative program, because of its high loan-to-value ratio (100 percent of replacement costs for nonprofit sponsors, 90 percent for limited dividend sponsors) has been a vehicle for providing homeownership opportunities for families immediately above the subsidy levels. The rental program, combined with the rent supplement program, authorized by the 1965 Housing Act, enables low income families to afford privately owned, financed and operated rental accommodations.

C. Section 221(d)(4): encourages the construction or rehabilitation of multifamily rental units for moderate income families through profit incentives to sponsors, tax incentives and use of replacement cost in determining the value on which the insured amount is based. Statutory provisions for Sections 221(d)(3) and 221(d)(4) are the same except for the type of sponsorship and the related profit restriction. Because of the obvious benefit provided by the profit incentive, combined with other incentives mentioned above, Section 221(d)(4) is the primary program for the development of unsubsidized rental housing for families of moderate income.

[12] To qualify, a tenant is subject to public housing income limits and asset limitations and must be one of the following: displaced by governmental action; 62 years of age or older; handicapped; living in substandard housing; or living in housing damaged by natural disaster.

Chart 1

Department of Housing and Urban Development Mortgage Insurance Program



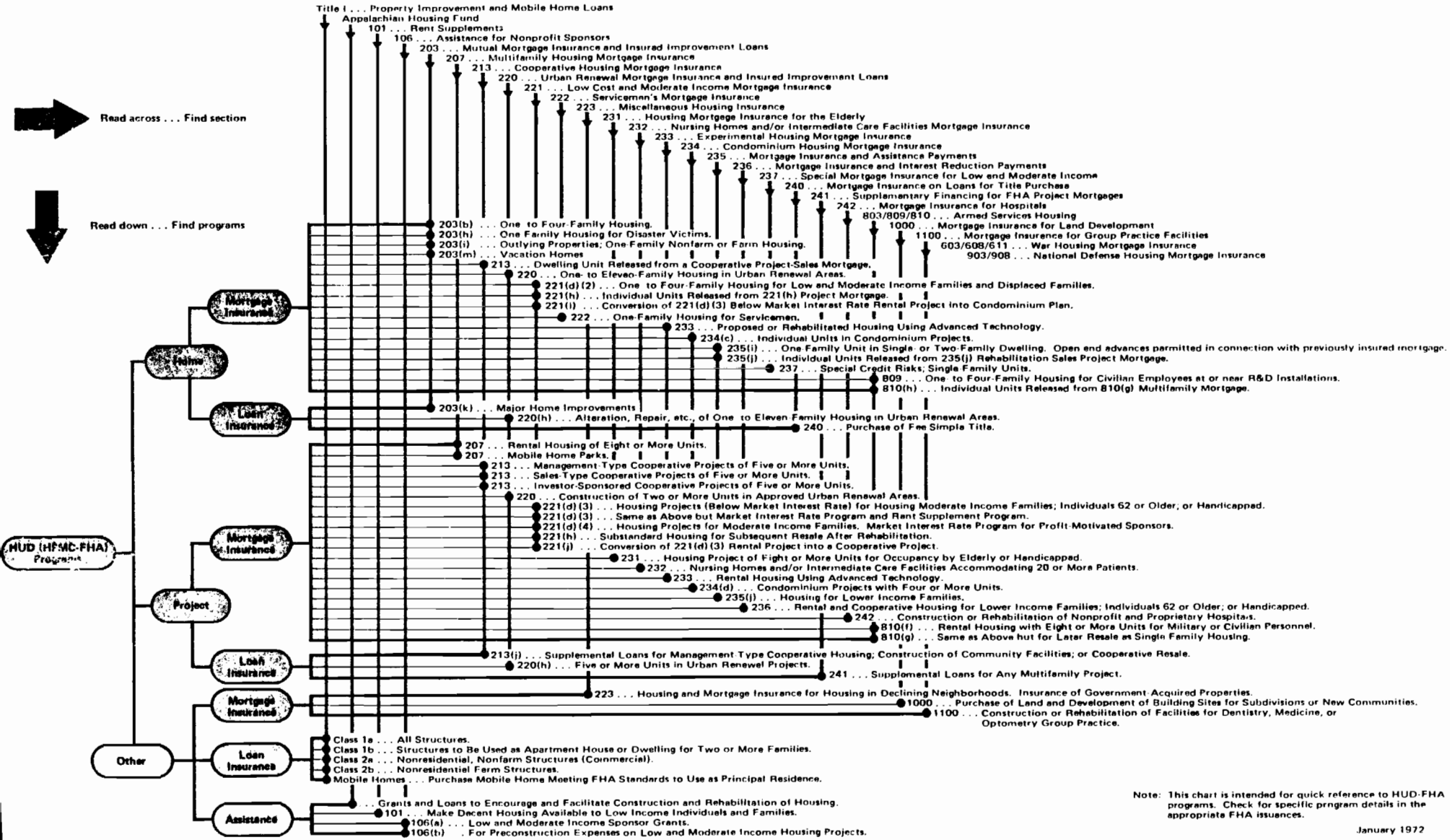
Note: This chart is intended for quick reference to HUD-FHA programs. Check for specific program details in the appropriate FHA issuances.

January 1972

Source: Department of Housing and Urban Development.

Chart 1

Department of Housing and Urban Development Mortgage Insurance Program



Note: This chart is intended for quick reference to HUD-FHA programs. Check for specific program details in the appropriate FHA issuances.

January 1972

Source: Department of Housing and Urban Development.

Congress quickly altered it to apply only to low income families.

The other new subsidy program enacted in 1965 was the Section 23 leasing operation, which became one of the major public housing programs. Under this program, local housing authorities are authorized to lease units in privately owned existing structures and make them available to low income families eligible for regular public housing. The usual public housing assistance is made available by HUD so that the local authority can pay the economic rent to the owner without charging the tenant more than the usual public housing rental.

In 1967, HUD initiated, as an administrative procedure, the "Turnkey Method." Under this variation of the regular public housing program, a private developer enters into a contract with a local housing authority to sell the project to the local authority upon completion. The introduction of private profitmaking developers into the production process reduced development costs and also increased program activity. A total of 214,096 units were under annual contribution contracts under Turnkey as of December 31, 1972, while 143,726 units were under management.

The Housing Act of 1965 also authorized the Section 115 program, providing for the use of urban renewal capital grant funds for limited grants to low income owners of homes in urban renewal areas to pay for necessary repairs and rehabilitation.

A very limited program of homeownership subsidies was introduced in 1966 with the enactment of Section 221(h). It authorized 3 percent mortgage loans (as under the Section 221(d)(3) Below-Market Interest Rate Program) to nonprofit sponsors who would buy and rehabilitate at least four homes, for subsequent resale to low income home purchasers. The low income home purchaser would also receive a 3 percent mortgage (via the Federal National Mortgage Association special assistance program).

The Creation of the Department of Housing and Urban Development

The Department of Housing and Urban Development Act, passed September 9, 1965, created HUD, although it was not actually organized until February 1966.

The act was a watershed in housing legislation. Most importantly, it raised the functions of the Housing and Home Finance Agency to Cabinet level and simplified the administration of all its functions by consolidating most statutory authority in the Secretary of the new Department. It did not, however, consolidate housing and urban development functions existing in other parts of the Federal Government. The Secretary was given power to organize the functions of the Department as he deemed appropriate; however, the act prescribed that there

> . . . shall be in the Department a Federal Housing Commissioner, who shall be one of the Assistant Secretaries, who shall head a Federal Housing Administration within the Department, who shall have such duties and powers as may be prescribed by the Secretary . . .

In creating HUD, the Congress characterized its action and intentions as follows:

> The Congress hereby declares that the general welfare and security of the Nation and the health and living standards of our people require, as a matter of national purpose, sound development of the Nation's communities and metropolitan areas in which the vast majority of its people live and work.
>
> To carry out such purpose, and in recognition of the increasing importance of housing and urban development in our national life, the Congress finds that establishment of an executive department is desirable to achieve the best administration of the principal programs of the Federal Government which provide assistance for housing and for the development of the Nation's Communities; to assist the President in achieving maximum coordination of the various Federal activities which have a major effect upon urban community, suburban, or metropolitan development; to encourage the solution of problems of housing, urban development, and mass transportation through State, county, town, village, or other local and private action, including promotion of interstate, regional, and metropolitan cooperation; to encourage the maximum contributions that may be made by vigorous private homebuilding and mortgage lending industries to housing, urban development, and the national economy; and to provide for full and appropriate consideration, at the national level, of the needs and interests of the Nation's Communities and of the people who live and work in them.

Douglas and Kaiser Commissions

The urban disturbance of the late 1960's led to the creation of two Presidential Commissions that were to have a profound impact upon

the redirection and expansion of Federal housing policies. In 1967, President Lyndon B. Johnson directed the creation of the National Commission on Urban Problems, known as the Douglas Commission after its chairman, Paul H. Douglas, Senator from Illinois from 1948–1966. The Commission's mandate was to recommend ". . . solutions, particularly those ways in which the efforts of the Federal Government, private industry, and local communities can be marshaled to increase the supply of low cost decent housing." The Douglas Commission's prime recommendation was to direct the Nation's housing assistance toward the poor, a group the Commission found had been neglected in national housing endeavors to that time.

Also in 1967 the President's Committee on Urban Housing, known as the Kaiser Commission after its chairman, industrialist Edgar F. Kaiser, was appointed with a charge to "find a way to harness the productive power of America . . . to the most pressing unfulfilled need of our society—that need is to provide the basic necessities of a decent home and healthy surroundings for every American family now imprisoned in the squalor of the slums." Among its many recommendations, the Committee called for the establishment of a 10-year goal of 26 million new and rehabilitated housing units, including at least 6 million for lower income families. That recommendation was to shape future congressional action and Federal policy.

National Housing Goals

The Johnson Administration recommended, and the Congress enacted, in the Housing and Urban Development Act of 1968, the housing goal proposed by the Kaiser Commission. That act includes the following:

Reaffirmation of Goal

Sec. 1601. The Congress finds that the supply of the Nation's housing is not increasing rapidly enough to meet the national housing goal, established in the Housing Act of 1949, of the "realization as soon as feasible of the goal of a decent home and a suitable living environment for every American family." The Congress reaffirms this national housing goal and determines that it can be substantially achieved within the next decade by the construction or rehabilitation of twenty-six million housing units, six million of these for low- and moderate-income families.

In that provision, the Congress declared for the first time a national housing goal in terms of housing units to be produced, and established a time frame for production.

The production thrust of the goal was made clearer by specific directions in the act that the President submit a report to the Congress setting forth a 10-year plan for meeting the goal and an annual report thereafter on the progress being made in meeting the objectives of the plan. Each annual report must also analyze problems and factors involved in production and make recommendations with respect to any additional legislation or administrative action necessary or desirable to meet the objectives of the plan.

The lesser emphasis on conservation and rehabilitation in connection with the 1968 enactment was reflected in the estimate by HUD Secretary Robert C. Weaver[13] that only 2 million of the 26 million units to be produced would be provided by rehabilitation assisted with public subsidy. Though not large, this projection was apparently optimistic and clearly exceeded past performance in rehabilitation activity. Another 2 million units were projected for rehabilitation by privately financed efforts, but these were not identified as part of the 26 million-unit production program.

The statutory language concerning the 1968 housing goal suggests the intended production emphasis. The affirmation of "a decent home and a suitable living environment for every American family" was language often used through the years in connection with production objectives and bears a connotation of home construction. The placing of the goal in the context of the "Declaration of National Housing Policy" in the Housing Act of 1949 lends support to the emphasis on production. That declaration is replete with references to "production," "the housing industry," "economy of maximum employment," "residential construction," and "stabilization of the housing industry at a high annual volume of residential construction." No mention was made then of conservation, existing housing supply, or rehabilitation.

[13] U.S. Congress, Senate Committee on Banking and Currency. *Housing and Urban Development Act of 1968*. Hearings before Subcommittee on Housing and Urban Affairs. 90th Cong., 2nd sess., 1968.

An extremely significant expansion of the subsidy concept was contained in the Housing and Urban Development Act of 1968, which adopted the principle of subsidizing interest rates, thus resulting in a rapid increase in all appropriations for housing subsidies.

One of these programs was the Section 235 homeownership assistance program, which originated in a proposal drafted by the Senate Committee on Banking and Currency in 1967. The Johnson Administration opposed these initial proposals; subsequently, the committee proceeded to develop legislation with the assistance of HUD officials. However, no legislation was enacted that year. The following year, HUD proposed and the Congress enacted legislation similar to that jointly developed. As enacted, Section 235 established a homeownership program providing special mortgage insurance and cash payments to help low and moderate income home purchasers meet mortgage payments by subsidizing debt service costs in excess of an amortization at 1 percent interest. Under this program, an eligible buyer[14] may purchase a private home with an FHA-insured mortgage, bearing the prevailing rate of interest, and the Federal Government makes a monthly assistance payment to the lender on his behalf. Provided the purchaser is applying at least 20 percent of his monthly income to the mortgage payments, he could pay each month as much as the same amount he would pay if the mortgage loan provided for only 1 percent interest. The Federal Government pays the rest.

Another significant addition to subsidy programs was the Section 236 multifamily rental housing program also enacted in the 1968 act. This program provides a subsidy formula similar to that under Section 235, although the mechanics of the Section 236 subsidy payment are geared to rental housing.[15]

An accompanying provision of the 1968 act contained a subsidy feature, Section 238, which established a special risk pool for which appropriations were authorized. This fund was authorized to be used for carrying out insurance obligations under the subsidized and certain other mortgage insurance programs. They included a new Section 223(e), which authorized insurance in "older, declining urban areas," where not all of the usual mortgage insurance requirements could be met.

The Sections 235 and 236 programs are similar to the subsidized rural housing program authorized by Title V of the Housing Act of 1949 and administered by the FmHA. The Section 502 homeownership program provides loans at a set interest rate (currently 7.25 percent) to qualified low and moderate income persons in rural areas for the purchase of single family homes; interest subsidies may be provided to eligible low income purchasers to reduce the effective interest rate to as low as 1 percent. Section 515 authorizes a corresponding program for multifamily rental; Section 521 authorizes a subsidized version of the Section 515 program that can reduce to as low as 1 percent the effective interest rate on loans made to nonprofit organizations and limited-profit corporations.

Partition of Federal National Mortgage Association

In 1968, the Administration concluded and the Congress agreed that the time had come to move forward with the conversion of the secondary market functions from a mixed-ownership Federal corporate activity into a privately owned and financed corporation, without waiting for the retirement of the Treasury-held stock, as had been contemplated by the Federal National Mortgage Association Charter Act of 1938.

This decision appears to have stemmed mainly from budgetary considerations, although it was also believed that the secondary market

[14] To qualify for benefits of this program, a homeowner must be the head of a family, a handicapped person, or a single person 62 years or older; usually income cannot be in excess of 135 percent of local limits for public housing; 20 percent of income must be paid toward monthly payments.

[15] In that case, a monthly housing assistance payment is made by the Federal Government to the mortgagee on behalf of the mortgagor. Qualifying requirements are similar to those of the Section 235 program; however, the tenant must pay 25 percent of his income toward monthly rental. In addition, the tax shelter used to induce participation of limited-dividend sponsors in the Section 236 program reduces Federal tax revenues, thus imposing further budgetary costs. This tax treatment of Section 236 sponsors is further discussed in Chapters 2 and 4.

function would flourish better in an environment more intimately related to the private market. As a result, the Housing and Urban Development Act of 1968 partitioned the Federal National Mortgage Association, as it then existed, changing it into two new corporations. One was a Federally chartered private corporation that, after a brief transition period, was to be privately owned, operated, and financed. This corporation was to retain its name—Federal National Mortgage Association. The second, a new wholly owned Federal corporation to be known as the Government National Mortgage Association, was to assume the functions of the former Federal National Mortgage Association with respect to special assistance and the management and liquidating operations.

In the conversion, all Treasury-held preferred stock was retired. The new Federal National Mortgage Association passed into the full ownership of its common stockholders and in due course the undistributed earnings and earned surplus of the predecessor corporation were distributed. The Federal National Mortgage Association remains subject to regulation by HUD.

An administrative procedure called "Tandem Plan" was developed under the Federal National Mortgage Association partition. Under this procedure the Government National Mortgage Association issues a commitment to purchase a mortgage qualifying for special assistance at a predetermined price more favorable than that available in the market (special assistance being unnecessary otherwise). This commitment is transferred to the Federal National Mortgage Association; when the mortgage is ready for delivery, the Government National Mortgage Association pays the Federal National Mortgage Association the difference between the committed price and the price the Federal National Mortgage Association would have paid in its regular market purchase program. Thus the immediate budget expenditure is reduced from the full amount of the purchase commitment to this difference. In this manner, by paying above-market prices and selling at market prices, the Government National Mortgage Association provides indirect subsidies to borrowers and lenders. (The Tandem Plan is discussed more fully in Chapter 3.)

Modification of Low Rent Public Housing Program

An important change in the low rent public housing program was made by Section 213(a) of the Housing and Urban Development Act of 1969, known as the Brooke amendment. The amendment limited rents charged by local housing authorities to 25 percent of the tenant's income. Subsequently, the Congress authorized Federal public housing subsidies for operating expenses, where necessary, to assure the low rent character of the public housing project. (Section 213(a) is further discussed in Chapter 5.)

Aid to Displaced Persons

Subsidies for the relocation of displaced families in connection with all Federal programs were placed on a uniform basis by legislation that was debated during much of the 1960's but finally enacted as the Uniform Relocation Assistance and Real Property Acquisitions Policies Act of 1970. This legislation adopted most of the relocation provisions already in effect under HUD programs and gave both owners and tenants who were displaced the right to substantial payments under Federal or federally assisted development programs. The act also provides that:

> . . . no person shall be required to move from his dwelling on or after the effective date of this title, on account of any Federal project, unless the Federal agency head is satisfied that replacement housing is available to such person.

Model Cities

During the 1960's, support developed for a new and broader approach to the housing undersupply and other problems of urban areas. A program which became known as "Model Cities" was authorized as the principal provision of the Demonstration Cities and Metropolitan Development Act of 1966. It was based on a congressional finding and declaration that:

> . . . improving the quality of urban life is the most critical domestic problem facing the United States. The persistence of widespread urban slums and blights, the concentration of persons of low income in older urban areas, and the unmet needs for additional housing and community facilities and services arising from rapid expan-

sion of our urban population have resulted in a marked deterioration in the quality of the environment and the lives of large numbers of our people while the Nation as a whole prospers . . .

Under the 1966 act, the Federal Government was authorized to make grants and provide technical assistance to city demonstration agencies to enable the agencies to plan, develop, and conduct programs to improve their physical environment, increase their supply of housing for low and moderate income people, and to provide educational and social services vital to health and welfare.

That enactment was significant in giving cities the broadest discretion in developing proposed programs, subject only to general criteria prescribed in the statute. Discretion remained in HUD, however, to select and fund those undertakings it considered best for demonstrating to other cities the potential benefits of such initiatives.

New Communities

In the early 1960's there was increasing interest in the development of whole new communities as one means of adjusting to the Nation's increasing population and helping to meet some of the problems of urban congestion. As with other indirect programs related to housing, the new communities proposal contained significant housing components similar to those of earlier urban renewal programs. The Housing and Home Finance Agency proposed a new mortgage insurance program for land development needed by new communities, but Congress considered it too ambitious and enacted a truncated program of "land development."

The 1965 new communities proposal was enacted, however, in the Demonstration Cities and Metropolitan Development Act of 1966. To be eligible for mortgage insurance, a proposed new community had to be of such size and scope as to make a substantial contribution to economic growth of the area. This contribution was to be in the form of economies in providing improved housing sites, adequate housing for those employed in that area, maximum accessibility to industrial and other employment centers and to commercial, recreational, and maximum accessibility to any major central city in the area. The development had to be approved by the local government.

Recognizing that mortgage insurance alone was inadequate to stimulate sufficient volume of credit for new community development, HUD recommended in 1968 an entirely new additional assistance program based on the Federal guarantee of bonds and other obligations issued by the private developer of the new community. This meant that the Federal Government would guarantee with the full faith and credit of the United States the payment of principal and interest on the obligations of the private developer, if sold to investors or at public sale as approved by HUD after it had approved all other prerequisites with respect to the development. That program, which included certain supplemental grants for public utilities and other facilities, was enacted as Title IV of the Housing and Urban Development Act of 1968.

The guarantee program was reenacted with broader scope and further supplemental financial aids in Title VII of the Housing and Urban Development Act of 1970. The major functions in the program were placed under a "New Community Development Corporation" in HUD with a five-person board of directors, including the Secretary of HUD as the chairman; a General Manager appointed by the President; and three persons appointed by the Secretary. Under the 1970 act, the new communities development project has to meet the same standards as under the earlier program, including requirements concerning planning and a substantial provision of housing for low and moderate income persons. Development must also assist the local home building industry and encourage its broad participation, particularly by small builders.

The changes made by the 1970 act were set in the context of an extensive legislative statement on national urban growth policy. That statement established standards for the development of such a policy and required the President to submit to the Congress a report on urban growth every 2 years beginning in 1972, giving prescribed information on urban growth and recommending any legislation considered desirable.

Federal Housing Laws: Conflicts, Duplication, and Confusion

There is no need for great complexity in Federal housing laws. Mortgage insurance is a relatively simple and clear-cut concept, requiring no more than two programs, apart from subsidy operations: one for home mortgages and one for mortgages on multifamily structures, with adequate authority in the agency to provide for varying conditions and circumstances. Indeed, the original National Housing Act of 1934 was just that.

Instead, the Nation's housing laws today, after almost 40 years, are a hodgepodge of accumulated authorizations for some 46 unsubsidized programs and some 20 which are subsidized, including those administered by the VA and FmHA. They contain internal inconsistencies, numerous duplications, cross-purposes, and overlaps as well as outright conflicts and gimmickry. In some cases, the objectives themselves are open to serious question.

The complicated maze of HUD program laws, filling hundreds of pages in the statute books, are properly recognized as replete with inconsistencies, conflicts, and obsolete provisions and without overall design or coordinated structure. All this is magnified in the red tape flowing from implementing regulations.

Testimony given in Congress by the executive branch has emphasized the number and complexity of these existing authorities, as well as the frustration, cost, and red tape resulting from this hodgepodge of programs. It seriously thwarts good administration; confuses even the experts; discourages participation by builders, lenders, and sponsors; bewilders consumers; and hinders congressional oversight. In one of several statements to that effect, former HUD Secretary George W. Romney said to the Senate Subcommittee on Housing and Urban Affairs:[16]

> To function properly, our housing programs must bring together private builders, private lenders, private housing sponsors, public agencies and private purchasers. At present the number and complexity of our existing statutory authorities act as a deterrent to the effective participation of these groups in our housing programs. Even the most sophisticated and experienced builders, lenders and sponsors find it frustrating and costly to accommodate their operations to the red tape and delay occasioned by the maze of our confusing authorizations and the regulations, circulars, forms and processing procedures that have grown out of them.
>
> The man most successful and at ease in the present statutory framework of our housing programs is the packager, knowledgeable in the intricacies of our forms and procedures, who can put together an attractive application and milk the most in subsidy out of the Federal programs by combining the different forms of assistance available under our several statutory authorities. Too often the most efficient producers of housing refuse to participate in our programs because they are unwilling to deal with the intricacies of our processing and program requirements.

Romney's complaint about the Federal Government's housing programs has been voiced on frequent occasions by leading members of the Senate and House banking committees that have congressional jurisdiction over housing legislation. In fact, there has always been recognition that serious problems have resulted from the duplicative and conflicting nature of the numerous housing programs. As early as the 1940's, significant recommendations were made to have the entire National Housing Act of 1934 rewritten. In 1970 a HUD legislative proposal with this objective was submitted to the Congress and has received considerable attention from legislative leaders. Comprehensive legislation of this nature has not been enacted, however.

Why Did the Housing Laws Develop As They Did?

Perhaps the major reason why the housing laws developed as they did has been the complexity and multiplicity of housing program objectives—economic growth, community growth, assisting the poor, furthering civil rights, and so on, all added one on top of another to each individual housing program. While reflecting the complexity of the problems involved, in many instances those multiple programmatic goals have been conflicting ones.

Another reason has been the sheer mechanics of the way the Federal Government has adopted housing policies. Until 1970, Con-

[16] U.S. Congress, Senate Commitee on Banking and Currency. *Housing and Urban Development Legislation of 1970*. Hearings before Subcommittee on Housing and Urban Affairs. 91st Cong., 2nd sess., 1970.

gress enacted an omnibus housing bill almost every year since the conclusion of World War II. An omnibus bill covers many independent items of legislation over a broad subject and reflects the accumulation of proposals in the executive branch and congressional committees over a period of a year or more.

Normally, the congressional committees responsible for housing legislation have not acted on housing bills referred to them in the interim years between enactment of omnibus legislation. The years of omnibus housing bills covered the period of increasing Federal involvement in housing and other social and economic matters. These years also covered frequent periods of substantial inflation, which upset the validity of numerous dollar ceilings in the housing statutes, thus requiring extensive amendments. The enacted housing bills were usually a combination of executive branch recommendations, redefined by Congress to reflect its own interests and notions, as well as the pleadings of special interest groups. Typically, each omnibus housing bill contained as riders various agency proposals and committee recommendations that could not have been enacted standing alone as separate pieces of legislation. To obtain the support—or at least remove the opposition—of organizations or individuals in Congress, a variety of amendments were added—such as an amendment favored by a national interest group or special aid for a project in the district of a particular Representative. With this "something for everybody" approach, critics often referred to an enacted housing bill as a Christmas tree bill bearing gifts for all.

Generally, the Department's legislative proposals to Congress were not based on a study or reevaluation of the relevant policies and legislative authorities. Until recently there was not even a continuing long-range study looking toward the next year's legislative program. Typically, each year was characterized by a belated effort by the agency to meet a deadline for presenting to the Bureau of the Budget (now Office of Management and Budget) the legislative recommendations for the coming year. Sometimes new approaches of possible merit were discarded simply because of the lack of time needed for study.

The problems were further compounded by divided responsibility for policy development within the executive branch. For example, the earliest Federal programs designed to generate mortgage credit for housing were placed in separate Government agencies. It naturally developed that the executive branch recommendations for such programs came primarily from the agency involved, which was deemed to know best its own needs, or how it would be affected by a given proposal. Accordingly, the recommendations were fragmented and narrow.

This practice still continues to the extent that separate housing credit programs are developed simultaneously but independently by the VA, the Federal Home Loan Bank Board, and the FmHA, as well as by HUD. Other less extensive housing activities are carried on by the Department of Defense, the Department of the Interior (Bureau of Indian Affairs), the Atomic Energy Commission and others.

At the same time, there is some overlap of congressional committee jurisdiction over housing programs between the banking and the veteran's committees.

In more recent years, the statutory complications have been multiplied by the separate authorizations for additional subsidy operations under several different types of major programs: Section 202 direct loans at below-market interest rates; Section 221(d)(3) mortgage insurance at below-market interest rates supported by the Federal National Mortgage Association purchases; rent supplements; and the subsidized interest rates for home purchasers and rental housing sponsors under Sections 235, 236, 502, and 521.

Also, it must be recognized that in formulating proposed housing legislation there are conflicting major policy goals with respect to housing itself, or with respect to housing and other major Government objectives. These often account for compromises and gaps in meeting desirable and consistent housing objectives.

Multiple Goals

The multiple goals are perhaps the greatest reason for the proliferation and the confused state of housing laws and housing programs. Throughout the years, individual housing programs have been assigned the awe-

some job of achieving higher or stable housing production, higher wages for construction workers, equal opportunity, urban renewal, and a higher quality environment—while at the same time taking care to protect the consumer and further the free enterprise system without unbalancing the Federal budget or upsetting public opinion.

Government Participation v. Independent Private Enterprise: The conflict between Government participation in the housing market and an independent private enterprise system presented the major issue for the 1931 President's Conference on Home Building and Home Ownership. With the unprecedented concern for the plight of the homebuilding industry and the national economy during the Depression, the reports of the conference are nevertheless replete with expressions of fear concerning any Government participation in housing credit operations. But with this background of conditions, the Congress for the first time put the Federal Government substantially into this field of operations.

This conflict of goals still presents an issue in most new program proposals being considered. With respect to any proposal, the position taken by an individual within the range of these goals is directly related to his political and economic philosophy. Production incentives are often tempered with protection to "private enterprise," meaning those similar operations handled without the benefits of the new program. The degree of Federal participation is weighed against the urgency of the need and the extent of pressure for the proposal from constituents or private or public special interest groups.

Program Goals v. Budget Goals: Normally, the breadth or authorized volume of any program using appropriated funds is modified by Federal budget goals. This is true of any program involving grants, loans, or other forms of Federal expenditure such as those made through the special assistance functions of the Government National Mortgage Association.

In addition to dollar controls, budget goals may determine the very nature of the program. Budget officials historically have opposed direct loan programs, without regard to the Administration in power at any given time, because of their initial budget impact.

Production Goals v. Consumer Protections or Benefits: Normally, consumer protections involve some additional burden on the lender, builder, or manager of the housing. For example, builders have objected to the existing requirement that they give the home purchaser a warranty against structural defects, and the requirement that the purchaser receive a copy of the HUD "appraised value" of the property. Such requirements may be objected to because they involve red tape and may involve real financial loss to builders. These and many other mortgage insurance requirements determine whether a sponsor decides to use a Federal mortgage program. To the degree that a builder chooses not to use a given program because of additional consumer protection, the curtailment of housing production under the program occurs.

Production Goals v. Equal Opportunity Goals: Equal opportunity regulations present a good example of conflicting goals in housing policies: the major purpose of subsidy housing programs—to make more adequate housing available for low or lower income families—sometimes conflicts with equal opportunity objectives. This is true where equal opportunity regulations prohibit the location of federally assisted housing in areas of racial concentration, even though those racially concentrated areas might be the ones where there is the greatest need for low and moderate income housing and might also be the areas where the community is most willing to accept such federally assisted housing. As a result of equal opportunity objectives, particularly where implemented by HUD's project selection criteria for subsidized housing, total volume production has been reduced in some communities.

Moreover, equal opportunity regulations, like affirmative marketing requirements, apply only to federally assisted housing and those regulations add to the red tape already associated with Federal programs and therefore cost lenders and builders more time and more money to use the program. As a result, lenders and builders often opt to construct privately financed housing, thereby reducing the volume

of housing built in the FHA-supported low and moderate income ranges.

Production Goals v. Environmental Quality Goals: Just as there is a tension between equal opportunity objectives and housing production objectives, there is a tension between environmental quality objectives and housing production objectives.

The National Environmental Policy Act of 1969 requires all Federal agencies to evaluate the environmental impact of all major actions affecting the quality of the environment. To implement the act, HUD has established procedures and standards for environmental review of all applications for housing insurance or assistance except those concerning one- to four-family dwellings. Detailed environmental impact statements are required to be filed for all housing projects that are major Federal actions significantly affecting the quality of the human environment.

Production Goals v. Stabilizing Wages for Construction Labor: Ever since the National Housing Act of 1934 creating the FHA, one of the goals of most Federal housing programs has been the stimulation of overall activity and stabilization of wages in the construction industry. As a result, sponsors constructing federally assisted projects other than one- to four-family homes have been required to pay the prevailing wage rate for the local labor market area, as determined by the Labor Department under the provisions of the Davis-Bacon Act of 1931. This prevents wages on such projects from undercutting prevailing wages.

Like the equal opportunity and environmental quality regulations, the Davis-Bacon Act applies only to federally assisted housing. Moreover, in some communities, application of the prevailing wage determination acts to raise the cost of labor, thereby making production of housing more costly.

Public and Political Acceptance v. Efficiency and Cost Savings: In choosing the program technique for an established objective, it is not unusual for the choice to be made on the basis of what the affected private sector or public opinion may accept. This is done even though it may not necessarily be the most equitable, efficient, or the least expensive operation in either the short or long term. For example, ever since 1950, direct Federal loan programs for a broad range of housing have been introduced in Congress and rejected or ignored, a paramount reason being the adverse reaction of private lending institutions. Alternatives that are used include the indirect and more complicated procedures of the Government's secondary marketing operations that provide the subsidy, and a financial yield to private lenders. An example of this approach was the Section 221(d)(3) program, where the lender's profit accrued chiefly through servicing privileges and construction financing opportunities with virtually no private risk.

In addition, the forms of subsidy that are less overt and visible have often been preferred to direct and identified subsidy payments. Examples include the disguised subsidy provided through the below-market mortgage rates under Section 221(d)(3), and the Government National Mortgage Association Tandem Plans, and the similar subsidy provided by the FmHA through its financing arrangements in which the subsidy finally surfaces in the form of an appropriation for restoration of losses incurred by the Rural Housing Insurance Fund.

Political Reality v. Consistency: Major inconsistencies in housing legislation flow from the known position of Congress toward benefiting certain groups rather than others. Direct loans at low interest rates to farmers were accepted and noncontroversial at a time when such assistance to low income families generally was extremely controversial. Similarly, the absence of premium charges for veterans, plus other benefits, under the VA loan guarantee program represented a special approach for one group only.

Programmatic Differences

Besides the possible conflicts among the ultimate and multiple objectives of Federal housing programs, less important but nevertheless significant differences and inconsistencies exist among the numerous programs, causing unnecessary confusion.

Mutuality: Only the regular Section 203 home mortgage programs and the management type of cooperative housing program under Section 213 have a "mutuality" feature designed to return to the home purchaser or mortgagor, in effect, the unneeded portion of the premiums he paid. In the case of Section 203, this feature was contemplated in the original 1934 enactment as an additional means of establishing an adequate insurance reserve. Because there had been no significant experience with fixing premiums under mortgage insurance, the mutuality feature was intended to permit premiums to be sufficiently high for soundness of the system while at the same time assuring the homeowner that his premiums were not excessive.

As experience with the Section 203 program developed, mutuality proved to be unnecessary as a method of determining appropriate premium amounts. FHA insurance became an accepted part of home financing, and mutuality was not necessary to persuade consumers of the soundness of the program. Yet it continued with all its original requirements for establishing "group accounts" for similar kinds of mortgages and for keeping records on individual transactions in order to compute and make such payments to each individual mortgagor as the credit balance in his particular group account warranted. In 1954, the "group accounts" were abolished but otherwise the system remains. Today it serves no purpose.

Mutuality is objectionable principally as an anachronism, but also as an inefficient operating procedure. It applies only to the above programs in a manner inconsistent with operations under other programs, requiring different recordkeeping and a separate staff to handle the payment of distributive shares of funds to mortgagors.

Cost Limits: Construction cost limits under some of the housing programs are inconsistent. Under the low rent public housing program, for example, these limits are fixed on the basis of prototype costs established for each area. Under mortgage insurance programs such as Section 235 and 236, the maximum mortgage amount is limited to a fixed-dollar ceiling for the whole country with occasional authority to designate a fixed greater amount in high cost areas. Such ceilings vary among programs. Generally, the discretion given here is not adequate to permit full adjustment to cost variations, and this actually prevents construction under some programs in certain areas. Conversely, in other low cost areas the dollar ceilings are so high they are deemed to be inequitable when compared to nationwide figures.

Economic Soundness: Under the Sections 203 and 207 mortgage insurance programs, the property or projects with respect to which the mortgage is executed must be "economically sound." This underwriting standard still exists with respect to those programs but it has been generally waived for each of the special purpose mortgage insurance programs, and an "acceptable risk" standard has been substituted. The most significant waiver to date of the economic soundness standard was made by Section 223(e), which also permits waiver of other eligibility requirements to encourage more mortgage insurance in any "older, declining area." The area had to be "reasonably viable" and the property "an acceptable risk," terms designed to give consideration to the needs of "families of low and moderate income in such area."

The substitution of "acceptable risk" for "economic soundness" produced confusion and inconsistency because, although Congress intended the substitution to encourage liberalization, it certainly did not intend to authorize the insurance of unsound loans. The extent to which "acceptable risk" is something less than "economic soundness" is vague in the statutes, because the legislation gives no standard at all for determining that difference, or provides only vague language such as "taking into consideration the need for housing low income people." Some contend the quoted terms are interchangeable, because risk is always present in insurance, while at the same time the insurance should always be reasonably sound. In practice, however, "acceptable risk" has been applied quite differently from "economic soundness."

Appraised Value: According to another underwriting concept, the insured mortgage under the original FHA programs could not ex-

ceed in amount the appraised value of the property. That standard took into account the long-range value of the property over the life of the mortgage. However, a "replacement cost" maximum amount generally was substituted for "appraised value" in the special mortgage insurance programs enacted after the original Sections 203 and 207 programs and aimed at special groups or special areas, such as declining inner city neighborhoods. A maximum mortgage amount computed on the basis of replacement cost, as opposed to one computed on the basis of "appraised value," usually results in a higher maximum mortgage amount. This occurs particularly because "replacement cost" ignores future value of the property, and the use of that technique lowers the underwriting standards applied and establishes an important inconsistency in mortgage insurance operations and in the standards of the mortgage instruments insured by HUD and sold in the secondary market throughout the country. This was deliberately authorized by Congress to encourage sponsors to participate in the special purpose programs, particularly those operating in urban renewal areas.

Maximum Dollar Mortgage Amounts: Each of the many mortgage insurance programs has flat dollar limits on the amount of eligible mortgages. In the case of home mortgages, these ceilings range from $14,400 to $33,000 for a single-family unit, with a 50 percent increase permitted in Alaska, Hawaii, and Guam. While amendments have brought about some consistency from time to time, there are still differences that cannot be explained on any basis other than the average costs at the time of the various enactments, or the policies prevalent at those times. Examples of this are the discrepancies between the dollar ceilings in the regular Section 203 home mortgage program, the Section 220 home mortgage program for urban renewal areas, and the home mortgages under Section 221 for moderate income families, especially mortgages on structures for more than one family.

The dollar ceilings applicable to the multifamily housing programs present a different problem of inconsistency. Each program has such an array of varying ceilings that they defy meaningful comparison. These ceilings have fixed maximum amounts per mortgage program, varying from $12.5 million to $50 million, but the more significant variations are geared to amounts per dwelling unit for units of varying sizes in various types of structures and areas.

Downpayments: Statutory provisions determining necessary downpayments by mortgagor/purchasers contain desirable variations for differences in mortgage amount and some other factors, but they also contain inconsistencies. Generally, the amount of the downpayment is determined by the permissible loan-to-value ratio of the mortgage. The loan-to-value ratio varies from 75 percent (in the case of recreational housing) to as much as 100 percent (which can apply to a mortgage amount as high as $24,000 in the case of Section 221(d)(2) housing for moderate income families and to Section 235 subsidized housing). The 100 percent maximum loan is not applicable to a comparable mortgage amount under other programs. In the case of Section 221(d)(2), unlike other programs, specific downpayment dollar amounts are prescribed on the basis of the number of units in the structure and on whether the purchaser has been displaced from his previous home.

The formula for arriving at the loan-to-value ratio allowable on an individual mortgage usually is stated in terms of a fixed percentage of the first X dollars of appraised value, with progressively smaller percentages prescribed for additional increments of value, up to the maximum mortgage amount stipulated in the statute. However, these graduated steps and the applicable percentages attached to each are not uniformly applied to all programs; this can be seen, for example, by comparing their use with respect to home mortgages insured under Sections 203 and 222. Some of these differences are, of course, justifiable, because of differing objectives and target groups.

Treatment of Families Under Subsidy Programs: Statutory requirements controlling the treatment of families in subsidy housing programs vary greatly, often without logic or rationale. In some programs, such as rent supplements and Section 235, a tenant or homeowner must contribute a stated percentage of his income either to rent or mortgage

payments; in others, such as Section 221(d)(3), he need not. In some programs, very liberal deductions from family income are permitted both in determining eligibility for occupancy or other participation and the amount of rent the family must pay; in other programs, only the most limited deductions from income are permissible. In some of the subsidized programs, a tenant must leave the unit if his income rises past a certain level; in others, he need not. In some programs, the assets of an eligible family are severely limited, but not in other programs.

In the public housing program, maximum income limits are based on the income group in the area not served by private unassisted housing, and are actually fixed by each of some 3,000 housing authorities. Except with respect to public housing for the elderly and the displaced, and housing leased under Section 23, public housing rentals at time of admission must be at least 20 percent below the lowest rentals in acceptable private housing that is unassisted and available in substantial supply. Public housing rentals generally cannot exceed 25 percent of the tenant's income. There is a wide range of public housing eligibility limits throughout the Nation as illustrated by Table I.

Table 1. Range of Eligibility Limits, Low Rent Public Housing, Four-Person Households

City	Limit
New York	$7,800
Chicago	6,500
Los Angeles	6,100
Boston	6,000
Detroit	6,000
St. Louis	6,000
Washington, D.C.	5,800
San Francisco	5,700
Seattle	5,700
Denver	5,600
Kansas City	5,500
Atlanta	5,000
New Orleans	4,800
Philadelphia	4,750
San Antonio	4,700

Source: Department of Housing and Urban Development.

One reason for this is the geographical differences in housing costs; another is the lack of accurate data on local area rents.

In the rent supplement program, income limits are tied to the limits actually established in the community for public housing purposes, except that the definitions of income are different. In the Section 235 homeownership subsidy program and the Section 236 rental subsidy program, there is a standard based on 135 percent of public housing limits in the area, but with a limited exception related to the Section 221(d)(3) subsidized interest program.

Local Approval Requirement: Unlike most private housing—whether assisted with FHA insurance or not—a rent supplement project cannot be undertaken in a community unless its local governing body has approved it through adoption of an applicable "Workable Program" or otherwise. This does not apply to the Section 236 rental program, which also assists private housing but does prevent use of rent supplements in connection with some Section 236 projects.

Income Gaps: Some specific statutory provisions are contrary to the general purpose of carrying out a program on an equitable basis of distribution. The original 20-percent-gap provision in the low rent public housing law is still in effect (with some exceptions). It eliminates an income bracket from benefits, for no other reason than to assure private sponsors that public housing will not approach an income group they might serve. The above limitations—tying income eligibility under the FHA-subsidized housing programs to ceilings fixed locally for public housing—create arbitrary gaps in program benefits and create obvious inequities among communities.

Hidden Subsidies and Costly Devices to Defer Budget Impact: Program financing schemes to avoid the need for appropriations or to permit a technical budget reduction are inconsistent with good management, candid information about Government costs, and efficient and economical administration. They generally result in unnecessary complications.

The device of hidden (or partially hidden) subsidies in housing—in contrast to overt subsi-

dies—is common in housing programs as well as other Government operations. An early use of this device in housing was through the Federal National Mortgage Association special assistance operations—now being continued by Government National Mortgage Association—where the subsidy is provided by purchasing mortgages at prices above their value at the time—often at par. This contrasts with the direct loan and the subsidized interest rate housing programs. The use of the Tandem Plan in a variety of ways is one form of subsidy that is sufficiently covert to avoid the controversy that would result from a direct subsidy of equal amount.

Another hidden subsidy exists under the rural housing insured loan system of the FmHA. The Housing Act of 1965 established that system and a Rural Housing Insurance Fund to finance it. This was done mainly to avoid the budget considerations that had restricted direct loans under the FmHA's original authority. Under the insurance system the rural housing loan is made by the FmHA and secured by a note and mortgage. The note is packaged with other similar notes as collateral for a special type of Government-guaranteed security. These securities are sold in the private market at rates determined by conditions in the money market at the time. The proceeds of the blanket security sales are deposited in the fund. Because the interest cost on the blanket securities exceeds the interests realized on the underlying notes, subsidies are necessary and are paid on the loan transactions. These are treated as operating costs and paid from income to the fund to the extent available. Deficits in the fund are restored with annual appropriations by the Congress.

A major factor shaping Federal housing subsidy programs has been the desire to structure the subsidy mechanism so as artificially to minimize the immediate impact of the program on the Federal budget. Accordingly, interest subsidy programs that spread the budget impact of the subsidy over periods as long as 40 years are often favored over other types of subsidies whose budget impact is more immediate.

Interest Rate Ceiling: In the overall housing credit policy of the Federal Government, there is a major conflict with respect to control of interest rates. All FHA- and VA-insured mortage loans are subject to maximum interest rate controls prescribed in Federal regulations,[17] while conventional loans by Federal savings and loan associations are not subject to such Federal controls, although assisted by the United States through the facilities and financial backing of the Federal Home Loan Bank System. This inconsistency has become more pronounced since the savings and loan associations have been given the facilities of a Government secondary market in both the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. The latter corporation was created by the Emergency Home Finance Act of 1970 to carry on, under the direction of the Board of Directors of the Federal Home Loan Bank Board, a secondary market in both conventional and Government-assisted residential mortgages. The same act gave the Federal National Mortgage Association authority to deal in conventional mortgages.

President Nixon, in his August 3, 1973, "Message to the Congress on Recommendations for Change in the United States Financial System," proposed that the interest ceiling on FHA and VA mortgage loans be removed. Noting that these ceilings have failed to keep costs down and at the same time have restricted the flow of private funds into mortgage markets, the President urged individual States to follow the Federal lead and remove similar barriers to housing finance.

VA Guarantee and FHA Insurance: These two programs contain a number of important differences in their requirements and procedures that cause confusion for builders, lenders, and home purchasers. It is especially troublesome to builders and purchasers because the two programs often are used in the same housing development. Major differences in the FHA and VA operations are:

1. The VA uses a "guaranty" system in

[17] These regulatory ceilings are subject to statutory ceilings; the Congress, however, has authorized the Secretary of Housing and Urban Development and the Administrator of Veterans Affairs to set the ceilings by administrative decision.

contrast to the FHA "insurance." This means that VA loans carry full protection against loss (including interest and foreclosure costs) up to the limit of the guaranty on each loan without charge to either borrower or lender to cover VA risks; FHA requires annual mortgage insurance premiums as well as a slight coinsurance by the lender that can result in some loss of interest and a portion of foreclosure costs.

2. The VA-guaranteed loan can be up to the full "reasonable value" of the property, in contrast to the downpayment generally required for a home purchased under FHA procedures. This becomes a more significant difference in the higher cost ranges.

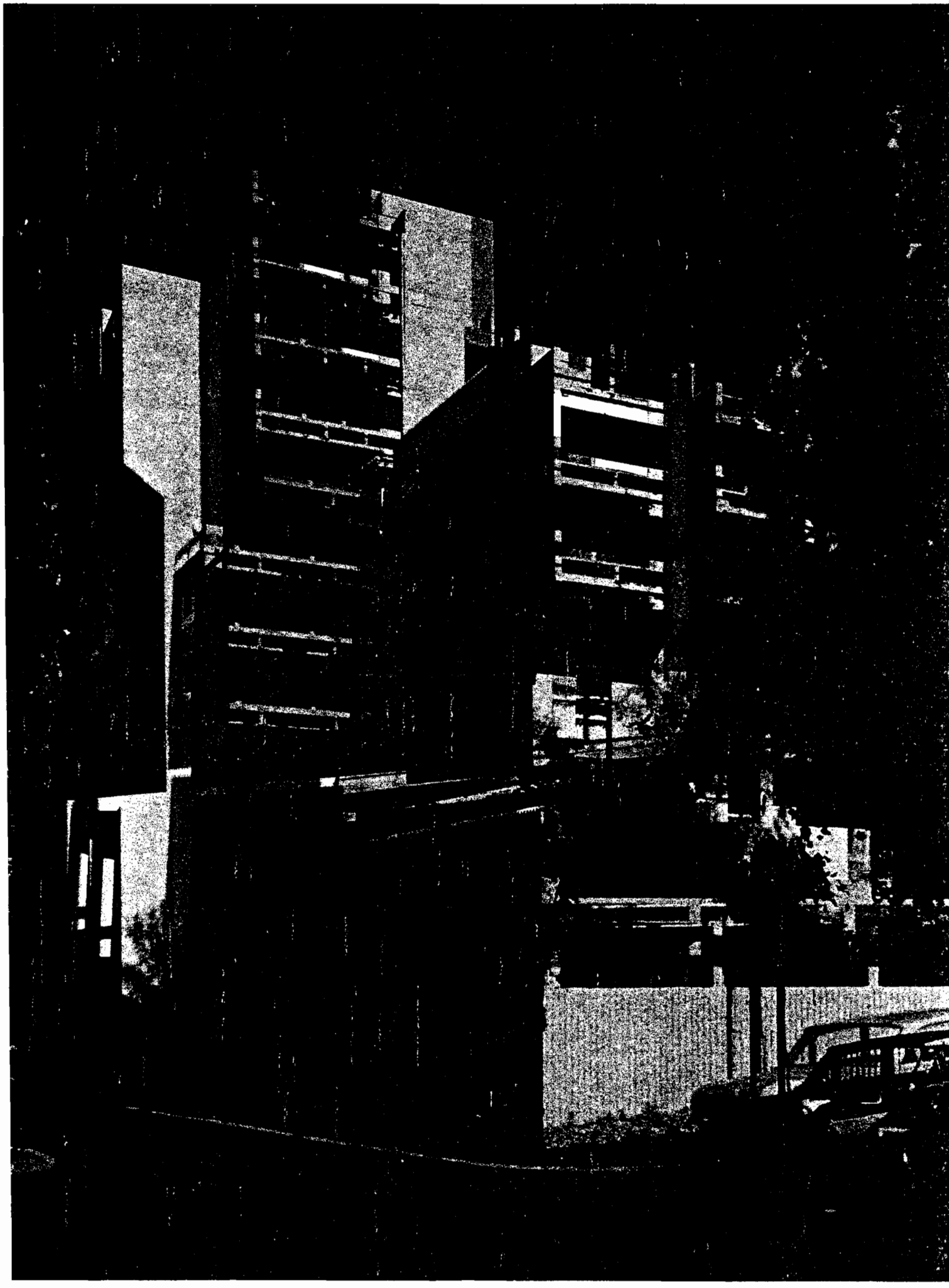
3. The VA established the "reasonable value" for the purpose of fixing the loan amount, but this becomes, in effect, the sales price, and is distinguished from "value" established by FHA for computing maximum mortgage amount. The latter is based upon the value of the property as security for long-range insurance purposes.

4. The VA follows quite different procedures in event of default on the loan and foreclosure proceedings.

Duplications

Although not so serious as conflicts and inconsistencies in the housing laws, duplicating provisions are so extensive and so pervasive in these laws that they constitute a major problem. Duplicative provisions have varying effects. In the case of the many FHA mortgage insurance programs there is so much unnecessary repetition of program provisions, including eligible mortgage terms for each program, that it seems as if there were as many administrative agencies as there are programs. This results not only in a massive number of bureaucratic rules and regulations, but inevitably in inconsistencies and further confusion because of the way pressures for amendatory legislation and enactment occur.

Apart from programmatic duplication within HUD, there also is functional duplication among the primary housing agencies—HUD, VA, and (especially in communities under 10.000 population) the Agriculture Department.



2 Indirect Federal Housing Activities

Introduction

The Federal Government participates in the housing market in many different ways—through tax policies, regulation of mortgage financing, mortgage insurance, subsidy payments, welfare assistance, credit policy, labor policy, equal housing opportunity policy, environmental policy, and numerous other lesser activities.

Some of these activities assist consumers in acquiring housing, others assist lenders and builders in providing housing, and still others alter or influence the conditions in which the housing market operates. In short, the Federal Government directly and indirectly exercises a major influence over the production and consumption of housing.

Analysis of Federal housing policy has tended to focus upon the direct Federal housing programs, such as those administered by HUD, the Department of Agriculture, and the VA, and upon mortgage market operations by the Federal National Mortgage Association, the Federal Home Loan Bank Board, and the Government National Mortgage Association. The Federal Government's role, however, is far more complex and far more pervasive than is evidenced by the direct housing programs that form the core of housing legislation.

Because of the magnitude of the housing market, direct Federal programs often play a strictly supplementary role. A very small fraction of houses built or mortgage loans made in any one year are the result of direct Federal housing programs. The Federal Government, in some ways, exercises a greater influence through its indirect interventions in the housing market—for example, the income tax treatment of homeowners and of investors in housing; Federal credit policies, such as those instituted by the Federal Reserve Board, which strongly affect the cost of financing a home purchase in a given period; and the interest limitation set by the Federal Government on savings and loan institutions and savings banks, which can strongly affect the availability of funds for mortgage financing.

The direct and indirect cost in 1972 of Federal intervention in the housing market totaled at least $14 to $15 billion and of this total only $2.5 billion was expended on direct federally operated housing subsidy programs. In addition, there was some $2.6 billion in Federal payments to State and local governments that was used by welfare recipients for housing. Exceeding the cost of such direct programs, however, was an indirect cost of $6.2 billion—the amount of revenue forgone by the Treasury Department due to income tax deductions by individuals for mortgage interest payments and local property taxes. In addition, there were revenues lost from special capital gains tax treatment on the sale of homes—another form of indirect assistance to the housing market. Federal support of the mortgage market also has a major, albeit indirect impact, but one not precisely measurable in budget outlays or tax revenue losses.

The following illustrates the relative order of magnitude of the Federal interventions:

	Cost in Calendar Year 1972 (in billions)
Homeowners' deductions	$6.2
Federal subsidized housing programs	2.5
Federal welfare assistance payments for housing	2.6
Other taxes forgone (e.g., capital gains on home sales)	3.0 to 4.0

Certain other Federal policies, although ostensibly unrelated to housing, have—or promise to have—great impact on the Nation's construction and supply of housing. Environmental considerations, for example, have become a major new factor in both federally sponsored and privately developed housing. As a result of the National Environmental Policy Act of 1969, all Federal agencies are required to consider the impact of their policies and programs on the physical, social, and economic environment; this includes federally assisted housing projects. Environmental considerations—including requirements flowing from Federal regulation of the quality of air, water, noise, and other materials and processes, as well as those requirements of legislation now pending in Congress that would affect land use and

other environmental concerns—will assume, and in many places already have assumed, a major role in determining the location, design, and cost of housing.

Similarly, through its labor policies, the Federal Government exerts an influence over the cost of housing. Under the Davis-Bacon Act of 1931, administered by the Labor Department, the prevailing onsite wage rate must be paid on all federally assisted projects. (Coverage does not extend to one-to-four-family units constructed under federally insured or subsidized financing.) Although this requirement applies directly only to federally financed housing, it may indirectly influence labor costs for all other construction.

Another factor influencing the sale or rental of housing has been antidiscrimination policies enforced by the Federal Government. Through a number of legislative acts and administrative and judicial decisions, the Federal Government has moved to eliminate racial discrimination in the sale or rental of housing, thus seeking to assure the availability of housing on an equitable basis to minority groups. This fair housing mandate has added a social objective with far-reaching implications for future housing development to the original economic objectives of the Nation's housing policies.

The proliferation of Federal policies with widely diverse goals and origins having major impact on housing has brought with it a fragmentation of the responsibility for developing housing policy both within the executive branch and in Congress. For example, HUD administers programs to encourage the construction and ownership of homes through various forms of Federal assistance; the Treasury Department administers tax policies that have important effects on homeownership and housing construction; the Department of Health, Education, and Welfare has the responsibility for programs that in part provide housing for the needy, while at the same time HUD is subsidizing housing for low income families; the Bureau of Indian Affairs of the Department of the Interior, the Department of Agriculture, the Veterans Administration, and the Department of Defense are also involved in housing.

Similarly, congressional responsibility for the various facets of housing policy is divided among various committees. The basic housing legislation is developed by the banking committees in the House and Senate, while tax and welfare legislation affecting housing is drafted by the House Ways and Means Committee and the Senate Finance Committee.[1]

This divided responsibility stems, in part, from the highly complex nature of the housing sector itself. This complexity and the fragmentation of current Government involvement have made it more difficult for the Government to develop a comprehensive housing policy. To the extent that public debate on housing policy has concentrated on direct Federal housing programs and mortgage market activity, the breadth and scale of Government intervention—and the degree of fragmentation—have tended to become obscured. This chapter focuses on some of the major points of indirect Federal intervention in the housing market with particular emphasis on Federal tax policy.

A number of Federal programs not discussed here also have had an indirect but often very substantial impact on housing: highway, mass transit, and airport subsidies; relocation assistance; urban renewal; and community development subsidies such as sewer and water grants, public facility grants, open space assistance, and urban planning grants. These involve direct Federal expenditures; however, whereas the Federal role discussed here is, for the most part, either regulatory in nature or involves tax revenue forgone rather than direct expenditures.

Tax Policies

Through its tax laws, the Federal Govern-

[1] There are 12 congressional committees with legislative responsibility involved in housing: Six in the Senate (Agriculture and Forestry; Appropriations; Banking, Housing and Urban Affairs; Finance; Judiciary; and Veterans Affairs) and six in the House (Agriculture; Appropriations; Banking and Currency; Judiciary; Veterans' Affairs; and Ways and Means). In recent years, a number of other congressional committees exercising an oversight function also have addressed themselves to housing, in particular the Joint Economic Committee and the Subcommittee on Housing for the Elderly of the Senate Special Committee on Aging. Legislative committees peripherally involved in housing are the Armed Services and the Interior and Insular Affairs committees in the House and Senate.

ment exercises a major influence over the housing market. Its pervasive impact on housing comes through special benefits and deductions granted on income taxes for businesses as well as for the individual. By providing tax writeoffs, the Federal Government encourages investment in housing, thereby increasing the supply of housing. By granting special deductions to homeowners, the Government promotes homeownership.

Originally, tax policies generally were thought of as a way to give special benefits to individuals, rather than as an instrument to help achieve explicit housing goals. In recent years, however, a convergence has developed between tax policy and housing policy and, with it, a clearer understanding of how they are interrelated.

Tax policies increasingly have been used as an instrument to promote housing goals. For example, when the tax laws were revised in 1969, one provision (Section 167 of the Internal Revenue Code) was rewritten for the express purpose of attracting investment capital into residential housing. The provision constituted a deliberate decision by Congress to use tax laws to promote the construction of housing, particularly for low and moderate income families.

Using tax laws as a tool to achieve desirable social objectives inevitably raises the question of equity. Tax benefits for housing result in forgone Federal revenues that might be used to achieve other objectives or to benefit groups other than homeowners. A problem arises in weighing the value of different goals: Do tax benefits create inequities between economic groups? Do they benefit higher income families who can afford homes without such assistance at the expense of others who cannot? Do they discriminate against renters? Do they give the housing industry a tax advantage to which other industries fulfilling other basic needs—such as food processors or clothing manufacturers—might be equally entitled? Do they encourage new construction at the expense of rehabilitation?

As housing programs and the tax code become increasingly complex and intertwined, such questions of social and economic equity will become increasingly important in the development of a coherent housing policy.

Income Tax Incentives for Homeowners

The Internal Revenue Code reflects an evolution of a policy that began with the first income tax experiments during the Civil War, providing that certain tax benefits should accrue to homeownership at the expense of potential Federal revenues and other forms of consumption or investment. In the Revenue Acts of 1864 and 1865, taxpayers were permitted to deduct interest expense and local tax payments. Within these, two categories of expenses related to homeownership: mortgage interest payments and property taxes. The policy was restated in the first statute implementing the 1913 constitutional amendment establishing the Federal income tax system existing today. The policy has remained virtually unchanged.

In 1972, more than 24 million taxpayers who lived in their own homes—almost one-third of all taxpayers—took advantage of these two tax benefits, now contained in Sections 163 and 164 of the Internal Revenue Code.

In recent years, homeowners were allowed a third category of tax benefits when Congress approved legislation permitting a homeowner to defer the tax on any gain realized in the sale of his principal residence. The Congress approved the new provision (Section 1034 of the Internal Revenue Code) in 1951 at the height of the Korean War with the stated intent of alleviating the hardships associated with relocations brought on by wartime mobilization, and facilitating the purchase of larger homes by growing families.

Pursuant to Section 1034, a homeowner who sells his home and purchases another of equal or higher price within 1 year, will not be taxed at that point on any capital gain realized (calculated generally as the difference between the original cost of the home plus the cost of capital improvements and the purchase price of the new home). The tax is thus deferred until a homeowner finally sells a home without buying another of equal or greater price or when he buys a home at a lower price. In addition, when a homeowner who has been deferring his taxes under Section 1034 dies, the gains realized are totally excluded from taxation pursuant to Section 1014 of the Internal Revenue Code. In sum, the effect of Section 1034 is

to promote both social and geographic mobility and to widen the housing market by providing homeowners, when they move, an incentive to buy another home of equal or greater price.

Section 1034 created a potential problem, however, for the elderly person who may have wished to sell his present home and move to smaller, less costly accommodations, investing the gain from the sale to provide for his retirement. Thus, Congress in the 1964 Revenue Act provided (in Section 121 of the Internal Revenue Code) that any gain realized by a taxpayer 65 or older on a house sold for under $20,000 would not be taxed, and only a portion of the gain on homes sold for more than $20,000 would be taxed, depending on the amount of the gain and the adjusted sales price. A taxpayer, however, may utilize this provision only once. The result of this provision was to enhance the value of an investment in a house, which represents the most important and, in some cases, the only major investment made by most taxpayers.

Clearly, then, the benefits to homeowners from the Federal income tax laws have substantial economic and social impact. Table 1 indicates the magnitude of the impact of the mortgage interest and property tax deductions.

Not included in the table is the estimated loss of revenue in 1973 by homeowners who were entitled to defer or exclude the Federal tax on any capital gains realized from the sale or other disposition of their homes. If all such gains realized in 1973 were taxed, the Department of the Treasury has estimated that revenues for 1973 would increase, as a consequence, by about $1.7 billion. If, in addition, homeowners who have over the years compounded their gains through the sale of several homes were taxed on their gains in previous years, 1973 revenues would increase by an additional $1.3 billion, although this basically would be a one-time increase.

The relative tax savings generated by the homeowners' deductions, as Table 1 shows, go primarily to middle and upper income taxpay-

Table 1. Revenue Cost of Allowing Homeowners Deductions for Mortgage Interest and Real Estate Taxes, 1972

Adjusted Gross Income Class	Returns with a Tax Increase				
	Number of Returns (thousands)	Percent of all Returns in Income Class	Total Costs of the Deductions (millions)	Average Costs of the Deductions	Cost of Deductions as a Percent of Tax Liability*
Less than $3,000	193	1.1%	$4.4	$23	2.0%
3,000– 4,999	467	4.9	23.8	51	1.3
5,000– 6,999	1,670	18.9	131.7	79	3.5
7,000– 9,999	4,725	35.7	565.2	120	5.7
10,000–14,999	7,396	48.1	1,130.0	153	5.7
15,000–19,999	5,038	70.0	1,323.1	263	8.2
20,000–49,999	4,241	78.7	2,236.7	527	9.5
50,000–99,999	382	87.0	533.1	1,397	6.7
100,000 or more	92	90.2	231.2	2,502	3.0
Totals	24,205	31.0%	6,179.2	255	6.8%

*Expressed as a percentage of total tax liability after credits for all returns in the adjusted gross income class.

Source: Department of the Treasury

ers. There are three reasons for this. First, homeownership is less widespread among low income groups; second, low income homeowners tend to have less expensive homes, allowing less opportunity for tax savings; and, third, low income homeowners have low Federal tax rates and therefore less to gain from deductions.

The percentage of taxpayers in each income bracket who benefit from the deductions rises sharply as income rises. In 1972, only 1.1 percent of all taxpayers with adjusted gross income of less than $3,000 benefited from the deductions, whereas 90.2 percent of those in the $100,000-or-more bracket benefited. As the table demonstrates, the bulk of the $6.2 billion in total benefits—$5.5 billion—went to taxpayers with adjusted gross incomes of $10,000 or more. The lower income taxpayer, however, may realize certain progressive tax savings through the standard deduction, which remains constant for all income groups.

The most costly tax benefit in terms of forgone revenue—but the least well-defined one accruing to homeowners, some tax reform advocates contend—occurs by virtue of the absence of a tax on the "income" derived from investment in a home. This is the so-called "imputed net rental" argument, which is essentially that if a home is treated as a taxable asset or investment, and deductions for interest and property taxes are allowed, then it also should be taxed on its income-producing potential. Imputed net rental is the difference between the gross rent that an owner-occupant could receive if he rented his home, and the overall cost of producing that income, including depreciation, maintenance, and repair costs (which are not deductible for homeowners). Some tax analysts contend that all homeowners should be required to count such potential rental income as part of their gross income for Federal tax purposes, just as investment income from other types of assets must be counted.[2]

A study conducted for the National Housing Policy Review projected the estimated revenue loss for 1973 due to the exclusion of net imputed rent at $6.04 billion.[3]

Tax Preferences for Homeowners: Outlines of Debate

The result of the homeowner tax preferences is to reduce the cost of owning a home from what it otherwise would be and, thereby, to help make owning a home appear more attractive to consumers than renting one. It is difficult, however, to draw precise comparisons between the cost of renting and buying. The renter, for example, has the advantage of being able to invest and obtain an immediate return on the money that a homeowner must use for a downpayment. However, the renter-investor must pay taxes on this return, while the homeowner-investor receives his "return" tax free. The tax advantage of homeownership over renting also varies with income and the size of the downpayment required. The renter cannot deduct the portion of his rent that goes to meet mortgage interest and property tax expenses. On the other hand, the owners of rental property deduct such expenses and, to the extent a particular housing market is competitive, the renters may benefit indirectly from the tax benefits accorded the owners.

The National Housing Policy Review study of the revenue costs of the homeowner tax preferences concluded that, counting the exclusion of imputed rent from gross income, homeowner tax benefits reduce the gross costs on owner-occupied units by from 10 to 15 percent.[4] The study contended that these tax benefits bring about a 5 to 7 percent increase in the probability of homeownership. Consequently, the study concluded, there were 3.2 million to 4 million owner occupied units in 1970 that, in the absence of homeowner tax benefits, would in all probability have been rental units.

There has been considerable debate over four major policy issues related to the existing system of homeowner tax benefits. First, should imputed rent be included in a homeowner's

[2] Henry Aaron. *Shelter and Subsidies: Who Benefits from Federal Housing Policies.* Washington, D.C.: The Brookings Institution, 1972.

[3] Urban Systems Research and Engineering, Inc., "Housing and Federal Taxation: Costs and Effectiveness," a report prepared for the National Housing Policy Review, 1973.

[4] "Housing and Federal Taxation: Costs and Effectiveness," op. cit.

taxable gross income for tax purposes? Second, should the existing system of homeowner tax deductions for property tax and interest be expanded, eliminated, or modified? Third, should Section 1034 of the tax code, which permits a homeowner to defer the payment of taxes on capital gains realized on the sale of an owner-occupied house, be expanded, eliminated, or modified? And, fourth, should Section 121 of the tax code, which eliminates all or part of the gain realized on the sale of an owner occupied unit by an elderly family, be modified or expanded?

Basically, proponents of tax reform argue that the present system of taxing owner-occupied units is inequitable because it favors homeowners over renters, provides proportionately greater rewards to higher income taxpayers than it does to lower income taxpayers, and favors investments in housing over investments in other types of assets.[5]

Imputed Rent: Some tax reform advocates suggest that either the net imputed rental value of a property be taxed or that deductions for mortgage interest and property taxes be disallowed.

Proponents of this change contend that if net imputed rent were taxed, the tax law would treat renters and homeowners in an even-handed manner. Investment in owner-occupied homes and in other types of assets would then be taxed in a similar fashion and a substantial additional amount of revenue would be generated, as has been noted.

Those who oppose taxing net imputed rent argue as follows: First, imputed income is not otherwise taxed under the Internal Revenue Code. Second, it is inequitable to tax the use of an owner-occupied unit unless the imputed income from all types of property—including cars, boats, planes, recreational vehicles, television sets, radios, etc.—is also taxed. And, third, home buyers who had made long-range financial commitments on the basis of the existing tax law would be placed in an unfavorable and essentially unfair financial position if the full net imputed rental value of their property were taxed, unless a long transition period preceded the change.

Mortgage Interest and Property Taxes: Supporters of the existing law make the following points in defense of the mortgage interest and property tax deductions:

First, permitting mortgage interest and property tax deductions is consistent with the tax treatment of other personal assets, as well as with the general principle underlying the current tax system—that taxpayers should not pay a tax on a tax. Second, disallowing the deductions, it is argued, could lead to a reduction in the number of homeownership units, which, conceivably, could have an undesirable impact on the sense of identity and stability in a community that homeownership allegedly helps to foster. It would also mean that fewer people would have the hedge against inflation that homeownership provides in those cases where rising equity in a home keeps pace with price increases. Third, homeowner deductions, which tax analysts say have a regressive effect on the tax system by rewarding those with large incomes more than those with small incomes, should not be the sole target of reform. Other deductions, such as for charitable contributions, also have a regressive effect. Homeowner deductions should not be disallowed unless the whole system is reformed. And, fourth, elimination of the deductions would exert pressure on the rental market, which at the present time is at least partially competitive with owner-occupied housing and could therefore result in some increases in rental schedules.

Critics of the mortgage interest and property tax deductions, in addition to their general argument about the basic inequitability of homeowners' preferences, also contend that the mortgage interest and property tax deductions—because they confer greater benefits on those in middle and high income brackets—lead to an overconsumption of housing by higher bracket taxpayers. This, critics say, has contributed in turn to suburban sprawl and urban decay by encouraging the quest for bigger homes in outlying areas and accelerating the turnover of existing housing in urban areas.

Capital Gains Postponement: Proponents

[5] For more detailed discussion, see Richard E. Slitor, "Rationale of the Present Tax Benefits for Homeowners," a study prepared for the National Housing Policy Review, 1973.

of reform maintain that Section 1034—which, as described earlier, permits postponement of a tax on capital gains realized in the sale of an owner-occupied home—has the following disadvantages: First, it results in a substantial estimated revenue loss. (See Table 2.) Second, it may encourage some unnecessary movement on the part of families who move to larger accommodations instead of improving their present homes. And, third, it results in overconsumption of housing, particularly when a family moves from a high cost area to a lower cost area of the country.

There are, it is argued, two major advantages of Section 1034: first, it can encourage "filtering down" of owner-occupied units to lower income groups, an effect described in more detail in Chapters 4 and 6; and, second, it can encourage mobility, thereby enabling families to move to new locations or areas where better or more remunerative jobs may be available.

Section 121, described earlier, allows an elderly taxpayer a whole or partial exemption from taxation on the gain realized in the sale of his home, depending on the size of the gain and the adjusted sales price.

The chief advantage of Section 121 is that it provides an incentive to an elderly taxpayer who is "overhoused" to move into smaller, less costly accommodations. The elderly taxpayer's home can then be utilized appropriately by a younger, larger family. The chief disadvantage of the provision is the tax loss to the Treasury. In addition, on the premise that elderly families lend stability to marginal neighborhoods, the provision has a negative impact by making it easier for such families to leave a neighborhood.

Deduction Ceilings: A ceiling on the total amount of mortgage interest and property tax deductions that a homeowner could claim is one of the basic changes favored among advocates of tax reform.

According to an analysis prepared by the Treasury Department for HUD (Table 2), an absolute ceiling (as opposed to percentage-of-income ceiling) of $2,500 on property tax and mortgage interest deductions, had it been in effect in 1972, would have required 2.7 percent of the taxpayers to pay higher taxes and it would have generated an additional $749 million in revenue. For those taxpayers affected, the average increase in annual taxes would have totaled $352. Fewer than 100,000 homeowners earning less than $10,000 (0.2 percent of all taxpayers in that bracket) would have paid additional taxes, and in those few instances the additional amount would have averaged less than $100 for each. No taxpayers earning less than $5,000 would have paid additional taxes due to the ceiling. One half of one percent of those earning between $7,000 and $10,000 would have paid more and 1.4 percent of those between $10,000 and $15,000 would have paid

Table 2. Options for Limiting the Amount of Property Tax and Mortgage Interest Deductible by Individual Taxpayers

Limit on Homeowner Interest and Property Tax Deduction	1972 Taxpayers Affected by Limit		Additional Tax Revenues ($ Millions)	Additional Average Tax for Taxpayers Affected
	Number in Thousands	Percent		
$2,500	2,125	2.7%	$749	$352
3,000	1,225	1.6	551	409
2,500 to 3,250	2,103	2.7	464	220
3,000 to 3,750	1,215	1.6	330	271
4,000	423	0.5	264	623

Source: Department of Housing and Urban Development, National Housing Policy Review, based on data from Department of the Treasury

more. But 20 percent of those in the $20,000 to $50,000 bracket, 39 percent in the $50,000 to $100,000 range, and 52 percent of those above $100,000 would have paid substantially more. Table 2 shows the impact of alternative ceiling levels.

Income Tax Incentives for Residential Rental Housing Development

Investment decisions concerning real estate traditionally have been strongly influenced by tax considerations. Prior to enactment of the Tax Reform Act of 1969, the tax code did not provide different tax incentives for residential and nonresidential property although the incentives available for investment in new properties were greater than those provided for used property investments. As a result, investment in higher risk, less profitable ventures such as housing, particularly housing for low and moderate income families, was discouraged by the tax laws. Furthermore, after the Great Depression, real estate investment tended to go into business development, such as office buildings, rather than into residential housing.

The pre–1969 tax provisions offered no incentive, and in fact may have been a deterrent, to improvement of existing properties. Finally, properties such as shopping centers and office buildings that would have been economically sound investments even without the tax incentives, were being marketed for the tax shelter they provided higher income bracket investors.

The 1969 Tax Reform Act amended the Internal Revenue Code to provide preferred treatment for investments in residential over nonresidential properties and for certain types of subsidized housing over other residential property. The act also increased the pre–1969 preference for investments in new versus used properties (except in the case of the 5-year writeoff of rehabilitation expenditures on low income housing). This preferred treatment generally was established by decreasing the availability and attractiveness of accelerated depreciation deductions for certain classes of real property rather than by increasing the incentives available for residential, subsidized, and new properties.

Prior to 1969, depreciation could be computed by either the straight line or an accelerated method. Generally, in the case of newly constructed property, the taxpayer could employ the "sum-of-the-year-digits" method or the "double declining balance" method (200 percent of the straight line rate). In the case of used property, the declining balance method of 150 percent of straight line was available. Under prior law a portion of the gain realized on the sale of real property was "recaptured" and taxed as ordinary income rather than as a capital gain, unless the asset was held for a period of 10 years. The amount recaptured was equal to—whichever was smaller—the amount of gain recognized or the amount of "additional depreciation" (the amount of depreciation in excess of straight line depreciation) taken on the asset, multiplied by a certain percentage as determined by the length of time the property was held. This percentage declined at the rate of 1 percent per month for every month after 20 months the property was held and was reduced to zero at the end of the tenth year.

Under the 1969 act, the depreciation rules (Section 167 of the Internal Revenue Code) provide that: (1) new residential rental property may be depreciated utilizing the double-declining balance or sum-of-the-years-digits methods of depreciation; (2) new nonresidential property may be depreciated using the 150 percent declining balance method; (3) used residential rental property with a useful life of more than 20 years can be depreciated under the 125 percent declining balance method; and (4) all nonresidential property as well as used residential property with a useful life of less than 20 years must be depreciated using the straight line method.

The "recapture" rules applicable to real property are also substantially different as a result of the 1969 act. Only housing for low and moderate income families that is assisted under the Section 236 or Section 221(d)(3) rental housing assistance programs or under certain State or local programs providing housing assistance is eligible for the pre–1969 10-year-phaseout recapture rule. Accelerated depreciation taken in excess of straight line depreciation ("additional depreciation") on all other residential property is fully recaptured if the property is sold within 100 months of its acquisition. More-

over, the percentage of additional depreciation declines at the rate of 1 percent per month. Thus, full phaseout or recapture of additional depreciation does not occur until $16^2/_3$ years after the property is acquired. All additional depreciation taken on nonresidential property is fully recaptured as ordinary income regardless of the period of time the property is held.

Two additional provisions were added to the Internal Revenue Code in 1969 that relate to housing for low and moderate income families. Section 167(k), enacted to stimulate investment in rehabilitation of existing housing for low and moderate income families, permits a taxpayer to elect to compute depreciation attributable to qualified rehabilitation expenditures (incurred in connection with the rehabilitation of existing dwelling units for low and moderate income families) under the straight line method, using a useful life of 60 months. The advantage of this provision is that it permits a taxpayer to depreciate an asset (for which qualified rehabilitation expenditures are made) over a much shorter useful life than it would otherwise have been assigned. This is referred to as "rapid amortization." Rehabilitation expenditures cannot be less than $3,000 nor more than $15,000 per unit to qualify for Section 167(k) treatment.

Moreover, the 1969 act added Section 1039, which permits the owner of a certain type of federally assisted rental project to elect to defer payment of a tax on the gain realized on the disposition of such housing, provided that (1) the tenants living in the project or an organization formed for their benefit purchase it, and (2) the owner reinvests the sales proceeds in a similar type of housing within a given period of time. Owners of State or locally assisted housing projects cannot participate in the Section 1039 provision (commonly referred to as the "rollover provision"). Section 1039 is analogous to the capital gains deferral accorded homeowners by Section 1034. The congressional purposes for enacting Section 1039 were: (1) to help prevent housing deterioration by promoting tenant ownership, and (2) to keep capital invested in federally subsidized housing. To date the Section 1039 provision has not been utilized, probably because in the short period since the Tax Reform Act of 1969 the optimum time at which to dispose of a subsidized project has not yet been reached.

Impact of Tax Reform Act of 1969

A recent analysis of the effect of the Tax Reform Act of 1969 on housing production found that the act has diverted substantial resources from nonresidential to residential structures. The diversion for 1972 is roughly estimated at $1.2 billion, which is the equivalent of 80,000 rental housing units at an average cost of $15,000 per unit (or 60,000 units at an average cost of $20,000 per unit).[6] The study also found that the act may also have diverted considerable capital expenditures from producers' durable equipment, which was made vulnerable by the repeal of the investment credit in the 1969 act. The credit was reinstituted in late 1971, but it is roughly estimated that the result of this phase of the 1969 tax reform legislation was to release some $2.75 billion of investment funds from producers' durable equipment, making it available directly or indirectly to the rental housing field. This would be equivalent to 183,333 rental housing units at $15,000 per unit or 137,000 units at $20,000 per unit.

Five major arguments have been made in support of the tax incentive system established by the 1969 act: First, that it has successfully attracted capital into conventional residential rental housing and, in unprecedented amounts, into subsidized housing investments. Second, that it provides an incentive without direct Federal expenditure; while costs in forgone revenue represent "back door" expenditures and thus may be undesirable from a management standpoint, it is still substantially less difficult politically to provide funds for a particular activity through tax incentives than with appropriated funds requiring periodic congressional approval. Third, that the forgone revenue costs of subsidizing housing for low and moderate income families represent only a small percentage of the total benefit provided. (Moreover, the total forgone revenue costs of providing accelerated depreciation for all rental housing represent less than one-tenth of the forgone revenue costs of supporting homeownership through interest and property tax deductions.) Fourth, that unless all tax sheltered investments are eliminated or substantially curtailed, removal of the current incentives

[6] "Rationale of the Present Tax Benefits for Homeowners," op. cit.

for rental housing might, in the long run, result in only a minimal tax revenue gain. Fifth, that residential rental investment has traditionally been considered exceptionally risky. Some additional incentive is therefore required.

Critics of the present tax incentive system for rental housing raise the following points in opposition. First, since the current tax incentives available for real estate investment are provided in the form of artificial tax losses, the higher the tax bracket of an investor the greater the benefit derived from such losses. Investors in lower tax brackets (those with a marginal aggregate Federal, State, and local tax rate of less than 50 percent), therefore, generally find tax shelter investments unattractive. Second, since the tax benefits available in a project of a given size do not vary with the risks involved, investors will pay less for a high risk than a low risk project. Therefore, the current system encourages sponsors to avoid high risk areas most in need of housing. Third, since sponsors of low and moderate income housing cannot in most circumstances utilize the tax "loss" generated by a project, they must syndicate the project. Syndication involves significant "middle man" costs that reduce the net amount realized by the sponsor. If the sponsor received a direct payment equal to the net amount realized, a substantial amount of the benefit would be saved. Fourth, the present system may have a negative effect on project maintenance and longevity. Fifth, capital is diverted from investment in more productive sectors than housing because of the existence of the tax shelters.

Tax Loss and Subsidized Housing

Tax benefits represent only one of a number of inducements for investors in conventional housing projects. Cash distributions from rents constitute the principal inducement for such investors; tax shelters and capital appreciations on sales are viewed as lesser considerations. The tax benefits available in subsidized housing projects, however, are considered to be the prime if not the only inducement.

The more advantageous financing and recapture rules available to investors in subsidized housing add further importance to the tax factor in this case. For example, in a Section 236 project, a 90 percent loan (which is not available in conventional projects) provides greater financing leverage and, consequently, a greater ratio of depreciation dollar losses to equity invested. Moreover, a 40-year repayment period (instead of the conventional 20–25 year period) results in greater interest and smaller principal payments in the early years of the mortgage. This is also advantageous for investors seeking tax shelter. In addition, other profit opportunities available in conventional projects are limited in subsidized projects and as a result they generally are not anticipated by the investor. For example, cash distributions in a Section 236 project are limited to 6 percent of the initial stated equity. Experience with the Section 236 program to date, however, indicates that few, if any, projects have had any funds available for distribution to investors. (It should be noted, however, that if 6 percent cash distributions are made, an investor's rate of return will improve significantly.)

The investor in residential real estate is able to take tax losses both during the construction period and the period of rental operations. Certain expenses incurred during the construction period, such as interest and property taxes, can be taken as immediate deductions rather than capitalized and included in the project cost to be depreciated. Because project income typically is not generated during the construction period, all the deductions can be used to offset income from other sources. During the time a project is rented, the major tax benefit available is the depreciation action. Generally, the more rapid the method of depreciation permitted, the greater the tax loss—and thus the shelter advantage—provided.

In most cases, residential rental property purchased as a tax shelter is owned by a limited partnership because that form of ownership, unlike a corporation, permits tax losses (including those derived from construction deductions and depreciation) to be passed through to the individual partner/taxpayer who, as a limited partner, enjoys limited liability. In such cases, the taxpayer's basis in the project—which generally is equal to his capital contribution plus his proportionate share of the project debt—is reduced dollar-for-dollar by the tax losses taken.

Tax-Exempt Financing of Housing

Another significant Federal intervention is tax-exempt financing of housing. Federal tax law, based on the long established doctrine of intergovernmental tax immunity, provides in Section 103 of the Internal Revenue Code that interest on State and local obligations be exempt from taxation. In addition, the United States Housing Act of 1937 provides that local housing authority bonds issued to finance public housing are exempt from Federal taxation. The 1937 act also provides that obligations of the local authorities will be secured by the full faith and credit of the United States through the pledge of the Federal Government to the payment of annual contribution contracts, which assure the low rent character of public housing projects.

The Federal tax exemption of interest income from local agency bonds and other obligations was one of the factors making it easier to use private funds, instead of public funds, in financing local public housing projects. This financing device was of historic importance to public housing and was enormously significant in the whole field of municipal and local agency financing. One effect of the tax-exempt status of interest on public housing bonds is that investors accept a lower interest rate than they would on taxable bonds or conventional mortgages. The lower tax-exempt rates have in turn kept down the direct cost of public housing by, in effect, causing the Federal Government to supplement the annual contribution for debt service with a tax exemption in the form of forgone revenue.

Public housing authorities and State housing finance agencies are the major issuers of tax-exempt debt for housing purposes.

At the end of 1972, $11.2 billion of federally guaranteed, tax-exempt, local housing authority securities ($7.3 billion in bonds and $3.9 billion in notes) were outstanding; that amount is 6 percent of the total outstanding municipal debt (including obligations issued by States, local governments, and special purpose districts). In 1972, $958.9 million worth of bonds were issued; to date, in 1973, $563.8 million worth of bonds have been issued. Total mortgage financing on residential structures in recent years has fluctuated between $44 billion and $90 billion annually.

The benefit of financing public housing through tax-exempt bonds guaranteed by the Federal Government has been to provide the lowest possible interest rate on 40-year bonds, and thereby a lower annual direct Federal subsidy payment to local housing authorities. Such financing on bonds issued in 1972 reduced the 40-year budgetary cost of providing housing for low income households by an estimated $622.4 million (nondiscounted).

On the other hand, there is a substantial tax revenue loss to the Federal Government because of the tax-exempt status of public housing financing. The 40-year (nondiscounted) loss for 1972 bond issuances was estimated at $836.0 million, which exceeds by $213.6 million the interest cost (and subsidy) saving resulting from the tax exemption. Thus, if the financing of public housing were made taxable, the subsidy budget for public housing programs would have to be increased by the amount of the increased interest cost on taxable financing. But the overall net cost to the Government would be reduced due to the increased tax revenue gained by the elimination of tax-exempt financing.

The financing of public housing takes two forms. The first involves tax-exempt obligations of the local housing authority secured by the pledge of the Federal Government to pay the full cost of amortization, as in the conventional or turnkey programs where the housing authority is the developer or purchaser of the project. These are the only bonds in the market that are both federally guaranteed and tax-exempt. The second form involves private construction financing and permanent mortgage financing secured on the basis of a leasing commitment by a local housing authority to a developer under the Section 23 leasing program authorized by the 1965 Housing Act.

In 1969 and 1970, developers were unable to propose feasible projects for the leasing program because of high interest costs. Many turned to tax-exempt bond financing, either through the sale of the project to a nonprofit corporation qualified to issue tax-exempt bonds under Section 103 of the Internal Revenue Code, or through the sale of their mortgage on the project to the local housing authority that used its revenue bonding authority (as distinguished from its public housing bond authority)

to finance the purchase of the developer's mortgage. The authority's revenue bond and the mortgage carried virtually the same interest rates. In this way the project was financed at a lower interest rate and carried lower rents than would have been required under a conventional mortgage.

There are, however, some inherent limitations in the tax-exempt financing of leased housing projects. Where the nonprofit owner issues tax-exempt bonds, he usually must amortize the full cost of the project within the term of the 20-year lease because lenders are unwilling to extend credit beyond one period of the lease term and—at the expiration of the lease term—deed over the project to the local housing authority because of tax regulation requirements. In order for the bonds to be marketable, the nonprofit owner must receive a pledge from the local housing authority to turn over payments received under the authority's subsidy contract with the Federal Government in amounts sufficient to cover the debt service on the bonds. The result of this pledge is an indirect guarantee by the Federal Government of the payment on the nonprofit corporation's bond. In addition, the local housing authority usually assumes full project ownership responsibilities because it will ultimately take title to the project.

Thus, the Federal Government, as the indirect guarantor of the payment of the bonds, and the local housing authority, as the ultimate owner of the leased project, have assumed virtually the same risks as in conventional public housing projects.

As of June 30, 1973, approximately $250 million of leased housing had been financed by the issuance of tax-exempt bonds. Of this amount, $225 million was raised through tax-exempt bonds issued by nonprofit project owners, and approximately $25 million through tax-exempt revenue bonds issued by local housing authorities to purchase mortgages on the projects.

Administration Tax Reform Proposals

In April 1973, President Nixon presented to Congress a number of proposals for tax change directed toward three basic goals: Tax equity, simplification, and economic growth. Several of these proposals would modify the present nature of the Federal Government's intervention in housing through its tax policies. Two of these proposals are of substantial importance to real estate investment, and two others would be of significance to the housing field.

Minimum Taxable Income: The Minimum Taxable Income Proposal would replace the current minimum tax for individuals with a new provision that would prevent the combination of certain exclusions and deductions permitted under the Internal Revenue Code from offsetting more than half of a taxpayer's income; it would thus require every individual at least to pay a tax on that balance. As a consequence, recipients of disproportionately large tax preferences would be taxed more heavily than under the present minimum tax provisions.

The exclusions involved are those for (1) one-half of long-term capital gains, (2) the bargain element of a stock option at the time of exercise, (3) percentage depletion in excess of adjusted basis, and (4) income earned abroad and presently excluded under Section 911 of the Internal Revenue Code. Unlike the present minimum tax, the proposal would not include accelerated depreciation on real property as a preference (or "addback") item.

In applying the provisions, the specified exclusions would be added back to the taxpayer's adjusted gross income. From that sum would be subtracted the personal exemptions, plus $10,000 (an exemption to render the provisions inapplicable to low and middle income individuals). The resulting amount would be divided by two to arrive at the minimum taxable income on which the tax would be computed at the regular rates.

Artificial Loss Limitations: The Limitation of Artificial Accounting Loss proposal is designed to correct some of the inequities associated with tax shelter investments. It is not limited to real estate tax shelters but, rather, applies with some variation to all types of tax shelters such as oil and gas, cattle breeding, etc.

The proposal would permit "artificial accounting losses" to be offset only against "related income." With respect to real estate,

artificial accounting losses would include all deductible construction-period expenses, as well as the excess of accelerated over straight-line depreciation.

"Related income" to residential real estate would include rental income from all rental properties owned by the investor, not just the rental income from the project that generates the artificial accounting losses, as is the case with nonresidential property. Any nondeductible artificial accounting losses will not be lost, merely deferred until such time as the investor has sufficient related income against which such losses can be offset. The proposal as drafted does not apply specifically to subsidized housing, although it is the Treasury Department's intention that such housing will be covered. The proposal does apply, however, to rapid amortization available under Section 167(k) of the Internal Revenue Code, which is used almost exclusively in connection with a Federal, State, or local housing assistance program.

If the proposal is implemented in its present form, the following results are likely: First, rents in projects developed in strong market areas would tend to be somewhat higher than they might otherwise have been; second, the trend toward "retailing"—as condominiums—that otherwise would have been rental accommodations would be heightened; third, some "mix and match" syndications (combinations of projects that generate a significant cash flow with others—such as subsidized projects—that provide a basis for artificial accounting losses) would be developed. Existing high cash-flow projects, on which most accelerated depreciation has been used, would tend to become more popular, thus exerting upward pressure on the sales price of such developments.

Tax Credit for the Elderly: A third administration proposal, a Property Tax Credit for the Elderly, would allow low and middle income homeowners and renters, 65 or older, a credit against their Federal income taxes where payments of residential real property taxes (or that portion of rent deemed to constitute real property taxes) are excessive in relation to their incomes.

Those eligible could take a credit for the amount of "qualifying real property taxes" in excess of 5 percent of "household income," subject to the limitation that the total credit could not exceed $500. (Household income would be equal to adjusted gross income, plus unemployment benefit payments, old age or survivors benefit payments under the Social Security Act or the Railroad Retirement Act, and tax-exempt interest on governmental obligations.) Qualifying real property taxes, however, would not include real property taxes paid on property for which the taxpayer is receiving a financial subsidy or other benefit under a Federal, State, or local housing program; therefore the beneficiaries of assistance payments under the Section 235 Homeownership Assistance Program would be unable to utilize the Property Tax Credit for the Elderly.

Elderly persons who rent their homes or apartments also would be allowed a credit for "rent constituting real property taxes" in excess of 5 percent of household income, subject to a maximum credit of $500.

In general, married individuals could claim only the credit if they filed joint returns. Welfare recipients, moreover, would not be eligible for the credit.

This proposal is significant for two reasons: First, it provides direct—although not equal—tax relief to both elderly homeowners and renters, in contrast with present law, which benefits only homeowners; second, the credit provided would be refundable even if a taxpayer's credit exceeded his total tax liability. The Treasury Department estimates that the proposed credit would result in lost revenues of approximately $500 million a year.

Taxable Municipal Bond Act: Another proposal presented by the administration, the Taxable Municipal Bond Act of 1973, is intended to apply to public housing bonds. However, certain administrative and policy matters relating to the application of the proposal to these bonds must be resolved because of the unique nature of the Federal Government's involvement in such obligations.

Under this proposal, the issuer of a qualifying State or local obligation could elect to make its obligations either taxable or tax-exempt. When the issuer chooses to make the obligation taxable, a Federal subsidy would be paid equal to 30 percent of the issuer's annual net

interest expense, minus the administrative costs to the Treasury Department. Once the choice is made, it is irrevocable. The issuer's allowable expense does not include administrative costs.

Generally, all tax-exempt obligations are eligible for subsidy except in cases where (1) the interest expense is unreasonably high, (2) the obligation matures in less than 1 year, and (3) "it is held by a Congressionally established entity, owned in whole or in part by the United States, or by a unit which is an issuer of obligations to which Section 103(a)(1) applies."

Should the proposal be extended to public housing bonds, it is not clear—because of the uncertainty about the maturity and terms that would be utilized if the proposed option were available—whether it would result in actual savings to the Federal Government. According to the Treasury Department, however, the proposal would be advantageous to an issuer offering maturities beyond 20 years. On such maturities, the spread between the taxable and tax-exempt interest rates is less than 30 percent, so the 30 percent subsidy would result in a savings for the issuer.

Welfare Assistance Payments

Through its welfare programs the Federal Government makes a massive, although indirect, contribution in determining the housing conditions of millions of poor Americans.

The scope of this indirect intervention in the housing market can only be measured approximately. Estimates by the Department of Health, Education, and Welfare suggest, however, that of the total welfare expenditures in 1972 by State and Federal Governments, approximately $4.6 billion was used by welfare families for housing. By making further assumptions, it was estimated that of the $4.6 billion provided to the States by the Federal Government, $2.6 billion was used for housing. This highly approximate figure compares with the $2.5 billion the Federal Government allotted in the same year to carry out all of its direct housing subsidy programs. Federal welfare assistance, however, is not tied to housing. Federal matching grants are made to State governments to make cash payments to four classifications of low income people: The elderly, households with dependent children, the blind, and the disabled The preceding estimates are based on a review of the two major assistance programs: Aid to Families with Dependent Children, and Old Age Assistance.

It is difficult, for several reasons, to measure precisely how much support for housing the Federal Government is providing through welfare assistance expenditures. One reason is that the proportion of its cash assistance that a welfare family allocates to housing is based largely on its circumstances and priorities, which may bear little relationship to the level prescribed or assumed by the welfare agency. Even where benefits are earmarked for housing, the family may substitute those benefits for income from other sources without changing its total consumption of housing. Another reason is the diversity among the welfare systems of the various States.

In determining a "household needs" budget in setting welfare assistance levels, a housing cost component is established by the individual States and revised periodically. The extent to which full housing costs are included and earmarked in its welfare payment, if at all, varies widely among States. Some States pay rents up to some ceiling on an "as incurred" basis. Others determine the rent support level on the basis of prevailing rents in a given area. A growing number of States calculate family needs on an overall basis and provide assistance on a "flat grant" basis.

As shown in Table 3, total monthly welfare allotments vary widely within the States. Under the Aid to Families with Dependent Children program, the highest monthly rental allotment in 1972 was the $162 granted in the State of Connecticut. Only 15 States permitted payments of $100 or more. Thirteen States, plus Puerto Rico, the Virgin Islands, and Guam, had set a maximum level for housing support at $50 or below.

Table 3 also shows the amounts the States allotted for rental payments in 1972. There are limitations, however, on the thoroughness of the data contained in the table. Some States, for example, reported the maximum amount allowed for shelter, not what was actually paid out. In the absence of a maximum level, the

federally financed and supported projects must be at least equal to those prevailing in a given jurisdiction. The determination of what constitutes "prevailing" wages is made by the Secretary of Labor. By regulation, his determination is based on wage rates paid to the majority of workers in a given classification in a particular area. If a majority of workers are not paid the same rate, the prevailing rate is that paid to a plurality of workers, provided that they constitute at least 30 percent of those employed. In the event that fewer than 30 percent receive the same rate, the average rate is arrived at by adding the hourly rates paid to all workers in a classification and dividing by the total number of such workers.

Equal Housing Opportunity Policy

Over the past decade, the Federal Government has moved through legislative, judicial, and executive action toward eliminating racial discrimination in the sale or rental of housing to minority groups, adding a further social objective to housing programs that had been based largely on economic considerations.

Historically, the Federal Government's role in prohibiting discrimination dates back to the Civil Rights Act of 1866, which made purchasing, leasing, inheriting, selling, or owning property a right of every citizen. This broad objective, however, was undermined by various discriminatory practices that began developing during the Reconstruction Period (1865–1877), such as restrictive covenants on land use. These practices became so institutionalized during the ensuing three-quarters of a century that the Federal Government in its early housing programs was often found to be perpetuating discrimination by developing projects that were racially segregated.

The first significant reversal of this pattern came in 1948 when the Supreme Court held that racially restrictive covenants were unconstitutional.[7] Then, in 1962, President Kennedy, in Executive Order 11063, ordered that the Federal Government:

> . . . take all action necessary and appropriate to prevent discrimination because of race, color, creed or national origin in the sale, leasing rental or other disposition of residential property and related facilities . . .

That policy was furthered with the passage of the Civil Rights Act of 1964, Title VI, which prohibits discrimination in any federally assisted program.[8]

The landmark legislation on fair housing for all Americans came in 1968, when Congress went beyond federally assisted housing to outlaw discrimination in the private housing market. Title VIII of the Civil Rights Act of 1968—the so-called "fair housing" provision—bans discrimination in the sale, rental, and financing of the vast majority of housing units in the United States. The provision prohibits discrimination in all multifamily housing except one- to four-family dwellings in which the owner occupies a unit and all single-family homes except where the house is sold or rented by the owner-occupant without the use of a real estate broker, provided the house is not advertised in a discriminatory manner.

The provisions of Title VIII allow a person who believes he has been a victim of discrimination to file a complaint with the Secretary of HUD or with comparable State enforcement mechanisms where they exist. The Secretary is charged with the responsibility of investigating and resolving any substantial complaint by eliminating the discriminatory practices through conference, conciliation, and persuasion. If he cannot do so, the complainant may file suit in Federal (or in some cases, State) court.

Alternatively, a person who believes that he has been discriminated against may file a civil action directly in Federal court. The Attorney General also may file a suit in Federal court if he has reason to believe that there is a pattern or practice of discrimination or that a group of people has been denied its Title VIII rights.

Some two months after enactment of the 1968 act, the Supreme Court, citing as precedent the 1866 act, barred racial discrimination in the sale and rental of all property.[9] Thus, a person who believes that he has been racially discriminated against in a sale or rental trans-

[7] *Shelley* v. *Kramer,* 334 U.S. 1 (1948).

[8] Executive Order 11063 covered federally subsidized or insured housing. The 1964 Civil Rights Act superseded that policy to some extent but did not abrogate Executive Order 11063, which dealt with some matters not covered by the 1964 act. Federally insured housing, for example, was specifically excluded from the act.

[9] *Jones* v. *Mayer Co.,* 392 U.S. 409 (1968).

action involving any type of housing may file suit in a Federal Court without regard to the limitations of Title VIII of the 1968 act.

More than 1,330 complaints have been filed under Title VI of the 1964 act and more than 7,300 under Title VIII of the 1968 act. In the last year, the number of complaints has greatly increased as a result of a Government campaign to increase public awareness of Title VIII provisions.

The Department of Justice filed 135 Title VIII suits between January 1969 and June 1973. During the same period, HUD has referred 110 individual Title VIII complaints to the Justice Department with the recommendation that appropriate legal action be taken. Of these, the Justice Department has instituted at least 20 suits, one of which covered 15 individual complaints, and a second five such complaints.

During this same time period, HUD conciliated 1,218 Title VIII complaints. It is anticipated that the number of cases in which conciliation will be attempted will rise considerably due to: (1) the use of accelerated processing by which complaints involving multifamily units of 25 or fewer can be completely investigated and conciliated within two days; (2) greater expertise and number of HUD staff; and (3) other improved management practices.

Affirmative Action and Project Site Selection Criteria

The 1968 Civil Rights Act, Title VIII, provided that all executive departments and agencies were required to administer their programs and activities relating to housing in an "affirmative" manner so as to advance the objective of this title. This affirmative action requirement reinforced the provisions of Title VI of the 1964 Civil Rights Act prohibiting discriminatory actions by the Federal Government.

As a result of the *Shannon* v. *HUD* court decision in 1970,[10] HUD in 1972 established criteria aimed at providing minorities with housing opportunities in a wide range of locations in order to contribute to decreasing the effects of past housing discrimination.

The impact of these actions was felt by sponsors of projects who could be disqualified from Federal aid if the project was planned for areas of racial concentration. Through HUD's site selection rating system—"poor" to "superior"—priority was given to housing for minorities outside existing areas of racial concentration.

Further implementation of affirmative action objectives came with the establishment of fair housing marketing regulations by HUD in 1972. Under these regulations, a developer was required to market his project in such a manner that it would reach all racial and ethnic groups in the housing market area or face the loss of Federal support.

The new regulations require that the staff involved in the rental or sales of such projects be hired on a nondiscriminatory basis; that fair housing posters be prominently displayed on the site and in the rental and sales office; and that printed material and advertising must carry the Equal Housing Opportunity logotype. Finally, each of these actions must be described in an affirmative marketing plan submitted by the proposing developer at the time of his application for insurance or subsidy.

Environmental Policy

In response to the environmental movement of the 1960's, environmental concerns have become an important new factor in Federal housing policies and programs. The Environmental Protection Agency, created in 1970, is the Federal regulatory agency charged with the enforcement of provisions of statutes—such as the Clean Air Act Amendments of 1970 and the Federal Water Pollution Control Act of 1972—designed to abate and control pollution.

Within its jurisdiction fall control of water pollution, solid wastes, noise, and air quality. Its activities in these fields can have an immense impact on the supply, character, and location of housing, simply because the Agency influences the timing, character, and funding of key municipal facilities required to support housing. In its regulation of regional air, water, and solid waste pollution, the Agency requires that States as-

[10] *Shannon et al* v. *United States Department of Housing and Urban Development*, 436 Fed. 2d 809 (1970). In this decision the court ordered HUD to adopt "some institutionalized method whereby, on considering site selection or type selection (of housing), it has before it the relevant racial and socioeconomic information necessary for compliance with its duties under the 1964 and 1968 Civil Rights Acts."

sume increasing responsibility in the broad area of land use decisions, and thereby the location of housing. In addition, legislation now pending in Congress would further define the Federal, State, and local roles in other environmental areas—such as energy and land use development—that impact directly or indirectly upon housing.

In addition, The National Environmental Policy Act of 1969 requires all Federal agencies to review and evaluate the impact of their policies and programs on the environment. As interpreted, its impact on social and economic environments, as well as on the strictly physical environment, must be considered in governmental decisionmaking.

Clearly, environmental policies will have a major impact upon the location, design, availability, and probably the cost of future housing.

Section 102(2)(C) of the act defines the requirement for environmental impact statements. Every instrumentality of the Federal Government is required to:

> . . . include in every recommendation or report on proposals for legislation and other major Federal actions significantly affecting the quality of the human environment, a detailed statement by the responsible official on—(i.) the environmental impact of the proposed action, (ii.) any adverse environmental effects which cannot be avoided should the proposal be implemented, (iii.) alternatives to the proposed action, (iv.) the relationship between local short-term uses of man's environment and the maintenance and enhancement of long-term productivity, and (v.) any irreversible and irretrievable commitments of resources which would be involved in the proposed action, should it be implemented.

In response to the act, HUD's administrative guidelines now require that all federally assisted housing by the Department be subject to five types of environmental reviews:

First, HUD has established two levels of environmental clearance for environmental impact statements. (A) "Normal" clearance must be applied to every project application for insurance or subsidy assistance. This clearance is an assessment of site characteristics, environmental consequences of the proposed development, and a consideration of alternatives with superior environmental consequences. Field checks of sites and surroundings are required, as well as solicitation of comments from local planning agencies, and evidence of local government approval. (B) "Special" environmental clearance is required for all subdivisions of 50 or more lots and for all multifamily projects of 100 or more units, and for projects that are controversial.

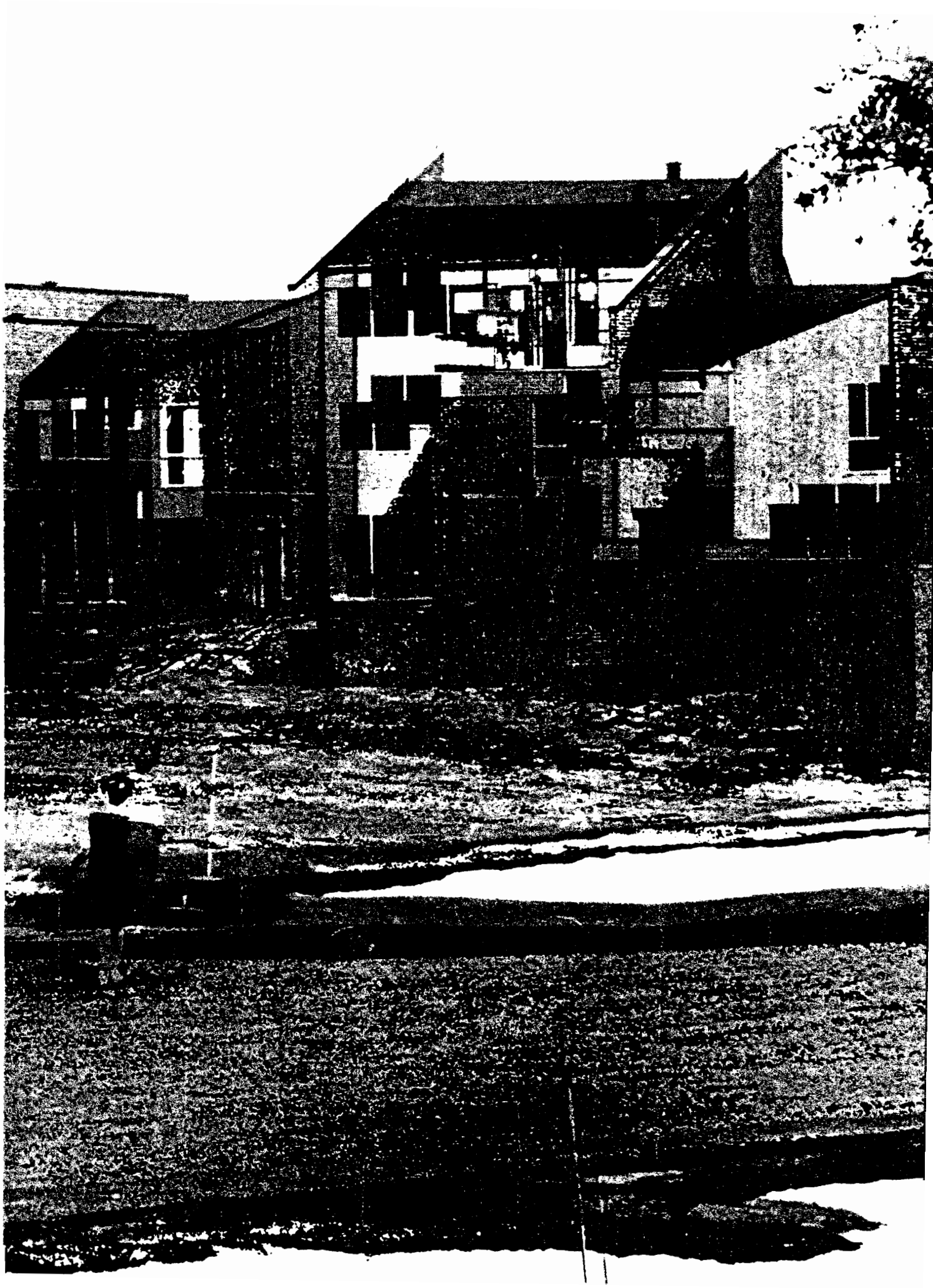
Second, in February 1972, HUD issued project selection criteria applying to all proposals for subsidized housing. Environmental considerations were included among the criteria to assure that site locations and site treatment would be appropriate, and adverse environmental impacts of the projects would be avoided. In December 1972, an evaluation of the first several months of performance was published. Data were furnished on environmental matters for 3,001 project proposals. Of these proposals, 972—32 percent—received an adequate rating; only 83 proposals—2 percent—received a poor rating. Of these 83, 37 were deemed to be subject to seriously adverse environmental conditions.

Third, on September 1, 1972, noise control standards were issued by HUD. They provide measures for estimating the impact of noise on housing sites and include techniques of measurement. Projects not meeting the noise standards cannot be assisted.

Fourth, HUD currently has in review a major revision of the Minimum Property Standards to govern the planning and construction of all HUD-insured and subsidized housing. These proposed new Minimum Property Standards will incorporate environmental quality considerations.

Fifth, citizens can challenge through court action HUD decisions related to environmental policy matters.

The Veterans Administration and the Farmers Home Administration—the other Federal agencies significantly involved in housing—are in the process of preparing administrative guidelines implementing the 1969 act.



3 Housing Finance

Introduction

This chapter offers an overview of the housing finance market. Its intent is to present the basic determinants of the demand for, and supply of, housing credit and to show how financial intermediaries direct the flow of funds from individual savers to the purchasers of housing. The activities of the Government in the housing finance market are described and related to these determinants.

A general survey of the housing finance market reveals the following significant characteristics and trends.

- The housing finance market is one of the largest users of borrowed funds in the Nation.
- Financial institutions that obtain loanable funds from savings deposits have been the major source of residential credit over the past generation.
- The supply of residential mortgage funds has been subject to significant fluctuation over the years.
- Government-sponsored second-layer lenders have constituted a significant source of housing credit during several recent periods of credit stringency.
- An increase in the liquidity and marketability of mortgages in recent years appears to have affected their yields and investment characteristics.
- The demand for credit to finance multifamily units has risen sharply over the past five years.

Two areas of particular interest covered in this chapter concern the efforts of Government and Government-sponsored agencies to moderate shortrun fluctuations in the supply of mortgage credit and to affect the longrun values of the mortgage interest rate and the quantity of mortgage credit outstanding. In this regard there is an important distinction to be made between shortrun fluctuations and the longrun values of mortgage market variables. It will be argued in this chapter that the activities of Government-sponsored agencies can have significant shortrun impacts on the mortgage market and residential construction activity while having somewhat less effect on the longrun values of the mortgage rate, mortgage stock, and housing stock.

Monetary phenomena play a particularly important role in the market for housing finance. Different opinions exist as to whether monetary forces significantly affect total consumption or investment, and individuals differ in their views concerning the efficacy of monetary policy as opposed to fiscal policy. There is, however, a consensus that monetary forces have a powerful and pervasive effect on residential construction activity through the markets for savings deposits, mortgages, and residential construction. This monetary impact operates through both the cost-of-capital (interest-rate) and credit rationing (availability-of-credit) channels, where the credit rationing effect is particularly important.

Credit rationing by mortgage-lending institutions is often observed when stringent credit conditions lead to a reduction in the volume of mortgage lending. Under such conditions the mortgage rate rises—but generally not fast enough to provide quickly a market-clearing price. In other words, the mortgage market becomes supply-constrained, and there is a shortage of credit because the quantity demanded exceeds the quantity supplied at the prevailing mortgage rate. It is during these periods of credit rationing that Government-sponsored credit agencies have their largest impact as they act to increase the supply of mortgage credit and reduce the degree of credit rationing.

In the longer run, the efforts of the Government-sponsored credit agencies to increase mortgage flows and lower mortgage interest rates are likely to be somewhat less effective. As the actions of these institutions begin to lower mortgage interest rates, private investors—finding that mortgages are becoming less desirable investments—may shift their funds to nonmortgage securities. Hence, any increase in the mortgage credit flow from Government-sponsored institutions may to some degree be offset by reductions in private lending.

When longrun mortgage credit flows are increased by Government policies, housing investments will, of course, be easier to finance and the quantity of housing purchased will rise. The increase in housing investments, however, is likely to be somewhat smaller than the

increase in mortgage credit flows, because potential owners will also find it easier to carry a higher loan-to-value ratio. In effect, some of the increased mortgage borrowing, using the home as collateral, allows the buyer to use less of his total assets for a downpayment and gives him more freedom to buy other things. It may also lessen the need for nonmortgage borrowing to finance purchase of consumer goods and other assets. For example, individuals often refinance their homes to provide resources to buy a college education for their children or to meet other nonhousing needs.

Government actions have had some lasting effects where they have changed the characteristics of the mortgage investment or the nature of the marketplace. Specifically, Government has reduced the risk of investing in mortgages by providing mortgage insurance and pooling risks into mortgage-backed securities. In addition, it has encouraged the development of private secondary markets and facilitated the flow of funds between geographically isolated markets. As Government continues to improve the efficiency of the mortgage market and demonstrates the viability of new innovations, its influence on the mortgage market will be correspondingly reduced.

The improved efficiency of the mortgage market is revealed by the fact that the gross yield advantage of residential mortgage loans over alternative long-term investments—such as corporate bonds—has fallen during the past two decades. The gross yield spread between residential mortgage loans and newly issued corporate bonds fell from an average of more than 150 basis points during the period 1955–1960 to an average of fewer than 50 basis points during the period 1970–1972. In 1970, the conventional mortgage rate was usually below the corporate bond rate on new issues. The gross yield spread between residential mortgage loans and newly issued corporate bonds has been below 100 basis points since 1966, and since 1969 it generally has been fewer than 50 basis points. Therefore, residential mortgage loans have lost much of their gross yield advantage over alternative long-term investments over the past two decades.

The first section of this chapter presents a general overview of the housing finance market. A brief description of the magnitude and composition of the outstanding residential mortgage debt is provided. Then, the housing finance market in the short and long runs is described.

The second part of the chapter presents various mortgage debt instruments that either have been used or proposed for use in housing finance.

The final section of this chapter describes in detail the various agencies and institutions that participate in the housing finance market.

Overview of Housing Finance Market

Since the end of World War II, the housing market has been one of the largest users of borrowed funds in the American economy. Between 1947 and 1971, the total net public and private debt outstanding in the United States rose from $415.7 billion to $1,996.4 billion—an increase of $1,580.7 billion, or 380 percent. During this same period, residential mortgage debt outstanding on nonfarm properties rose from $34.8 billion to $374.6 billion—an increase of $339.8 billion, or 976 percent. By comparison, private corporate debt outstanding increased by 660 percent during this same period as it rose from $108.9 billion to $827.3 billion. Overall, the increase in nonfarm residential mortgage debt accounted for 21 percent of the increase in total outstanding net debt.[1]

Reported mortgage debt outstanding on residential properties at the end of the fourth quarter of 1972 was $383.1 billion. Of this total, $327.9 billion, or 85.6 percent of the total, represented loans held by four types of financial institutions: Commercial banks, life insurance companies, mutual savings banks, and savings and loan associations. Savings and loan associations alone supplied more than 45 percent of this outstanding residential mortgage debt.

Table 1 presents holdings of land, construction, and long-term mortgage loans by type of property, financing, and lender. Charts 1 and 2 utilize data from Table 1 to illustrate the

[1] Council of Economic Advisers, *Economic Report of the President*, Washington, D.C.: Government Printing Office, 1973, pp. 264 and 266.

Table 1. Reported Holdings of Land, Construction, and Long Term Mortgage Loans, by Type of Property, Financing, and Lender, End of Fourth Quarter, 1972

(In Millions of Dollars)

Property Type	Commercial Banks (1)	Mutual Savings Banks (2)	Savings & Loan Associations (3)	Life Insurance Companies (4)	Noninsured Pension Funds (5)	Mortgage Investment Trusts (6)	State & Local Retirement Funds (7)	Federal Credit Agencies (8)	GNMA Pools, FHDA Blocks of Loans (9)	State & Local Credit Agencies (10)	Total for Groups Shown (11)
Construction Loans											
1-4 Family Homes	$4,243	$263	$5,307	$7	$0	$576	$16	$0	$0	$22	$10,433
Multifamily	2,800	585	3,998	38	0	2,809	22	89	0	811	11,152
Nonresidential	5,565	320	1,874	351	1	2,332	0	17	0	1	10,462
Farm Properties	63	*	8	14	0	0	0	0	0	0	85
Total Construction Loans	12,671	1,167	11,187	410	1	5,717	38	106	0	834	32,132
Long-Term Mortgage Loans											
1-4 Family Homes											
FHA Insured	7,236	14,955	13,340	8,391	545	61	1,780	15,477	3,857	374	66,016
VA Guaranteed	3,182	12,772	11,971	4,646	258	130	736	6,182	1,496	35	41,406
Conventional	40,815	19,901	135,489	8,374	263	188	384	3,575	4,801	2,089	215,878
Subtotal	51,233	47,627	160,800	21,411	1,066	378	2,900	25,235	10,154	2,497	323,301
Multifamily											
FHA Insured	379	1,528	680	1,553	183	1	1,695	4,643	151	354	11,167
Conventional	2,176	8,367	17,037	15,147	366	518	535	1,933	130	2,421	48,630
Subtotal	2,555	9,895	17,717	16,700	550	518	2,230	6,576	281	2,775	59,797
Nonresidential	25,362	10,217	14,243	30,657	1,059	1,579	1,011	3,187	98	649	88,063
Farm Properties	4,689	41	548	5,629	24	4	160	9,385	2,483	425	23,387
Total Long Term Mortgage Loans	83,838	67,781	193,308	74,397	2,699	2,480	6,301	44,383	13,015	6,345	494,548
Land Loans	2,577	228	1,745	305	28	1,966	11	*	0	0	6,859
Total Mortgage Loans	99,086	67,176	206,241	75,112	2,728	10,162	6,350	44,489	13,015	7,179	533,539

Note: Sum of components may not equal totals due to rounding.

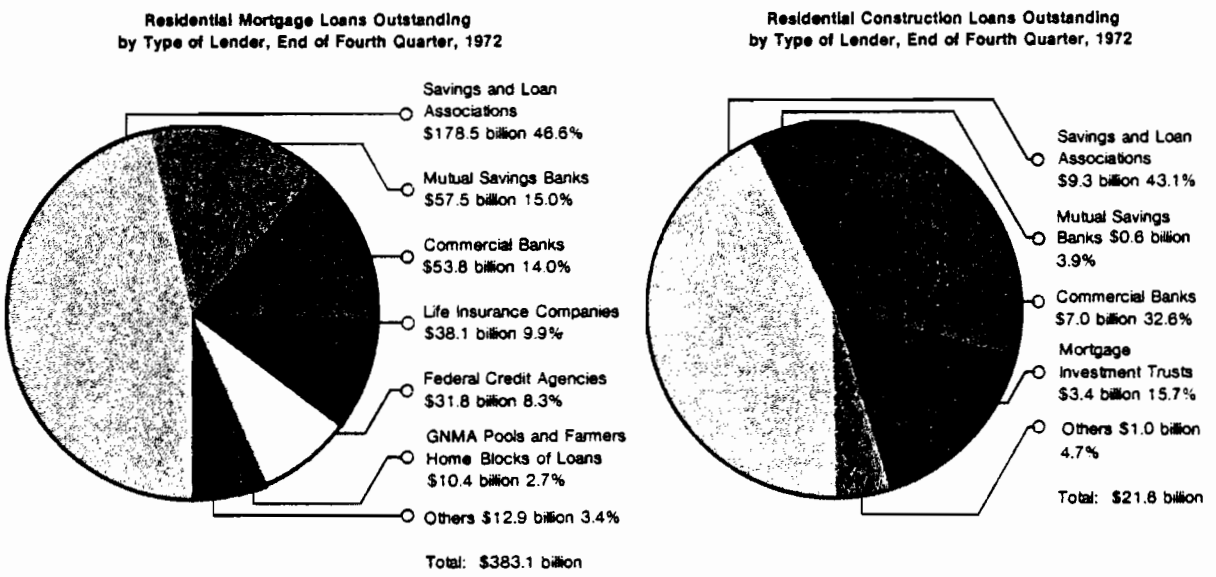
*Means less than $500,000.

Source: Department of Housing and Urban Development, *Survey of Mortgage Lending Activity*.

composition of construction and long-term mortgage loans by type of lender. Although the data on residential loans clearly illustrate that housing in the United States is financed predominantly by funds obtained from four types of private financial institutions, the lending activi-

Chart 1

Reported Holdings of Residential Mortgage and Construction Loans by Type of Lender, End of Fourth Quarter, 1972



Source: Department of Housing and Urban Development, Survey of Mortgage Lending Activity.

ties of these private institutions are supplemented and complemented by several private and public agencies in the field of housing finance.

Shortrun Problems in Housing Finance

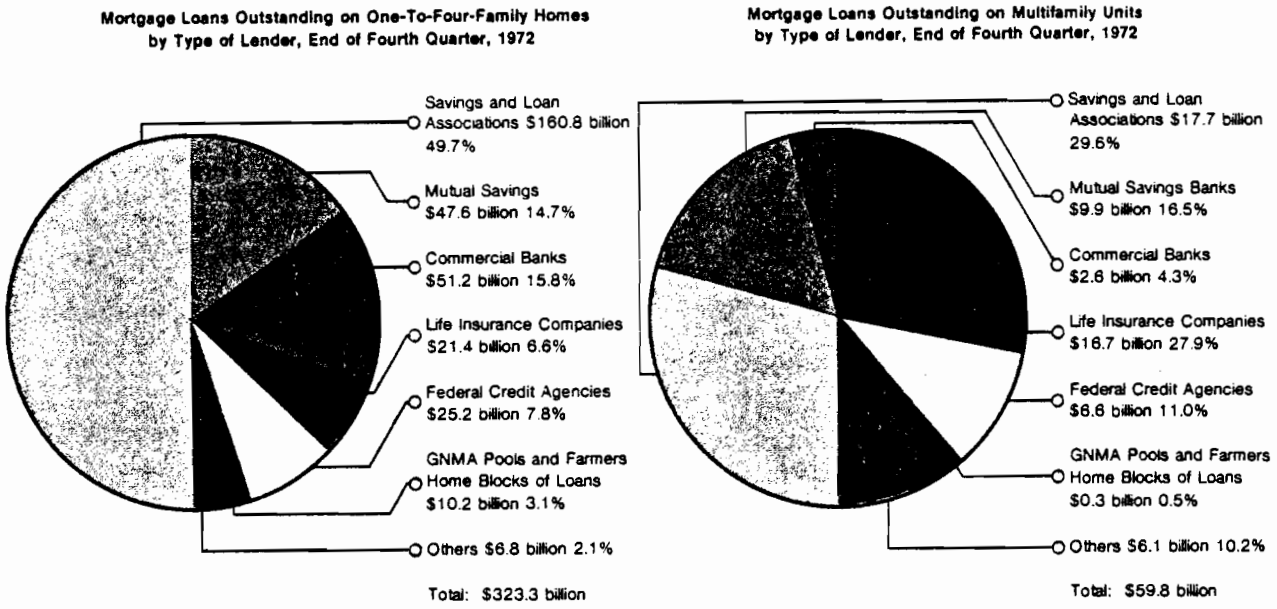
The residential construction industry has earned a reputation as one of the more cyclical sectors of the economy. The cycles tend to be well defined and of considerable magnitude. During the 1960's, there were three major declines in the value of new private housing construction put in place. Between 1959 and 1961, this amount fell 11.2 percent; between 1964 and 1967, the fall was 13.3 percent; and between 1969 and 1970, the fall was 9.4 percent. In all of these periods, the value of total new nonresidential construction continued to rise, revealing the relative instability of residential construction.[2]

There is general agreement that the primary determinant of this cyclical pattern is the supply of mortgage credit. The supply of credit made available to the homebuyer originates from the savings of individuals and corporations and is also partly determined by various governmental policies. These savings are passed from the saver to the homebuyer by a large number of private and government financial intermediaries. The bulk of the funds for residential mortgage credit passes through four types of private financial institutions: Savings and loan associations, mutual savings banks, commercial banks, and life insurance companies. The savings and loan associations and the mutual savings banks are often referred to

[2] Ibid., p. 236. Of course, housing is not the only cyclical industry. For example, the automobile and machine tool industries experience fluctuations that are sometimes even more severe.

Chart 2

Reported Holdings of Residential Mortgage Loans by Type of Property and Lender, End of Fourth Quarter, 1972



Source: Department of Housing and Urban Development, Survey of Mortgage Lending Activity.

collectively as thrift institutions. Thrift institutions and commercial banks are depository institutions that held almost three-fourths of the total residential mortgage debt outstanding in 1972. The fourth major supplier of residential mortgage funds—the life insurance companies—obtains funds from holders of life insurance policies. Therefore, the bulk of the funds for the extension of residential mortgage credit comes from private financial institutions that invest the savings of predominantly low and middle income individuals.

The four major types of mortgage-lending institutions and Real Estate Investment Trusts supply the bulk of short-term funds to the residential construction industry. At the end of 1972, these financial institutions were holding $20.6 billion in construction loans for residential housing units.

Commercial banks and life insurance companies have numerous investment opportunities; they hold mortgages as one of their many assets. These financial institutions select and arrange their portfolios on the basis of the return and risks attached to various assets. Mortgages, therefore, must compete with numerous other assets for a place in lenders' portfolios; the expected return and risk associated with mortgages then are compared with the expected returns and risks associated with competing assets when managers of portfolios make their investment decisions.

Savings and loan associations and mutual savings banks are the most highly specialized private mortgage-lending financial institutions. The high percentage of mortgages in their portfolios is primarily due to their history as specialists in housing finance, to government restrictions on their ability to invest in consumer and most business loans, and to the favorable tax treatment they receive for additions to their bad-debt reserves to back their mortgage holdings. Savings and loan associations typically hold more than 75 percent of their assets in

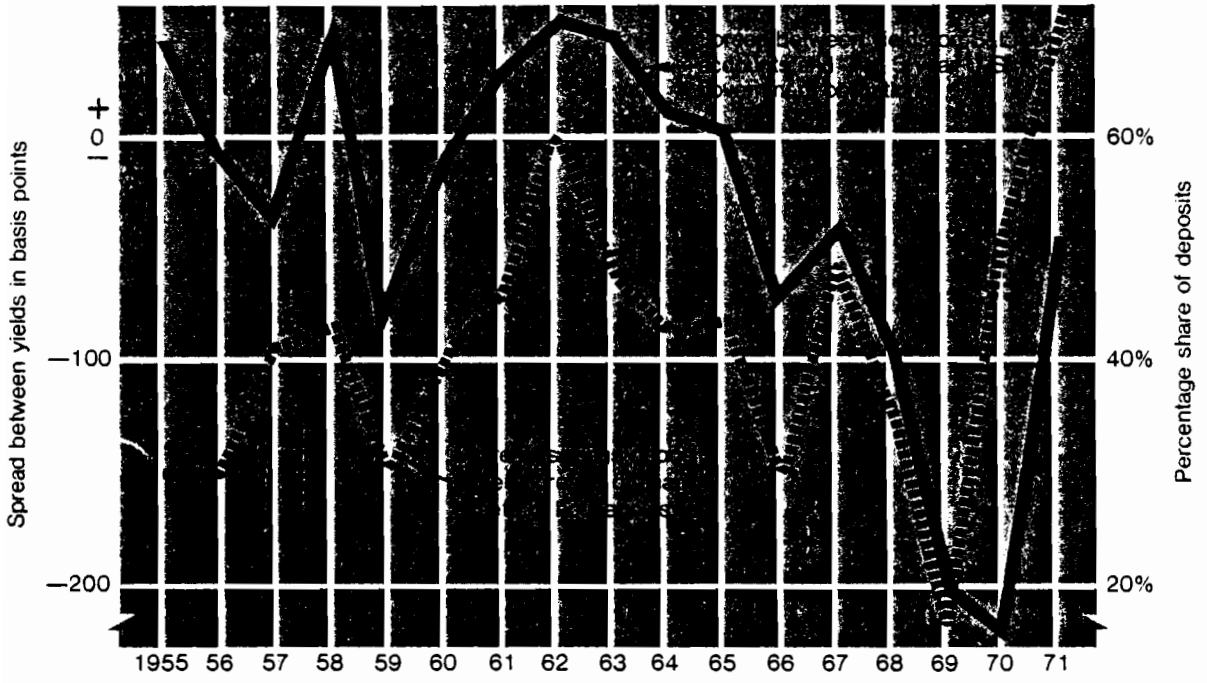
residential mortgages and held 46.4 percent of the outstanding residential mortgage debt in 1972.

Credit-flows into housing tend to vary greatly within the business cycle because of the structure and regulation of the major mortgage-lending institutions. Thrift institutions and commercial banks are hampered in their ability to maintain a steady flow of funds into housing finance because of the deposit interest rate ceilings set by various regulatory agencies. In addition, the asset liability structures of the thrift institutions would tend to reduce their ability to compete effectively for funds when market interest rates rise, even if there were no deposit rate ceilings.

The asset/liability structures of thrift institutions are characterized by long-term assets and short-term liabilities. The assets of thrift institutions consist mostly of mortgages that have an average maturity of 10 years, while their liabilities consist of savings deposits that are, for the most part, payable on demand. The problems created by this method of financial intermediation become particularly acute during periods of rising interest rates. When interest rates rise, thrift institutions must offer higher rates on their deposits to prevent depositors from removing their funds to purchase other higher yielding financial assets. However, the deposit interest rate that a thrift institution can afford to pay is limited by the effective yield of the long-term assets purchased in periods of lower interest

Chart 3

Share of Savings Deposits in Net Increase of Financial Assets of Households and Spread Between Yields on S&L Accounts and 3 to 5 Year U.S. Government Obligations 1955-1971



*Positive spread indicates yield on S&L accounts is above yield on 3 to 5 year U.S. Government obligations.

Source: Department of Housing and Urban Development, National Housing Policy Review, based on data from the Board of Governors of the Federal Reserve System and the Federal Home Loan Bank Board.

rates, which comprise the bulk of their asset portfolios.

As a result of the deposit rate ceilings and the asset/liability maturity dichotomy, the deposits of thrift institutions cannot compete with other financial assets during periods of rising interest rates; hence, thrift institutions tend to lose funds as their depositors take advantage of higher interest rates on other financial assets. This loss of deposits forces thrift institutions to curtail their mortgage lending, and housing production suffers accordingly.

The success of savings and loan institutions in attracting deposits during different time periods can be measured by the extent to which individuals choose to hold net increases in their total stock of financial assets in the form of savings deposits. Chart 3 examines the share of net additions to the financial assets of households that goes into savings deposits and shows that this share varies directly with the difference (spread) between interest on savings deposits and the rate on Government securities. The percentage share of savings deposits in the net additions to the financial assets of households fell dramatically in 1959, 1966, and 1969 as market interest rates rose in relation to the interest rates paid on savings deposits.

Financial intermediaries other than thrift institutions also tend to decrease their volume of mortgage lending during periods of rising interest rates and credit stringency. Mortgage rates tend to respond sluggishly to current financial conditions and rise proportionally less than other interest rates. In many States, the situation is exacerbated by usury laws. As market interest rates rise, lenders tend to decrease their volume of mortgage lending and purchase other financial assets whose yields gain in attractiveness relative to those on mortgages. This is particularly true of life insurance companies and commercial banks, which have a great deal of freedom in choosing the type of financial assets to hold in their portfolios.

In summary, the decline in residential construction activity during periods of rising interest rates is primarily attributable to four factors. First, thrift institutions become trapped by their asset/liability structure and have difficulty in retaining and attracting deposits to provide funds for mortgage lending. Second, ceilings on deposit interest rates prevent them from competing for funds, even in those instances when they could afford to raise rates. Third, other financial institutions decrease their volume of mortgage lending and shift into higher yielding securities as their rates rise relative to the mortgage rate. Fourth, effective State-imposed usury ceilings on mortgage rates intensify the shift away from mortgages and into other financial assets.

Government Programs to Reduce the Shortrun Fluctuations in Housing Finance

Recognizing that periods of rising interest rates and credit stringency have a severe impact on residential housing production, the Government over the years has taken a number of steps to moderate the cyclical fluctuations in mortgage credit availability.

The Government operates or sponsors several institutions and agencies that are essentially financial intermediaries whose purpose is to channel additional funds into housing whenever financial conditions threaten to reduce significantly the volume of mortgage credit.

The Federal Home Loan Bank System was established partly to counter the cyclical variations in housing credit availability. By making advances or short-term loans to member savings and loan associations when deposits were falling, it has had some success in stabilizing credit flows to mortgage markets.

Chart 4 provides some indication of the success of the Federal Home Loan Bank System's attempts to smooth out the supply of funds available to savings and loan associations. During the tight credit conditions of 1969, a significant amount of money was provided during a period in which net-savings inflows fell to virtually nothing. A less serious trough in savings flows also was smoothed out in 1972.

To finance these advances, the Federal Home Loan Bank System must sell its consolidated debentures in the Nation's securities markets. During periods of tight credit, such issues intensify interest rate pressures by competing with other borrowers for credit. However, this is one of the functions of the Federal Home Loan Bank System—to insure that the effects of

tight money are spread to all sectors of the economy and do not fall disproportionately on housing. This, of course, does not mean that the System attempts totally to insulate the housing sector from the need to cut bank spending during inflationary periods. Federal Home Loan Bank System activities, in fact, will not have this effect, because the interest rate charged on advances reflects the cost of funds to the System; during periods of tight money savings and loan borrowing, their lending to homebuyers will be restricted by the higher interest rates.

The Federal National Mortgage Association plays a similar role by purchasing federally underwritten mortgages—and, more recently, conventional mortgages—in order to moderate the decline in housing production that occurs during periods of credit stringency. During the tight credit conditions of 1966, the Federal National Mortgage Association made net purchases of slightly more than $2 billion in mortgages, while during a similar period in 1969 it made net purchases of more than $4 billion.

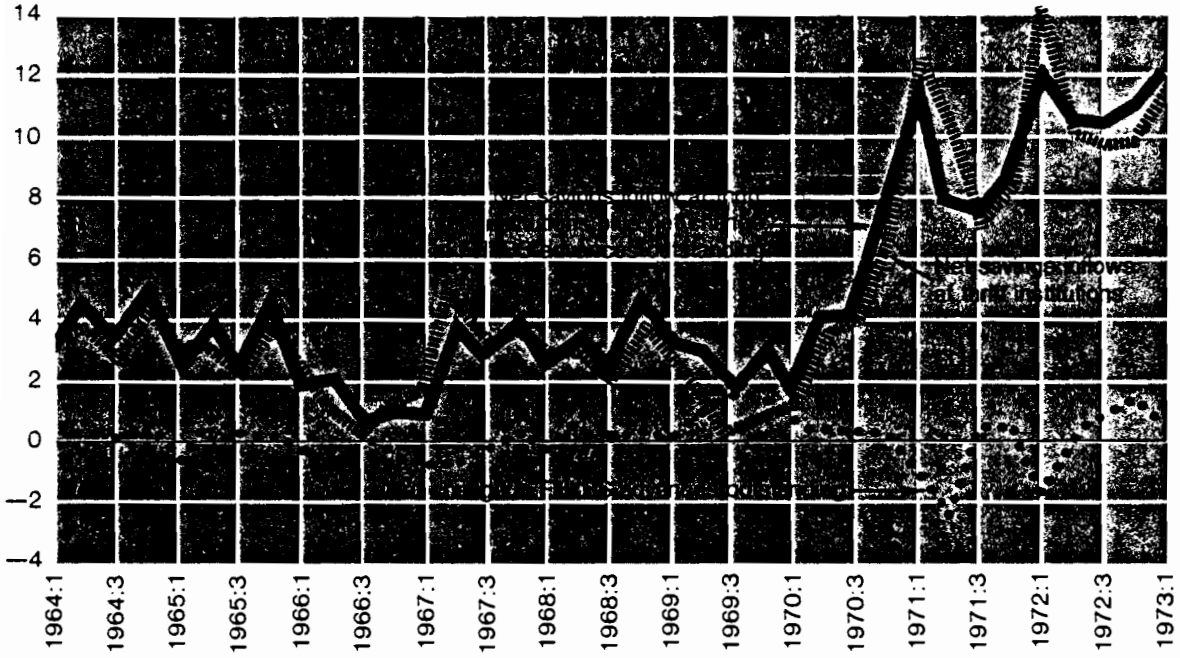
The Federal Home Loan Mortgage Corporation was established in 1970 with the authority to purchase conventional mortgages from savings and loan associations in order to improve the liquidity of their mortgage portfolios. Thus far, its mortgage purchases have been small relative to the size of the market and the level of purchases made by the Federal National Mortgage Association.

While the activities of these institutions provide general support to the mortgage market, another institution, the Government National Mortgage Association, has used its resources during periods of tight monetary condi-

Chart 4

Net Quarterly Federal Home Loan Bank System Advances and Savings Inflows at Thrift Institutions, 1964 Through First Quarter 1973

(Unadjusted quarterly rates in billions of dollars)



Source: Department of Housing and Urban Development, National Housing Policy Review, based on data from the Federal Home Loan Bank Board and the National Association of Mutual Savings Banks.

tions to maintain the flow of mortgage credit to lower income borrowers specifically. In 1971, the Government National Mortgage Association offered commitments to purchase FHA-insured mortgages valued at less than $22,000 per housing unit, bearing interest rates below the market rate in order to provide lower borrowing costs to a previously unsubsidized class of borrowers. From August to December of 1971, the Government National Mortgage Association offered commitments to purchase $2.4 billion of these mortgages, or about 40 percent of the FHA mortgages that originated during this period. The price offered for the mortgages implied an interest rate of 7.55 percent at a time that the FHA market rate was 7.9 percent. In other words, the Government National Mortgage Association subsidized borrowers and absorbed the differential when it resold the mortgages to the Federal National Mortgage Association.

In recent years, the Government has attempted to reduce the transfer of deposited funds from depository institutions to other financial assets. In 1970, the Department of the Treasury raised the minimum denominations of Treasury bills to $10,000 (notes and bonds are still $1,000). Government-sponsored institutions have also raised their minimum denominations to $15,000. These actions keep small savers from taking advantage of the returns on these instruments, since they do not have enough funds to transfer into Treasury bills and other higher yielding assets.

Although these institutions and policies have had some effect in moderating the wide fluctuations in the supply of mortgage funds, the most recent experience indicates that the availability of credit for housing finance still fluctuates because of variations in the flow of funds to depository institutions.

Recognizing that much of the instability in mortgage credit markets is a result of the regulatory environment in which the mortgage-lending institutions operate, President Nixon's recent *Recommendations for Change in the United States Financial System* attempts to improve this situation by fundamentally altering their regulatory framework. The President recommended that thrift institutions be given much more flexibility in investing their funds. They would be allowed to make a limited number of consumer loans, real estate loans under the same conditions as commercial banks, construction loans not tied to permanent financing, and community rehabilitation loans. They would also be allowed to expand their services to depositors by offering Negotiable Order of Withdrawal (NOW) accounts. The recommendations are intended to make these institutions potentially less susceptible to periods of credit stringency and to lessen the need for the protection offered by interest rate ceilings. Therefore, the interest rate ceilings on time and savings deposits at commercial banks and thrift institutions would gradually be phased out.

Mortgage Markets in the Long Run

Since the 1930's, the Federal Government has adopted a number of programs in an attempt to increase the flow of credit into mortgages in the long run. These actions can be divided into three broad categories:

- Programs that attempt to make mortgage investment more attractive by reducing the risk to the private mortgagee;
- Direct lending and net purchases of mortgages by Government and Government-sponsored institutions; and
- Tax advantages provided to certain categories of investors in mortgages.

Policies That Reduce Risk: Two risks are taken in mortgage investment. First, there is the risk that the borrower will default. Second, there is the risk that the lender will suffer a capital loss if he must sell the mortgage.

The insurance and guarantee programs of the FHA, Farmers Home Administration (FmHA), and the VA allow the mortgage lender to acquire protection against losses resulting from defaults. (These programs are described in detail at the end of this chapter.)

By reducing risk, such insurance or guarantee programs induce lenders to invest more in the mortgages which benefit from the program. Thus, the reduction of risk enables homebuyers to obtain more favorable credit terms with federally underwritten mortgages.

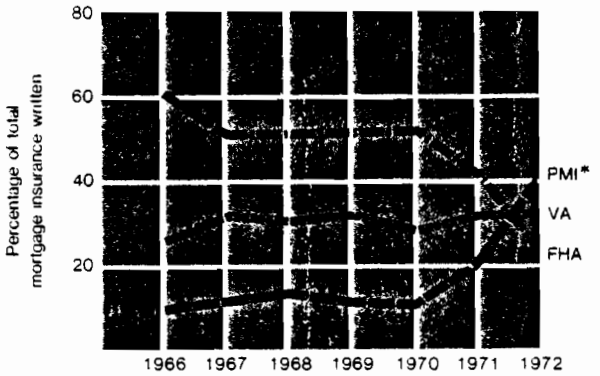
Because FHA, FmHA, and VA serve only part of the mortgage market, a large portion of

the funds that they attract will be drawn away from other parts of the mortgage market, while the rest will be drawn from other security markets. In other words, most of the lending that is insured or guaranteed does not represent new mortgage lending; it only reflects a redistribution of funds from conventional mortgages to insured and guaranteed loans. The programs, in fact, are explicitly designed to help particular groups through this redistribution—primarily buyers in the middle and lower income groups.

The FHA and VA have provided other benefits to mortgage markets besides making the mortgage a more attractive investment. These agencies pioneered the use of the long-term, low downpayment mortgage and demonstrated the usefulness of the instrument. In addition, they demonstrated that the provision of mortgage insurance for middle income groups can be self-financing, and thereby paved the way for the recent expansion of private mortgage insurers. Chart 5 illustrates the share of the mortgage insurance market covered by private insurers, FHA, and VA. In 1972, for the first time since the Great Depression, private mortgage insurers issued more insurance than did either FHA or VA.

Chart 5

Market Shares of Mortgage Insurers 1966-1972



*Private mortgage insurers

Source: Department of Housing and Urban Development, National Housing Policy Review.

Another important form of insurance is that provided to depositors by the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation. These programs protect depositors in thrift institutions against the possibility that their financial institution will experience a rash of defaults and be unable to repay their deposits. Hence, because deposits in lending institutions become more attractive, these institutions have a larger base for their lending activities than they would in the absence of deposit insurance.

Even if a mortgage is free of default risk to the lender, the mortgage holder accepts the risk that he will experience a capital loss when interest rates are higher than those prevailing when he made the loan. As noted above, Government and Government-sponsored institutions undertake actions that attempt to stabilize mortgage flows. These actions tend to smooth out shortrun fluctuations in mortgage interest rates and, by implication, mortgage prices. This reduction in mortgage price variability makes mortgages less risky as investments.

Government-sponsored institutions also play an important role in broadening the market for mortgages; this reduces the risk of capital loss on resale. If there is not a well-organized marketplace for mortgages with regularly quoted prices, a mortgage investor may find that he must artificially lower the price to find a buyer; this adds to the risk of holding mortgages. If there is a well-organized, deep market with quoted prices, the seller may still take a capital loss because of a rise in interest rates—but at least he knows that his decision to sell will not itself drive down the mortgage price significantly.

It is also important that the market be national in scope. When local markets are isolated from national markets, mortgage lenders are not able to diversify against local recessions.

The creation of the Federal National Mortgage Association (FNMA) in the 1930's was intended to aid the establishment of a deep, national, secondary market for FHA mortgages. Precisely defined, a secondary market is a resale market where completed mortgages are bought and sold. The present FNMA, however, is best described as a finan-

cial intermediary that attracts funds by selling bonds and notes, and uses these funds to purchase mortgages for its own portfolio. The pre-1966 FNMA not only purchased but also sold a relatively large portion of its mortgages as Table 2 illustrates. But the post-1966 FNMA has sold fewer mortgages relative to its purchases. During the period 1955–1965, the FNMA made net purchases of $3.6 billion, whereas it made net purchases of $21.3 billion during the period 1966–1972.

Today, FNMA is the largest single financial intermediary serving the mortgage market. Its size is illustrated by the fact that FNMA's purchases in 1970 absorbed about a third of all FHA- and VA-backed mortgages that originated in that year. Although FNMA has evolved from a pure secondary market institution into a financial intermediary, it must be emphasized that it still plays an important role in deepening the FHA-VA mortgage market and making it national in scope. Since 1970, it has also had the authority to buy conventional mortgages, although it has continued to concentrate its activity in the FHA-VA market.

In 1970, the Federal Home Loan Mortgage Corporation, owned by The Federal Home Loan District Banks, was created to broaden the market for conventional mortgages. It has been working actively to develop a private secondary market where investors can meet to buy and sell completed mortgages. To facilitate achievement of this goal, the Federal Home Loan Mortgage Corporation has taken a number of steps to enhance the attractiveness of mortgage instruments and to improve the market in which they are traded. These steps include:

Table 2. Federal National Mortgage Association Activity, 1955–1972
(Dollars in Millions)

Year	Mortgage Transactions During Period			Mortgage Holdings (Year-end)
	Purchases	Sales	Net Purchases	
1955	$86	$0	$86	$86
1956	575	5	570	649
1957	1,021	3	1,018	1,636
1958	260	466	−206	1,381
1959	735	4	731	2,050
1960	980	42	938	2,903
1961	624	522	102	2,872
1962	548	391	157	2,847
1963	181	780	−599	2,062
1964	198	78	120	1,997
1965	757	46	711	2,520
1966	2,081	*	2,081	4,396
1967	1,400	12	1,388	5,522
1968	1,944	0	1,944	7,167
1969	4,121	0	4,121	10,950
1970	5,078	0	5,078	15,502
1971	3,574	336	3,238	17,891
1972	3,699	213	3,486	19,891

*Less than $500,000

Note: All data adjusted to exclude special assistance and management and liquidation functions transferred to the Government National Mortgage Association in 1968.

Source: Department of Housing and Urban Development, National Housing Policy Review, based on data from the Federal National Mortgage Association.

- The development of a standard format for mortgage documents that would enable private investors to assess easily the quality of the mortgages being offered for sale.
- Weekly publication in the *Wall Street Journal* of yields on FHA and conventional single family mortgage loans sold in the secondary market.
- The introduction, together with FNMA, of a uniform mortgage document for each State in an effort to eliminate the different forms used in many States.
- Testing the feasibility of establishing an automated trading information system for the secondary market for both Government-insured or Government-guaranteed securities and conventional mortgages. Such a system would operate along the lines of the over-the-counter securities market. Interested market participants would have access to a terminal that would provide them with the necessary information to make a transaction: information such as yields, value, maturity, and type and location of the property secured by the mortgages being offered for sale. If a mortgage holder desired to sell some of his holdings, he could make the offer through this network to potential buyers all over the country. Likewise, interested buyers could easily find out what mortgages were being offered for sale. Such a system would facilitate the flow of information and greatly improve the secondary market.

While Government-sponsored institutions are playing an important role in perfecting mortgage markets, the private secondary market is already quite significant and still growing. Approximately 22 percent of the 1971 volume of $14 billion, and 34 percent of the 1972 volume of $18 billion of private secondary mortgage market purchases of one- to four-family home loans represented loans that were neither insured nor guaranteed by the Government or a Government-sponsored agency. These transactions took place primarily between mortgage bankers, savings and loan associations, mutual savings banks, and life insurance companies.

Direct Lending and Net Purchases of Mortgages by Government-Sponsored Institutions: With the exception of a small VA program, the Government has not engaged in direct lending for mortgages.[3] As shown in Table 2, however, FNMA has engaged in significant net purchases of mortgages in the secondary market since 1966. These are financed primarily by mortgage repayments and the issuance of debentures and other obligations.

The effectiveness of net purchases in driving down mortgage interest rates is limited in the long run. In the short run, FNMA purchases unquestionably drive down mortgage interest rates and increase the supply of mortgage credit. As mortgage interest rates fall, however, evidence suggests that other mortgage lenders begin to find mortgages less attractive, and they begin to shift to other securities. This shift occurs with a timelag. In other words, the longrun impact of FNMA purchases is less significant than the shortrun impact. While FNMA attracts funds to mortgages from new investors, the effects are likely to be offset somewhat in the long run as other sources of mortgage funds seek out new investment opportunities.[4]

The same longrun phenomenon also applies to the programs operated by Government National Mortgage Association and the Farmers Home Administration. By pooling mortgages and selling mortgage-backed bonds, these institutions significantly increase the supply of funds available for mortgages in the short run. But like the FNMA's purchase programs, these actions tend to reduce the mortgage interest rate; thus, in the long run some private lenders may shift out of the mortgages and into higher yielding securities.

Tax Advantages: In the past, thrift institutions were permitted allowances for bad debt reserves provided that a certain percentage of their investment portfolio was in mortgage investments. This undoubtedly increased their mortgage lending to levels greater than would otherwise occur, and thus imposed downward

[3] The Farmer's Home Administration temporarily makes a direct loan when it originates a mortgage, but notes or securities on the loan are soon sold to other investors.

[4] For an analysis of the FNMA's impact on the mortgage market, see Dwight M. Jaffee, "An Econometric Model of the Mortgage Market," published in *Savings Deposits, Mortgages, and Housing,* edited by Edward M. Granlech and Dwight Jaffee, Lexington Books, Lexington, Mass.: 1972, p. 171.

pressures on mortgage interest rates. Again, it must be noted that the resulting increase in mortgage lending by the thrift institutions cannot be considered a net addition to the total supply of mortgage funds, since some lenders, without the tax advantage, will have been driven out of the mortgage market by the slightly lower rates. In 1969, this tax advantage was significantly decreased, but President Nixon recently proposed active consideration of a new tax credit for all mortgage investors.

The President's tax proposal would allow an individual investor or financial institution a tax credit on income earned from mortgage investments. The size of the tax credit would decline as the portion of mortgages in the investor's portfolio declined. The proposal assumes that by effectively increasing the after-tax yield on mortgages, mortgages would become more attractive investments and lenders would be encouraged to increase the supply of funds for housing production and homeownership.

The fact that mortgage interest payments are deductible from adjusted gross income for tax purposes lowers after-tax interest costs to borrowers, thereby stimulating the demand for mortgage borrowing and increasing the flow of mortgage funds. (This deduction was discussed in detail in Chapter 2.)

Mortgage Debt Instruments

The kind of mortgage debt instrument agreed upon by the borrower and lender to define their contractual agreement is an important element in the process of housing finance. The instrument typically defines the method for repayment of principal and interest. The borrower and lender then negotiate such terms as the length and size of the loan, and the interest rate. Individualized contracts can be negotiated without the use of a standard, printed mortgage debt instrument, but this procedure—too involved and costly for most contractual negotiations—is used only in unusual situations where the available standard mortgage debt instruments fail to provide a contractual arrangement that adequately serves the interests of both borrower and lender.

There are certain advantages to limiting the number of repayment methods available to borrowers and lenders: It is easier for the borrower and lender to become familiar with the terms and implications of each method; transaction costs are reduced due to the limited number of options available; and secondary market operations are facilitated where there are large volumes of a limited number of mortgage types. Uniformity has an important effect upon the marketability of financial instruments; too many variations of mortgages can impair the development of the secondary mortgage market. On the other hand, limitations on the number of repayment methods limit the flexibility of the borrower and lender in finding a repayment method that suits their special needs. By encouraging the use of fixed-interest-rate, fully amortizing, level-payment mortgages, the Government has significantly limited the choices available to borrowers and lenders.

Government Restrictions on Contracts

The options available to mortgagors and mortgagees are usually restricted by numerous State and Federal laws and regulations that either require or proscribe certain provisions in contracts for mortgage loans. These State and Federal restrictions have been promulgated for various reasons and objectives; in the aggregate, however, they reduce the supply and demand for mortgage credit by limiting the options available to both borrowers and lenders.

One of the more obvious restrictions on mortgage contracts is the maximum legal interest rate on the loan as contained in most State usury laws. State laws also prescribe the conditions and procedures for foreclosures. The method of repayment also is typically defined or restricted by law or regulation. For example, the fully amortized mortgage loans made by federally chartered savings and loan associations cannot have any contractual periodic payment exceeding the previous period's contractual payment. Therefore, although the Federal Home Loan Bank Board's regulations for federally chartered savings and loan associations do

not require equal monthly payments, they do prohibit any period of increasing contractual periodic payments on fully amortized mortgage loans. The above restrictions on contracts constitute only a partial list, but they are among the most important restrictions on the options open to borrowers and lenders.

Mortgages Payable in Full at Maturity

Prior to the 1930's, most mortgage loans—corporate and Treasury bonds, for example—typically were unamortized, with all principal being paid at maturity. The term to maturity was usually between 5 and 10 years, and borrowers were required to make 50 percent downpayments. A large downpayment was required to reduce the loan-to-value ratio to a level consistent with the nature and risks of this type of mortgage loan.

This arrangement frequently left homeowners without the necessary funds when the loan matured. If the homeowner could not meet the lump-sum payment when the loan was due, the alternatives were either refinancing or default. Refinancing was usual and customary but not always available, especially in periods of tight credit.

A variation on the nonamortized loan was the use of sinking funds to accumulate the funds necessary to retire the debt at maturity. A borrower contracted to accumulate funds in a savings account by making periodic deposits so that the balance would equal the debt at maturity. This method closely resembles the fully amortized mortgage loan with periodic payments; it fell into disuse, however, in favor of the direct reduction loan. The direct reduction loan is a long-term, fixed-interest-rate, equal-monthly-payment, fully amortized loan. The current regulations of the Federal Home Loan Bank Board specifically instruct federally chartered savings and loan associations to use the direct reduction method, by which the periodic payments are applied directly to the reduction of the loan and not to a sinking fund in the form of a savings account. The use of sinking funds therefore represented the transitional stage between nonamortized and fully amortized mortgage loans.

The Current Form of the Mortgage Loan

Most home purchases during the past 40 years have been financed by direct reduction loan. The monthly payments made in direct reduction of the principal of the loan and the loan's fully amortized nature permit a lower downpayment and a longer term to maturity than that which prevailed under previous arrangements. The equal monthly payments also make it easy for households to plan their monthly budgets.

The direct reduction loan found its chief proponent in the Government during the 1930's through the activities of the Federal Housing Administration, the Home Owners' Loan Corporation, and the Federal Home Loan Bank Board's regulation of federally chartered savings and loan associations. FHA insurance was and remains available only for this type of loan. The method has worked well during the past four decades, and the Government's initial role had the effect of demonstrating the value of the instrument. If the method had not worked well, its use would not have spread beyond the area of Government regulation.

However, the long-term, fixed-interest-rate, equal-monthly-payment, fully amortized mortgage loan may not be the best instrument for all housing finance in today's inflationary economy. Most of the problems with this instrument relate to its requirements for an interest rate fixed at the outset for the full term of the mortgage and equal monthly payments. The alternative mortgage forms presented below relax one or both of these requirements in an attempt to produce a more flexible mortgage debt instrument for certain purposes and under certain conditions.

A difficulty with the fixed interest rate requirement is that it creates a problem for thrift institutions when market interest rates rise in response to unanticipated inflation or a general increase in the demand for credit. When market interest rates rise sharply, thrift institutions must raise their deposit rates to retain their depositors' funds. While they must pay higher rates on the entire amount of their borrowed funds, they receive higher rates only on their new loans. Consequently, they become tied to a low-yield portfolio while paying high rates for deposits. If

market interest rates rise sharply, the savings and loan industry is threatened with a serious decline in its net return. If market rates fall sharply, the above sequence is reversed somewhat but limited by the borrower's right to refinance the loan after paying required prepayment penalties.

The requirement for equal payments may work hardships on certain classes of borrowers. First, the requirement for equal monthly payments is a burden on younger borrowers whose incomes are expected to rise during the life of the loan. Because the earlier payments take a much larger portion of their disposable income than do later payments, young households with fixed payment mortgages may have to postpone homeownership until their current income rises by an amount which adequately covers the fixed mortgage payments. As will be shown later in this section, there are alternative mortgage instruments whose repayment schedules better correspond to an individual's expected rate of future income.

A second problem with the fixed-interest-rate, equal-payment requirement is that it creates problems for the borrower when inflation threatens. The lender demands that a premium be built into the interest rate to protect himself against inflation; this raises monthly payments immediately, whereas the borrower's money income is raised by inflation only gradually over the life of the mortgage.

In summary, the mortgage loan instrument in general use today was a major innovation of the 1930's that has served both borrower and lender for the past 40 years. However, it is not the only way to finance housing, and in many instances it may not be the best way: no one financial instrument is best for all transactions and conditions. Other instruments are available that offer more flexibility and might improve the efficiency of mortgage markets.

Alternative Mortgage Forms

Numerous alternative mortgage debt instruments are possible, and a few basic forms are briefly described below. Actually, there are as many possible instruments as there are ways to vary the manner of repayment of principal and interest, and some of these possibilities have already found their way into use. The main point to be made is that there are alternatives available to the mortgage loan instrument currently in general use, each with its own advantages and disadvantages.

Variable-Rate Mortgages

Variable-rate mortgages[5] replace the standard fixed mortgage rate with a flexible one related to prevailing market interest rates. In other words, the rate on the mortgage loan changes as market interest rates change. Actually, the variable-rate mortgage may be viewed as a sequence of refinanced short-term loans. In order to avoid the costs of constantly being involved in negotiations, the borrower and lender agree to accept an automatically determined rate tied by some formula to one or more interest rates. As a practical matter, the borrower and lender also agree to disregard insignificant changes in market rates, and the rates on variable-rate mortgage loans change only with important changes in market rates of interest.

There are three kinds of variable-rate mortgages. One form uses a fixed term to maturity and varies the monthly payments to reflect changes in the mortgage rate. A second form uses equal monthly payments and increases or decreases the term to maturity as interest rates rise or fall. The third form is a hybrid that varies the payments or the term to maturity, or both simultaneously, to reflect changes in interest rates.

A basic advantage of variable-payment mortgages is that they allow mortgage lenders to keep their deposit rates competitive with market rates and to maintain the share of mortgages in the aggregate supply of credit at all times. As a result, borrowers and homebuilders have a better chance to obtain credit during periods of rising interest rates. In addition, by reducing the risks associated with fixed-rate contracting over long periods of time, a lower average expected cost of borrowing on larger volume may be attained. Theory and empirical evidence both indicate that variable-rate mort-

[5] For a study of this topic, see George von Furstenberg, *The Economics of Mortgages with Variable Interest Rates*, Federal Home Loan Mortgage Corporation, Monograph No. 2, Washington, 1973.

gages have a lower average interest rate than fixed-rate mortgages.

A disadvantage of the variable-payment form is that a substantial rise in interest rates could find some borrowers hard-pressed to meet their payments, and this could lead to some increase in default rates. The variable term form does not have this disadvantage.

Variable-rate mortgages are used widely in such developed countries as Britain, France, Germany, Italy, Sweden, Australia, and the Union of South Africa. In addition, experience has shown that both fixed-rate and variable-rate instruments coexist where both are available. In the United States, the Federal Home Loan Bank Board regulations do not permit the use of the pure variable-payment form of the variable-rate mortgage by federally chartered savings and loan associations.

Interest-Only Mortgages

In one version of the interest-only mortgage, the borrower pays only the interest on outstanding principal during the early years of the loan. Another version entails early payments that do not even cover the full interest costs on the unpaid principal. In either case, payments are lower in the initial years and increase when both interest and principal are paid during later years.

A 30-year loan of $20,000 at 7.75 percent requires equal monthly payments of $143.29 under the currently predominant direct reduction method. A loan of the same size, maturity, and interest rate—entailing the payment of the full interest only during the first 5 years and direct reduction with equal monthly payments thereafter—requires equal monthly payments of $129.17 for the first 5 years and $151.07 for the remaining 25 years. Actually, it is not necessary to switch at some point to an equal-monthly-payment, direct-reduction loan; interest-only could be paid on the first payment or payments and after some point the repayment of principal could be phased in slowly.

Interest-only loans are riskier for lenders because no principal is initially repaid; the risk is further increased when the initial payments do not cover even the full interest costs on the unpaid principal. The advantage to young borrowers is that the payment rate is lower in earlier years when their incomes are also likely to be lower. The lender, however, might require a larger downpayment to cover the greater risk associated with the slow buildup in equity, and the advantages of the interest-only loan to the borrower might be thereby reduced.

Mortgage Payments Related to the Borrower's Income

This instrument is a fixed-rate, variable-monthly-payment, fully amortized mortgage that has its monthly payments tied directly to the borrower's income over the period of the loan. This type of loan utilizes a fixed interest rate with variable monthly payments and requires the borrower to commit himself to make monthly payments based on a mutually determined percentage of his monthly income. The term to maturity is varied as the monthly payments vary.

In order to protect the lender, there is a need to set limits on the minimum amount of the monthly payments and on the degree of forbearance that he must show. As in the case of variable-rate mortgages, the borrower and lender agree to ignore all but large or long-term changes in the borrower's income, since this would reduce administrative costs.

The income-related mortgage is not available for use by federally chartered savings and loan associations because Federal Home Loan Bank Board regulations now require that no monthly payment exceed a previous payment.

Private and Governmental Participants in Housing Finance

This section provides a detailed description of the various housing finance participants. The discussion is divided into three major segments: Private sector primary lenders and originators of mortgages; Government-sponsored mortgage market support institutions; and public and private insurers and guarantors of mortgages. The discussion of each participant includes its purpose, regulation, authority, and limitations;

its market share; and the segments of the market to which the participant caters.

Private Sector Primary Lenders and Originators of Mortgages

This section describes the activities of the private financial intermediaries serving as conduits for funds flowing from the saver to the purchaser of housing.

Savings and Loan Associations: The primary role of savings and loan associations is the pooling of savings funds for investment in residential mortgages. They are the largest source of conventional mortgage funds for both single family and multifamily housing. They now hold more than $260 billion in assets and they initiated about 55 percent of home mortgage loans made in 1972.

More than 75 percent of the savings and loan associations' assets are in residential mortgages. Other types of loans are made for commercial property, land development, construction, and mobile homes. The greatest portion of mortgages held (87 percent at the end of May 1973) are conventional; the rest are FHA and VA mortgages. The high percentage of mortgages in the portfolios of savings and loan associations is due primarily to their history and experience as specialists in housing finance and the favorable tax treatment they receive for holding mortgages.

Organizationally, savings and loan associations fall into two categories: Stock and mutual. Stock associations are privately owned; they operate in a manner similar to that of a corporation. In mutual associations, the equity is owned by the depositors, who share in the association's gross income. Most associations, and all federally chartered associations, are mutual institutions.

Savings and loan associations can be either State or federally chartered. Federally chartered associations are required to be members of both the Federal Home Loan Bank System and the Federal Savings and Loan Insurance Corporations. In addition to being regulated by these two agencies, federally chartered associations must operate within the confines of State statutes and their charters.

The major Federal Home Loan Bank Board requirements include: (a) economically sound mortgage loan policies; (b) a minimum proportion of assets (currently set at 5.5 percent of savings accounts and short-term borrowed funds) in either cash or United States Government securities; (c) limitations on mortgage loans such as the dollar amount per housing unit, maximum loan-to-value ratios and maturities, and specific lending areas; and (d) a ceiling on deposit rates, depending on the size and term of deposit.

Although the interest rate that federally chartered associations can offer on their deposits is limited by the deposit rate ceiling set by the Federal Home Loan Bank Board, their ability to compete for deposits is enhanced by their authority to offer higher interest rates on savings accounts than can commercial banks. The current interest rate ceiling on savings and loan passbook accounts is 25 basis points above the passbook rate at commercial banks.

All federally chartered savings and loan associations must be insured, but State chartered savings and loan associations may be insured or uninsured. The uninsured State associations are subject primarily to State statutes and are regulated by State banking agencies. State associations may choose to become members of the Federal Savings and Loan Insurance Corporation, in which case they are required to be members of the Federal Home Loan Bank Board. Thus, they are regulated by those two Federal agencies and by their State banking agency. Some States have set up insurance agencies similar to the Federal Savings and Loan Insurance Corporation as an alternative method of deposit insurance.

Mutual Savings Banks: Mutual savings banks are thrift institutions that intermediate between savers and borrowers. Total savings bank resources now exceed $100 billion. Almost all of these funds are invested in long-term assets, some 67 percent of which are in mortgages.

Unlike savings and loan associations, which can be either State or federally chartered, savings banks are State chartered only. Although they are primarily home mortgage lenders, they tend to have fewer restrictions on their investment policies than do savings and loan associations. As mutual organizations,

they are owned and operated for the benefit of their depositors, who receive a portion of the gross earnings as interest or dividends on deposits. The majority of savings banks are in the northeast, but some of the larger banks have member-owned companies in other parts of the country to assist them in mortgage acquisition and servicing.

Mutual savings bank investments in mortgages has been encouraged by the Tax Reform Act of 1969, which gave preferential tax treatment to earnings derived from mortgage investments.

Savings banks are the largest holders of FHA and VA home mortgages, with 25 percent of all outstanding federally underwritten mortgages in 1971. However, the expansion of private mortgage insurance companies and the concomitant decline in the importance of FHA have led to an increase in privately insured conventional mortgage lending by savings banks in relation to FHA mortgages.

Savings banks often acquire mortgages as a result of commitments made to mortgage bankers. Mortgage bankers originate the loans and sell them to savings banks, sometimes retaining the servicing function. In recent years, nearly one-third of all residential mortgage acquisitions by savings banks have been obtained through mortgage bankers.

Most savings banks are insured by the Federal Savings and Loan Insurance Corporation or by the Federal Deposit Insurance Corporation. Those belonging to the Federal Home Loan Bank System have access to Federal Home Loan Bank credit facilities and are subject to the system's regulations and deposit rate ceilings.

Commercial Banks: In recent years, commercial banks have increased their activity in the field of mortgage finance. Due to the nature of their liabilities—mainly demand, rather than time deposits—they had primarily restricted themselves, until the 1960's, more to short-term investments than to such long-term investments as mortgages. Growth and expansion of time deposits in the form of savings and certificates of deposit, and activities relating to trusteeship of pension funds, have allowed banks to participate increasingly in mortgage investments.

Mortgage investment by commercial banks accounted for only about 31 percent of the dollar volume of their time and savings deposits; about 90 percent of their gross mortgage acquisitions in 1972 were in conventional mortgage loans. Commercial banks generally keep their real estate lending to a minimum because of alternative lending opportunities and a desire to maintain liquidity. Many commercial banks invest in long-term mortgages as a personal service to their customers, although some commercial banks in fact specialize in mortgages. On the average, commercial banks require lower loan-to-value ratios and shorter maturities on their mortgages than do other mortgage lenders.

In addition to their long-term mortgage lending, commercial banks are quite active in the field of construction and development loans. The shorter maturity of these loans is geared more to the banks' liquidity requirements and fund availability than is mortgage lending, and the yields on construction loans are more attractive.

Commercial banks sometimes sell their mortgages (primarily single-family) to secondary market investors while retaining the servicing function. Some of the larger banks have also bought blocks of FHA and VA mortgages in the secondary market. Their involvement in making warehousing loans (loans to finance future mortgage activity) to mortgage companies and other lenders also directly supplements the availability of mortgage funds.

Bank regulation is either under national or State supervision, depending on the charter. National banks are allowed to invest the greater of 70 percent of their total time deposits, or 100 percent of their capital or surplus funds, in mortgage loans other than VA or FHA loans. Mortgage loans must constitute the first lien and be fully amortized by term. Mortgage loan terms allow up to 90 percent loan-to-value ratio if the maturity date is not more than 30 years. State banks are supervised by State banking departments or agencies that generally allow more liberal mortgage lending terms.

Life Insurance Companies: The general insurance function of life insurance companies creates a steady and sizable inflow of funds with a steady but relatively small and predictable outflow, leaving large sums continually

available for long-range investment. The investment pattern for these funds is based primarily upon return; as a result, mortgages must compete with other financial assets for life insurance companies' funds.

Life insurance companies' activity in mortgage lending has decreased over the last 20 years as they have shifted their funds toward corporate debt and equity holdings. In 1950, life insurance companies held about 19 percent of the stock of single-family mortgages, but this decreased to only about 6 percent in 1972. Multifamily holdings have remained about the same, with life insurance companies accounting for about 28 percent of the market at the end of 1972. As a percentage of total mortgages held in life insurance companies' asset portfolios, one- to four-family mortgages accounted for 53 percent of such holdings in 1950, but this declined to 29 percent in 1972.

Life insurance companies may be stock or mutual in organization. Most are stock companies, but mutual companies have about two-thirds of the assets of all U.S. life insurance companies. All are State chartered, and regulated by the legislation of their home States and of those States in which they operate. State regulations pertinent to the mortgage market include limitations on real estate and mortgage loan investments—New York's limitation, for example, is 50 percent—as well as on stock and bond purchases. They have authority to purchase real estate as well as to invest in single and multifamily mortgages, and have tended to become more active in modern real estate financing methods such as sale-leasebacks, joint ventures, etc.

State regulations also include maximum loan-to-value ratios (generally $66^2/_3$ to 75 percent) and types of loans. FHA and VA loans are exempt from the loan-to-value regulations, however, and follow FHA and VA regulations.

The predictability of funds and low liquidity requirements enable life insurance companies to commit large sums for purchases of pools of single-family mortgages, multifamily and commercial mortgages, and income-producing property. Their single-family lending primarily takes the form of bulk purchases from mortgage banking companies. Because of the lower yield on single-family mortgages, however, the trend is toward reduction of single-family loans in favor of other investments.

Mortgage Banking Companies: The mortgage banking industry originated with the need of a mortgage brokerage operation to act as intermediary between lenders and home buyers and builders. The largest part of their business has traditionally involved the origination of FHA and VA mortgage loans for sale to institutional investors. But because of the recent growth of private mortgage insurance companies, mortgage bankers are increasingly expanding their activities into the field of conventional mortgages. Corporate capital and warehousing loans (short-term loans, usually from commercial banks, which finance mortgages held in preparations for sale to permanent investors) serve to finance the mortgage companies' loan origination and liquidity position.

Mortgage bankers today service more than $100 billion in mortgages; they closed about 12 percent of all mortgages closed in 1972. The rapid growth of mortgage banking since World War II is related to the enthusiastic response to the FHA and VA programs. These Federal programs, coupled with the mortgage bankers' secondary function of document inspection and servicing of the purchased loans, created a relatively easy and safe investment in mortgages for large investors.

A further function of the mortgage banking company is to channel mortgage capital from capital-abundant areas to home buyers in capital-deficient areas.

Mortgage companies are corporations, and as such are subject to State corporate laws and regulations. A recent trend is for mortgage companies to become affiliated with large financial institutions, such as bank holding companies.

Federal and State supervision of mortgage banking has been minimal. Lately, however, States have begun to adopt licensing laws for mortgage companies. Mortgage bankers dealing in FHA loans must be approved by FHA and are subject to periodic examination and audit by FHA as to adequate capitalization and ability to service their loans. While there are no provisions in the law for VA to approve lenders, VA regulations serve to insure that each lender

must demonstrate the ability to service loans and exercise proper credit judgment.

Mortgage bankers operate by soliciting commitments from large institutions for large blocks of single-family loans and multifamily loans. Income is drawn directly from borrower fees, from servicing fees, and sometimes from sales of loans; and indirectly from large escrow deposits (used as compensating balances for bank lines of credit and warehousing loans). Other income may be drawn from sideline activities such as land development and construction loans, standby commitments, and new cities development.

Loans originate from home or branch offices, real estate brokers and builders, and in some cases through mortgage brokers and independent solicitors. On the sales side, the FNMA is one of the largest purchasers of mortgage company-initiated loans, while GNMA has had a great influence over mortgage banks' operations through use of its mortgage-backed security program. (For details, see FNMA, GNMA below.)

Investment Trusts: Real Estate Investment Trusts and Mortgage Investment Trusts act as financial intermediaries by issuing equity, debentures, and commercial paper, and borrowing with short-term loans to attract funds for investment in real estate. Real Estate Investment Trusts pay corporate income tax only on their retained earnings, provided that 75 percent of their income is derived from real estate and 90 percent of their profits is distributed to the shareholders.

There are basically two types of trusts: Equity trusts and mortgage trusts. Equity trusts buy existing office buildings and other income-producing property. Most of the early trusts were of the equity type and tended to have only a modest earnings record.

Mortgage trusts, however, have made excellent earnings in recent years; most of the newer trusts have been of this type.[6] Rather than buying property directly, mortgage trusts invest primarily in construction and development loans and long-term mortgages.

The greatest impact of Real Estate Investment Trusts on housing finance has been in the provision of apartment house construction and development loans. Mortgage Investment Trusts now account for more than 25 percent of apartment construction loans, making them the third largest construction and development lender after commercial banks and savings and loan associations. In other areas, such as the provision of one- to four-family construction loans, Mortgage Investment Trusts account for only 5 percent of the market; Real Estate Investment trusts account for less than 1 percent of all long-term loans made.

Pension Funds: Due to their tremendous growth over the last 50 years, pension funds represent perhaps the largest untapped potential for mortgage investment in the United States. Private noninsured pension assets currently total more than $116 billion, and State and local retirement fund assets amount to another $74 billion. Most fund administrators have shunned mortgage investment for several reasons, among them low relative yields, a lack of knowledge or expertise in real estate investment, and a desire to avoid the investigatory and administrative problems of mortgage investment. Pension funds, however, have recently expressed some interest in multifamily and commercial mortgages which usually offer higher yields than single-family residential mortgages. Purchase-leasebacks seem to be the preferred real estate investment by pension funds; yield is usually 150 basis points above the first mortgage rate plus a share of the increase in gross receipts of the property.

Current mortgage investment from pension funds is small (9 percent of total assets for State and local government pension funds combined, and 2.5 percent for all noninsured pension funds), but very recently the Government National Mortgage Association has had some success in attracting them to mortgage-backed securities that do not require pension funds to develop facilities and staff for mortgage portfolio administration. But until pension funds develop facilities and staff for mortgage portfolio administration, and until mortgages can compete viably with all other higher yielding investment alternatives, it is not likely that pension fund involvement in direct mortgage

[6] Peter A. Schulkin, "Recent Developments in the Real Estate Investment Trusts Industry," *Federal Home Loan Bank Board Journal*, VI, February, 1973, p. 11.

investment will be substantial. On the other hand, mortgage-backed bonds eventually may be more successful in attracting pension funds to mortgages indirectly.

Service Corporations: A 1964 amendment to the Home Owners Loan Corporation Act permitted savings and loan associations to form an organization called a service corporation, which resembles a Real Estate Investment Trust. There are two types of service corporations that can be formed. A type "A" service corporation is a statewide organization in which all eligible associations in the State may invest. An association may invest 1 percent of its total assets in the capital stock, obligations, or other securities of the corporation. The service corporation can then balance the associations' investment with debt capital from other sources. A type "B–1" corporation (owned by five or more associations) may borrow an amount equal to 4 percent of the assets of the holders of the capital stock in secured debt and up to 2 percent of such assets in unsecured debt.

A type "B–2" corporation may be owned by only a limited number (less than five) associations and is permitted to borrow unsecured debt in an amount equal to the holders' investment in the corporation's stock, obligations, or other securities, and borrow security debt up to four times the total of such investments by the associations.

The funds may be used for (1) the origination, purchasing, selling, contracting, and warehousing of first mortgages; (2) the acquisition of unimproved real estate and its development and subdivision for sale or rental; (3) the acquisition of improved real estate to be held for rental; (4) the acquisition of improved real estate and its remodeling or renovation for sale or rental; and (5) joint ventures in any of the above activities.

Although the Home Owners Loan Corporation Act permitted the formation of service corporations, most savings and loan associations expressed little interest in them because of the restrictive nature of Federal Home Loan Bank Board's interpretation of the act. In 1970, however, the Federal Home Loan Bank Board relaxed its interpretation of the act, with the result that savings and loan associations' interest in such corporations has increased considerably. Only 86 service corporations were operating in October 1970; the number grew to more than 900 by the end of 1972.[7]

Government-Sponsored Mortgage Market Support Institutions

Since the 1930's, the Government has established or sponsored a number of institutions designed to facilitate the financing of residential housing, enhance the liquidity of the mortgage market, and provide direct support to selected types of mortgages. This section describes the structure and operations of Government-sponsored mortgage market support institutions that provide "second layer" support to the private mortgage lenders discussed in the preceding section.

The Federal Home Loan Bank System: The Federal Home Loan Bank System's main function is that of a central credit facility to supplement the resources of its member institutions, mainly savings and loan associations. It was created by the Federal Home Loan Bank Act in July 1932 and was modeled after the Federal Reserve System. The Nation was partitioned into 12 districts, each with its own Federal Home Loan Bank to provide services to its member institutions. The System is supervised by the Federal Home Loan Bank Board. The Board consists of three members appointed by the President with the advice and consent of the Senate. Chart 6 provides an overview of the Federal Home Loan Bank System.

The Federal Home Loan Bank System extends credit in the form of advances to its mortgage-lending member institutions. An advance is a loan of funds, usually secured by collateral in the form of mortgages. Federal Home Loan Bank Board regulations set the maximum amount that any member of the Federal Home Loan Bank System may borrow at 50 percent of its total savings balances unless the Board specifically authorizes an exception.

The two major categories of advances are short-term and long-term advances. Short-term

[7] Durand A. Holladay, "Working with REIT's in Commercial Lending," *Federal Home Loan Bank Board Journal*, VI, March, 1973, p. 26.

advances have maturities ranging up to 12 months and typically are made to cover unusually large deposit withdrawals. Long-term advances may run as long as 10 years and are made for the purpose of loan expansion.

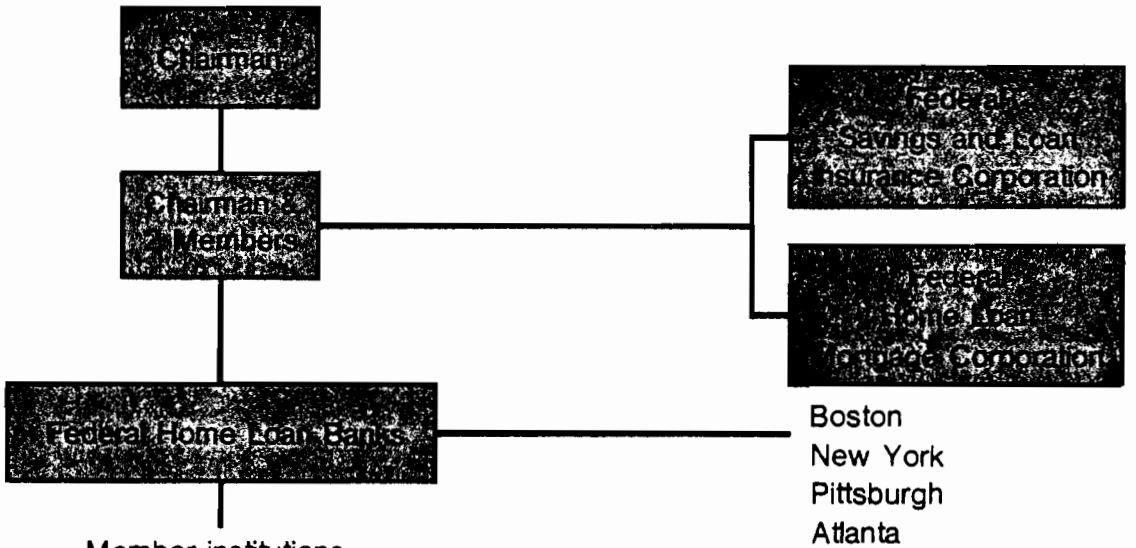
The rationale for the System's advances may be summarized as follows:

- Advances serve as a source of funds to meet heavy or unusual net withdrawal demands on the deposits of member institutions.
- Advances supply funds to smooth the differences between the seasonal savings inflows to member institutions and the closing of construction and home-purchase loans.
- Advances supplement local resources in capital deficit areas by helping to move funds to these areas from capital surplus areas.
- Advances link mortgage-lending member institutions to the Nation's capital markets by the issuance of the System's consolidated obligation in large denominations for sale to individual investors and financial institutions.
- Advances stabilize residential construction and financing in periods when monetary or financial conditions reduce the volume of mortgage lending.

Most funds for the Federal Home Loan Bank System come from the sale of district Federal Home Loan Bank stock to member

Chart 6

The Federal Home Loan Bank System



Member institutions, as of June 1973

2,037	Federally chartered savings and loan associations
2,292	State-chartered savings and loan associations
48	Mutual savings banks
2	Life insurance companies

Source: Department of Housing and Urban Development, National Housing Policy Review, based on data from the Federal Home Loan Bank Board.

institutions; the retained earnings of the banks; the deposits of member institutions kept at the banks; and the funds obtained from the sale of debentures known as consolidated obligations. Consolidated obligations are sold in the Nation's capital markets and are the System's most important source of funds.

Up until the mid-1960's, the Board's policy was designed to promote housing construction through increases in expansionary advances. Since then, having found itself with resources inadequate to moderate the effects of the tight credit situation in 1966 on mortgage-lending institutions, the Board changed its policy on advances to bring a countercyclical policy into effect. When monetary conditions were easy and mortgage funds were plentiful, district banks were directed to conserve their resources for periods of tight money when member institutions had difficulty attracting loanable funds. The Board changed its policy on advances again in the late 1960's from a countercyclical policy to the goal of sustaining a high rate of residential construction. To implement this policy, the Board began to encourage expansionary advances. This policy resulted in an increase in the aggregate value of outstanding long-term advances from $392 million in 1968 to $5 billion by the end of 1972.[8]

In addition to its role as a central credit facility, the Board also supervises the Federal Savings and Loan Insurance Corporation, which insures savings deposits up to $20,000 and regulates the lending activities of the member institutions. Members of the Federal Home Loan Bank System are subject to guidelines from the Federal Home Loan Bank Board such as liquidity ratios, types of mortgages, loan-to-value ratios, and the maximum amount of a loan. In January 1973, the Board changed its regulations to allow member institutions to issue subordinated debt in an amount of up to 50 percent of the member's net worth.

Federal National Mortgage Association: The Federal National Mortgage Association (FNMA) was chartered and organized in 1938 by the Federal Housing Administration to provide secondary market support for the new FHA mortgages. During its first decade of operation, the FNMA bought FHA mortgages when mortgage funds were scarce and sold mortgages when wartime conditions led to an abundance of loanable funds while investment outlets were restricted. In 1948, the FNMA was authorized to purchase VA mortgages. Although the Emergency Home Finance Act of 1970 gave the FNMA the authority to purchase conventional mortgages, actual purchases did not begin until February 1972, so virtually all its activity has been in the area of Government-insured or Government-guaranteed mortgages. Conventional mortgages accounted for only 1 percent of its mortgage portfolio at the end of 1972.[9] However, the FNMA has recently increased its purchases of conventional mortgages.

Over the years, the FNMA has used its resources to support a variety of Government housing programs. This role was changed by the Housing and Urban Development Act of 1968, which divided the "old" FNMA into two corporate entities: the "new" FNMA, privately owned and retaining the secondary market function, and the Government National Mortgage Association, an agency within the Department of Housing and Urban Development, which assumed the functions of special assistance, management, and liquidation.

Although the FNMA is now privately owned, the President of the United States appoints five of its 15 directors. The Secretary of HUD has general regulatory responsibility over the corporation. Within statutory guidelines, the Secretary of HUD (1) sets FNMA's debt ceiling and the ratio of debt to capital, (2) sets the maximum rate for its cash dividends, and (3) approves the issuance of all its stock, obligations, and other securities. The Secretary of the Treasury must approve all debt issues, including the terms and conditions of sale, in order to assure coordination with Treasury debt operations.

The FNMA's basic function is to maintain a secondary market facility for residential mortgages by buying and selling mortgages. The price at which FNMA issues commitments to purchase mortgages is determined by the Free Market System auction procedure, under which commitments for the purchase of mortgages are offered on a competitive basis.

[8] Federal Home Loan Bank Board, *Selected Balance Sheet Data*, July 1973.

[9] Department of Housing and Urban Development, *Survey of Mortgage Lending Activity*.

The sellers of mortgages to the FNMA include mortgage companies, commercial banks, savings and loan associations, mutual savings banks, and others. During 1972, mortgage companies accounted for 76 percent of the mortgages purchased by the FNMA; banks and trusts accounted for 14 percent; the remainder was purchased from savings and loan associations, life insurance companies, the GNMA, and other lenders. Sellers must meet and maintain FNMA standards; most of them also have FHA approval. Normally, FNMA sellers retain the servicing of the loans.

Funds for mortgage purchases and operations are obtained from mortgage repayments; sale of debentures, notes, and other obligations; commitment fees; proceeds from mortgage sales; and the differential between interest income and borrowing costs. All sellers of mortgages to the FNMA are required by law to hold common stock of an amount equal to 0.25 percent of the unpaid principal amount of mortgages and loans purchased or to be purchased by the FNMA from such sellers. All servicers of one- to four-family home mortgages for the FNMA are required to hold varying percentages of common stock in the unpaid principal amount of mortgages serviced by the FNMA.

The Farmers Home Administration: The purpose of the Farmers Home Administration is to administer the farm credit and rural housing programs authorized by three principal statutes, as amended: Title V of the Housing Act of 1949; the Consolidated Farm and Rural Development Act of 1972; and Part A, Title III of the Economic Opportunity Act of 1964. The financial assistance authorized by these laws is offered to farmers and residents of rural areas in the form of direct loans, insured loans, and grants. The funds for loans and grants made by the Farmers Home Administration are obtained from three sources: annual appropriations by Congress, loans from the United States Treasury, and private lenders who supply funds for loans insured by the agency. Most loans are now made on an insured basis and utilize funds borrowed from private lenders rather than the United States Treasury.

The Farmers Home Administration entered the area of housing finance by making direct loans to owners of farms under the authority of the Housing Act of 1949. In 1961, the direct housing loans were extended to other residents in rural areas. Virtually all of the housing finance furnished by the Farmers Home Administration was in the form of direct loans financed by borrowing from the U.S. Treasury, until the creation of the Rural Housing Insurance Fund in 1965 allowed this agency to expand its operations significantly by switching from direct to insured loans.

The direct loan programs were restricted by the need to borrow funds from the Treasury, because the use of Treasury funds required the inclusion of the amount of the direct loans in the national debt and the budget. The insured loan program allowed the Farmers Home Administration to finance rural housing loans through a revolving fund. A loan is made initially with funds obtained from the revolving fund, and then the loan is sold to a private investor under an insurance agreement. Today the majority of loans are sold in "blocks" in the capital market. This method of insuring and selling loans provides that most outstanding insured loans do not have to be included in the budget or entered into the national debt.

The basic loan program of the Farmers Home Administration provides for the insurance of housing loans to residents of rural areas with or without interest rate "credits." In August 1973, the maximum interest rate on such loans was 7.75 percent; that rate could be reduced to as low as 1 percent, based upon the borrower's ability to pay as determined by the Secretary of Agriculture. These loans enable rural residents to obtain decent, safe, sanitary, modest housing at reasonable rates. The income level of the applicant determines the maximum amount of the loan, and the program is limited to low and moderate income families. The losses incurred by the interest rate subsidies are financed from general tax revenues.

At the end of 1972, the Farmers Home Administration was servicing $5.3 billion in outstanding residential mortgage debt. About $4.9 billion of this debt was financed by sales of Farmers Home Administration's insured notes, which bear the full faith and credit of the United States.

The Administrator of the Farmers Home Administration is appointed by the President.

The agency maintains 42 State offices serving the 50 States, Puerto Rico, and the Virgin Islands, and 1,723 county offices. Each county office is under the direction of a county supervisor and all are located to serve every agricultural county. Local citizens participate in Farmers Home Administration programs in the farm county committees. Each committee consists of three people appointed to assist in the administration of the programs.

Government National Mortgage Association: The Government National Mortgage Association (GNMA) was created in 1968 to assume responsibility for the special assistance and management and liquidation functions of the "old" FNMA. The GNMA is a wholly owned corporate instrumentality of the U.S. Government, operating within HUD; the Secretary of HUD determines general GNMA policies and appoints GNMA officers.

The special assistance functions are operated exclusively for the account of the Federal Government, with funds provided by the Secretary of the Treasury under authorization of Congress for the purchase of mortgages for designated Government housing programs. Programs under special authorization include housing in Guam and Alaska; housing in disaster and urban renewal areas; housing under the Sections 235 and 236 single and multifamily programs; and housing for the elderly, armed forces, and other low and moderate income families. Many of the mortgages obtained under these programs have been sold later to private lenders, particularly under the procedure known as the "Tandem Plan" described below.

The GNMA is authorized to manage and liquidate the portfolio of mortgages acquired for the account of the Government between February 1938 and November 1954. This includes the pre-Charter mortgage portfolio and outstanding commitments of the "old" FNMA. Also included in the management and liquidation functions were mortgages that other departments and agencies of the Government had directly acquired—for example, mortgages held by the Reconstruction Finance Corporation, the Defense Home Loan Corporation, and in later years, mortgages received from the Public Housing Administration. This function represented the centralization of Government mortgage liquidation programs. The GNMA acts as fiduciary with respect to participations in mortgages sold to private investors prior to August 1968, of which $4.4 billion currently are outstanding. During fiscal year 1973, more than $1 billion of mortgages in the GNMA portfolio were sold directly to lenders during periodic auctions.

The GNMA's authorization to purchase mortgages is limited (the present limit is $7.75 billion), but its authorization can be replenished by resale of the mortgages it buys. For example, in certain of GNMA's Tandem Plans, the GNMA purchases the mortgages insured under subsidized housing programs from private lenders and then resells them to the FNMA or other investors at the lower prevailing market price. In an effort to encourage private lenders to hold these mortgages, the GNMA oversaw the first auction of interest subsidy mortgages, in the amount of $229 million, in June 1972.[10] In fiscal year 1973, the GNMA sold in auctions a total of $1.1 billion of mortgages purchased under the Tandem Plan. The funds to cover the losses on the Tandem Plan, which totaled $65 million in fiscal year 1973, are charged against operations of GNMA's revolving funds.

In addition to its special assistance and management and liquidation functions, the GNMA has developed a number of instruments that are sold by private lenders to attract more funds into housing. These instruments are the pass-through mortgage-backed security and the mortgage-backed bond, both of which are fully guaranteed by GNMA for the timely payment of principal and interest.

The pass-through securities are issued in denominations of $25,000 and are fully amortized, with the investor receiving monthly payments of principal and interest as well as any prepayments of the mortgages backing the pass-throughs. Almost all of the pass-throughs have been issued by mortgage companies as an alternative to selling directly to institutional investors the mortgages they originate. The issuer of the pass-throughs must pay the GNMA an application fee of $500 per pool of mortgages to obtain a commitment from the GNMA to guarantee the pass-through plus a

[10] Department of Housing and Urban Development, Government National Mortgage Association, *Annual Report 1972*, Washington, DC.: Government Printing Office, 1972.

fee of 6 basis points (0.06 percent) on the unpaid principal balance on the pass-through securities.

As of June 30, 1973, a total of $7.8 billion of pass-throughs had been sold. During the first 3 years of the program, savings and loan associations and mutual savings banks purchased more than 60 percent of these securities. Since March 1973, however, more than 80 percent of the pass-throughs issued have been sold to pension funds, life insurance companies, and other institutions.

Federal Home Loan Mortgage Corporation: The Emergency Home Finance Act of 1970 created the Federal Home Loan Mortgage Corporation, the principal purpose of which is to serve as a central credit facility and secondary market for conventional mortgages. The Federal Home Loan Mortgage Corporation is a private corporation and is a member of the Federal Home Loan Bank System. The three Presidentially appointed directors of the Federal Home Loan Bank Board also serve as the directors of the Corporation. The Federal Home Loan Mortgage Corporation was initially financed by the sale of $100 million in nonvoting stock with a no-call provision to the 12 Federal Home Loan District Banks. Additional funds have been acquired through the sale of bonds and participation certificates.

Because most mortgages originated by lenders are of the conventional type, the absence of a central credit facility for these mortgages has limited the ability of public agencies to moderate fluctuations in housing starts and to insure that mortgage lenders have adequate funds and liquidity.

The Federal Home Loan Mortgage Corporation plays two primary roles as a mortgage market support agency. First, it acts as a financial intermediary and mortgage broker by purchasing mortgages for its own portfolio or for sale to other investors. Second, it attempts to develop a private secondary market for mortgages that will exist independent of Government-sponsored mortgage market support institutions.

Although the Federal Home Loan Mortgage Corporation was established to support the conventional market, most of its initial purchases have been Government-insured or Government-guaranteed mortgages. Conventional mortgages accounted for only about 12 percent of its total purchases during 1972, but the Federal Home Loan Mortgage Corporation anticipates that in 1973 more than 80 percent of its volume will be in the conventional mortgage sector. As a new organization, the scope of its activities is small in relation to the size of the market. The Federal Home Loan Mortgage Corporation's purchases of FHA–VA mortgages in 1972 accounted for only 4.9 percent of the FHA–VA mortgages originated that year.

The sales participation certificates represent a participation in groups of conventional mortgages acquired by the Federal Home Loan Mortgage Corporation. The Federal Home Loan Mortgage Corporation acquires a participation interest by providing a portion of the funds for a group of mortgages originated by a private lender. It then separates this acquired participation into certificates designed for easy marketability and sells them to investors at a yield slightly below the yield on the pool of mortgages. The Federal Home Loan Mortgage Corporation guarantees the timely payment of interest and principal. Approximately $550 million of these certificates had been sold by the end of 1972, mostly to savings and loan associations.[11]

INSURERS AND GUARANTORS

This subsection deals with the principal public and private institutions that insure or guarantee mortgages:

- Federal Housing Administration;
- Veterans Administration; and
- Private mortgage insurance companies.

By insuring or guaranteeing the prompt payment of principal and interest on individual mortgages, as well as the payment of claims on default, these institutions contribute to the marketability of mortgages by decreasing the risk of mortgage investment. This enables large quantities of mortgages to be aggregated in salable blocks and exchanged on the secondary market with relative safety for the investor.

Each institution is discussed below in terms

[11] Federal Home Loan Mortgage Corporation, *1972 Annual Report*, Washington, D.C.: 1973.

of operation and market acceptability, volume, specific segments of the market it serves, and its effect on lending risk.

Federal Housing Administration: The Federal Housing Administration was created by the 1934 National Housing Act with the authority to insure mortgage loans made by private lenders on homes through creation of a mutual mortgage insurance fund. Prior to 1934, residential mortgages often required a 50 percent downpayment and a 5-year term during which interest was payable annually; frequently the principal fell due in full at the end of the term. FHA changed the nature of housing finance by offering different terms: long-term, level debt service and low downpayment. This resulted in reduced monthly payments and enabled greater numbers of families with little savings but adequate incomes to qualify for home loans. The principal purposes of FHA are to improve home financing practices, to encourage improvements in housing standards and conditions, and to facilitate homeownership.

FHA is a Government agency operating within the Department of Housing and Urban Development. The FHA Commissioner is an Assistant Secretary of HUD.

FHA administers a number of mortgage insurance programs under which mortgage lenders are insured against loss in financing first mortgages on single-family homes, on multifamily housing projects, and on loans to finance repairs and/or home improvements. FHA is designed to be a self-funded entity; the main source of funds is a mortgage insurance premium paid by the mortgagor. This generally amounts to 0.5 percent of the principal balance outstanding.

The security of FHA-insured loans makes them the safest investment available in the mortgage market. Although default imposes legal and other costs that are not covered, the 100 percent Government backing greatly reduces risk, and consequently they are the most heavily traded instruments in the secondary mortgage market, accounting for about 39 percent of all residential loan purchases in 1972.

The current ceiling on allowable interest rates for FHA-insured mortgages is 9.5 percent. The borrower must also pay the 0.5 percent insurance premium, making the effective borrowing costs of an FHA loan 10.0 percent. When market interest rates on mortgage debt rise above the FHA ceiling rate, lenders and investors must acquire FHA loans at a discount in order to obtain a competitive yield. Although the mortgagors are not permitted to pay the discount directly, they do so indirectly by paying a higher price for the house because the seller must pay the discount.

Delays in processing, insurance payment delays, and competition from private mortgage insurance companies have contributed to declines in the last two years in the volume of FHA insurance written.

FHA also administers a number of programs that do not involve mortgage insurance. The nonmortgage insurance programs include:

- A recent supplement program under which low income families in approved projects can receive rent supplement payments for that portion of the rent in excess of 25 percent of their family income;
- Homeownership programs that assist low income families in acquiring a place of residence by making assistance payments on mortgages to lenders on behalf of qualified borrowers; and
- A nonprofit sponsor assistance program that will loan interest-free money to qualifying nonprofit organizations for preconstruction expenses.

Veterans Administration: The housing function of the Veterans Administration is to aid veterans in obtaining loans on favorable terms to buy or build homes with no downpayment required by the Government. It maintains three major areas of authority:

- Partially to guarantee loans made to veterans by eligible lenders;
- To insure loans made to veterans by private lenders; and
- To make direct loans to veterans in instances where mortgage credit is not otherwise available.

Eligible beneficiaries include World War II and Korean War veterans, unremarried widows of veterans, and veterans of service after January 31, 1955. In fiscal year 1973, VA guaranteed more than 365,000 home loans totaling nearly $8.5 billion.

Lenders are not required to be approved by VA in order to process loans. VA regulations provide, however, that lenders must demonstrate ability to properly service loans, maintain adequate loan accounting records, and make proper credit determinations. The distinction between supervised and nonsupervised lenders is that supervised lenders may close loans and report them for automatic guarantee, whereas nonsupervised lenders are required to submit all loans to VA for approval before closing.

Practically all VA-guaranteed loans relate to the purchase of single-family homes, mobile homes, and units in condominium projects. VA is authorized to insure loans, but this form of lender protection is intended principally for short-term business loans, although a few home loans have been insured.

The VA guaranty is for 60 percent of the loan, but not to exceed $12,500. VA appraises each property which is to be the security for a guaranteed loan. Before a loan may be guaranteed, the determination must be made that the veteran is a satisfactory credit risk and that he has the income with which to repay the loan obligation. All VA loans are required to be secured by first liens.

The attraction of VA loans to lenders and investors is that the protection afforded by the guaranty reduces the risk of mortgage investment. In the event of default, VA will settle with the mortgage holder by allowing interest accrued to the date of foreclosure, plus foreclosure expenses. All such settlements are paid in cash and such payments are made promptly after VA's receipt of guarantee claims.

VA home loans have several advantages for veterans.

- No downpayment is required.
- The loan may be repaid in part or in full at any time without penalty.
- VA will allow for circumstances involving temporary distress leading to difficulties in making loan payments.
- The veteran has the benefit of VA appraisal services, construction supervision, a builder's warranty, and oversight of the mortgage lender's activities.

The current ceiling interest rate on VA mortgages is 9.5 percent. Although veterans are forbidden to pay discount points directly, they do so indirectly by paying a higher price for their homes.

Private Mortgage Insurance: During the past few years, private mortgage insurance companies have become increasingly active in the field of mortgage insurance. The role of private mortgage insurance companies in the market is somewhat supplementary to FHA/VA and offers the lender of conventional loans an inducement to invest in high loan-to-value ratio mortgages with relatively little risk. The availability of high loan-to-value conventional mortgages makes homeownership a possibility for a larger number of families.

Private mortgage insurance companies are subject to the regulation of the States in which they operate. Most States have granted licenses to mortgage insurers under general provisions of the insurance codes, although some are more comprehensive—specifying liquidity requirements, domain, maximum coverage, total liability, dividend policy, reserve requirements, fee limitations, etc.

A lender who has been approved by a private mortgage insurance company may submit an application for insurance on a loan if he feels that the credit of the applicant borrower is satisfactory and the lender wishes to avoid the risk of property value decline. This practice usually is exercised on loans with a loan-to-value ratio of 90 percent or higher. The highest loan-to-value ratio on conventional mortgages that the Federal Home Loan Bank Board permits member savings and loan associations to originate is 95 percent. The Comptroller of the Currency restricts national banks to a maximum loan-to-value ratio of 90 percent on such loans. Since private mortgage insurance normally covers the top 25 percent of a 95 percent loan (it pays 25 percent of a total claim after foreclosure) then the property value would have to decline about 30 percent (5 percent equity and 25 percent coverage) before the lender would actually lose money on his investment in the mortgage.

The mortgagor usually pays the insurance premium, typically 0.25 percent per annum on the unpaid balance of the loan. This is about one-half the FHA premium. The policy is sub-

ject to cancellation at the discretion of the lender. After the mortgagor has amortized the loan to 60 to 70 percent of value, the lender frequently will permit the policy to terminate because risk of losing principal through foreclosure is then negligible.

Private mortgage insurance companies can process insurance applications very quickly, usually reporting a decision within 24 to 48 hours of receipt of the application. Insurance claims also are processed rapidly. In addition to their relatively low costs, this facility gives private mortgage insurance companies a significant advantage over FHA.

The Federal National Mortgage Association and Federal Home Loan Mortgage Corporation have approved at least eight private mortgage insurance companies whose insured loans they will purchase in their conventional secondary market operations.

4 Suspended Subsidy Programs

Introduction

The Congress of the United States in 1949 established as a national goal "a decent home and a suitable living environment for every American family." Almost 2 decades later, despite substantial progress in the elimination of substandard housing, full achievement of that goal remained elusive. Consequently, in the Housing Act of 1968, the Congress added to the original objective a specific 10-year production target aimed at making the goal a reality. Congress determined that the goal of a decent home for all "could be substantially achieved within the next decade by the construction or rehabilitation of 26 million housing units, 6 million of them for low and moderate income families."

To initiate new progress toward that production target, several new programs were initiated and existing programs expanded in fiscal year 1969. A summary of the characteristics of the major subsidized housing programs is contained in Table 1. These programs have two elements in common: they are basically production programs (i.e., designed to increase the supply of housing); and the subsidy payments are tied to the dwelling unit—if the occupant family moves out of the unit, it loses the housing subsidy.

Under these programs, rental and homeownership units were produced so that the varied life styles and needs of low and moderate income families could be accommodated. Rural areas were accorded a share of the new dwellings; profitmaking as well as nonprofit developers and sponsors were given a role. The Tax Reform Act of 1969 encouraged further involvement of profitmaking enterprises by providing special treatment for investors in low and moderate income housing.

The legislative history of the 1968 Housing Act demonstrates a continuing desire to replace substandard with standard housing, to stabilize the housing industry, to retard the decay of central cities, and to provide training and jobs for disadvantaged persons. But apparently little consideration was given to the economic and social costs and benefits, the equity aspects, and the overall impact on local housing markets of subsidizing large numbers of newly built units for lower income families.

In 1970, in a major production effort, about 470,000 subsidized units—more than twice as many as in any previous year—were started or substantially rehabilitated under HUD and Farmers Home Administration (FmHA) programs. The new subsidized starts alone amounted to almost 30 percent of all housing starts in 1970 (Table 2). In the same year, almost 80,000 existing housing units were committed for subsidy to house low and moderate income families. In many cases, these housing units were improved in quality through rehabilitation (Table 3). In 1971, almost as many subsidized units were started or rehabilitated as in 1970.

Even as early as 1970, however, concern about subsidized housing programs began to surface. The House Committee on Banking and Currency concluded after an investigation that the Federal Housing Administration "may be well on its way toward insuring itself into a national housing scandal."[1] Moreover, purchasers were reported to be abandoning homes in some parts of the country and overproduction was apparent elsewhere. Widely publicized scandals in 1971 raised additional questions about Government-subsidized housing programs.

A 1972 internal HUD audit[2] indicated that the cost of Section 236 dwelling units was higher than similar conventionally built units and that architectural fees were often excessive; a General Accounting Office audit[3] of the Section 236 program in 1972 reported excessive land valuations, among other problems. As acquisitions by the Secretary began to mount, several press articles referred to HUD as the Nation's largest slumlord. Members of Congress and HUD received numerous letters from persons

[1] U.S. Congress, House Committee on Banking and Currency, Staff Report Recommendations, *Investigation and Hearing of Abuses in Federal Low- and Moderate-Income Housing Programs*, Washington, D.C.: Government Printing Office, 1970, p. 1.

[2] Department of Housing and Urban Development, Office of Audit, *Report on Audit of Section 236 Multifamily Housing Program*, Washington, D.C., January 29, 1972.

[3] General Accounting Office, *Opportunities to Improve Effectiveness and Reduce Costs of Rental Assistance Housing Program*, Washington, D.C., January 10, 1973.

Table 1. Summary of Major Subsidy Program Characteristics

Program	Low rent public housing
Objective	Assist Local Housing Authorities (LHA) to provide decent, safe, and sanitary housing for low income families at rents they can afford.
Mortgage Limits	Cost for dwelling construction and equipment may not exceed by more than 10 percent the published prototype cost for the area.
Subsidy	Loans made for planning and construction. Annual contributions made to cover debt service or, for leased units, the difference between actual and market rents. Contributions also available for operating subsidies. Tenant to pay no more than 25 percent of adjusted income toward rent.
Eligibility Criteria	Applicant must be a "family" as defined by LHA, or if a single person, must be at least 62 years of age, disabled, handicapped, or be displaced by Urban Renewal, other governmental action, or natural disaster.
Income Limits for Admission	Limits set by LHA and approved by HUD. Limits usually set at "typically low annual wage" in the area.

Program	Rent supplement
Objective	To make good quality housing available to low income families at a cost they can afford.
Mortgage Limits	Limits applicable to Section 236 or other program under which the project is financed.
Subsidy	Direct cash payments to owner of housing on behalf of tenant to cover difference between tenant's payment and economic rent. Tenant to pay 25 percent of adjusted income or 30 percent of economic rent, whichever is greater.
Eligibility Criteria	The family or individual must be an occupant of substandard housing, victim of natural disaster, displaced by government action, handicapped, or at least 62 years of age; a family may also qualify if head or spouse is in armed forces.
Income Limits for Admission	Established by HUD, no higher than the local public housing limits.

Program	Section 235
Objective	To make homeownership of good quality housing more readily available to lower income families.
Mortgage Limits	$18,000 (or $21,000 in high cost areas); $3,000 can be added for property consisting of four bedrooms purchased by family of five or more persons.

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Subsidy	Direct cash payment to lender on behalf of lower income family, which can reduce amortization cost to as low as 1 percent interest. Homeowner must pay a minimum of 20 percent of adjusted income toward regular monthly payments.
Eligibility Criteria	Must be a "family" of two or more persons related by blood, marriage, or operation of law, or handicapped person, or a single person at least 62 years of age.
Income Limits for Admission	Adjusted family income must not exceed 135 percent of public housing income limits for the area. "Exception" limits may be used for up to 20 percent of contract authority.

Program	Section 236
Objective	To provide good quality rental and cooperative housing for persons of lower income.
Mortgage Limits	Varies by size of unit, type of structure, and cost level of area from $9,200 to $37,935 per unit; total limit of $12.5 million per project.
Subsidy	Direct cash payments to lender on behalf of owner. Payments can reduce amortization cost to 1 percent interest. Tenant pays the greater of 25 percent of adjusted income or established "basic" rent.
Eligibility Criteria	Same as Section 235. (Also 10 percent of dwelling units may be used for single people under 62 years of age.)
Income Limits for Admission	Same as Section 235.

Program	Farmers Home Administration Section 502 interest credit
Objective	To make homeownership of good quality housing more readily available to low and moderate income rural families.
Mortgage Limits	100 percent of appraised value for modest housing.
Subsidy	Credits which reduce amortization cost to as low as 1 percent interest. Homeowner must pay a minimum of 20 percent of adjusted income toward mortgage payments, taxes, and insurance.
Eligibility Criteria	Must be a family which does not have an adequate home and will become resident in a rural area after the loan is closed. Also unable to obtain credit at reasonable terms.
Income Limits for Admission	$7,000 annual adjusted income.

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Program	Farmers Home Administration Section 504
Objective	Assist rural owner-occupants to make their dwellings safe and sanitary and to remove health hazards.
Mortgage Limits	Maximum loan $2,500; additional $1,000 may be used for repairs or improvements involving water supply or plumbing.
Subsidy	Interest rate is 1 percent; loan repayable in up to 10 years.
Eligibility Criteria	Must be homeowner or long term lessee living in hazardous dwelling in a rural area, and unable to obtain credit at reasonable terms.
Income Limits for Admission	Low income; income sufficient to allow repayment, but not sufficient to qualify for section 502.

Source: Department of Housing and Urban Development and Department of Agriculture.

Table 2. Annual Housing Production, 1961–1972

(Units in Thousands)

Calendar Year	Housing Starts				Federally Subsidized Rehabilitation	Mobile Home Shipments	Total Housing Production
	Total	Non-subsidized	Federally Subsidized	Subsidized as Percent of Total			
1961	1,365.0	1,328.8	36.2	2.7%	2.4	90.2	1,457.6
1962	1,492.5	1,453.6	38.9	2.6	2.5	118.0	1,613.0
1963	1,634.9	1,587.3	47.6	2.9	2.6	150.8	1,788.3
1964	1,561.0	1,505.9	55.1	3.5	3.4	191.3	1,755.7
1965	1,509.7	1,446.0	63.7	4.2	5.9	216.5	1,732.1
1966	1,195.8	1,124.9	70.9	5.9	11.6	217.3	1,424.7
1967	1,321.9	1,230.5	91.4	6.9	16.1	240.4	1,578.4
1968	1,545.4	1,379.9	165.5	10.7	36.1	318.0	1,899.5
1969	1,499.5	1,299.6	199.9	13.3	32.1	412.7	1,944.3
1970	1,469.0	1,039.2	429.8	29.3	40.7	401.2	1,910.9
1971	2,084.5	1,654.5	430.0	20.6	41.0	496.6	2,622.0
1972	2,378.5	2,039.7	338.8	14.2	50.8	575.9	3,005.2

Note: Detail may not add to totals because of rounding.

Source: Department of Housing and Urban Development; Department of Agriculture; Mobile Home Manufacturers' Association.

expressing dismay that families with incomes similar to theirs were receiving brand new housing while paying less rent because of Government subsidy payments. A Department of Agriculture audit of FmHA programs found major problems in some projects, including inadequate water supplies, septic systems, and road development.[4] Although some of these

[4] Department of Agriculture, Office of the Inspector General, *Review of Farmers Home Administration Activities with Emphasis on the Rural Housing Program*, 1973, unpublished.

States reported an average monthly rental component. Also, the monthly rental allotment is available only for certain sizes of families. There is no average for all family sizes. As a result, the housing costs listed under Aid to Families with Dependent Children is derived by multiplying the shelter cost estimate for a family of four by the number of families receiving Aid to Families with Dependent Children. The Old Age Assistance column was derived by multiplying the rent allotment for a one-person household by the number of recipients in the program.

It can be assumed that in the absence of overall welfare assistance from Federal, State, and local governments, housing conditions would be much worse for many of the aid recipients. It is widely recognized, however, that the levels of total welfare assistance in most cases are not adequate for providing an acceptable standard of living, including safe and sanitary housing.

Where overall welfare levels, including housing allotments, are low, the recipient is often unable or unwilling to provide a reasonable return to landlords renting standard housing. This inadequate market demand in lower income areas with high concentrations of welfare recipients is believed to encourage disinvestment in, and abandonment of, older housing units; this may be an important factor in the decay of inner city housing. Of course, what is true of housing is true of all other items in the family's budget: If the combination of family earnings and assistance payments is not sufficiently high, consumption will suffer.

Table 3. Estimated Expenditures on Housing Through Public Assistance Programs in 1972

State	AFDC Monthly Rent Allowance	AFDC Caseload	AFDC Monthly Housing Cost for Caseload	OAA Monthly Rent Allowance	OAA Caseload	OAA Housing Cost for Caseload
Alabama	$19	42,927	$815,613	$40	113,403	$4,563,120
Alaska	140*	4,021	562,940	145	1,997	289,565
Arizona	81	18,829	1,525,149	49	13,719	672,231
Arkansas	35	21,911	766,885	35	58,245	2,038,575
California	140	444,865	62,281,100	63	307,748	19,388,124
Colorado	69	30,580	2,110,020	45	31,137	1,401,165
Connecticut	162	31,853	5,160,186	103	8,288	853,664
Delaware	63	9,282	589,766	66	2,987	197,142
District of Columbia	94	26,668	2,506,792	68	4,055	275,740
Florida	81	89,562	7,254,522	50	68,535	3,426,750
Georgia	46	96,252	4,427,592	40	91,578	3,663,120
Guam	20**	610	12,200	20**	479	9,580
Hawaii	157	11,553	1,813,821	59	2,975	175,525
Idaho	68	6,824	464,032	76	3,405	258,780
Illinois	97	186,019	18,043,643	97	34,202	3,313,594
Indiana	100	47,680	4,760,800	100	16,005	1,600,500
Iowa	70	24,258	1,698,060	33	21,581	712,173
Kansas	125	21,068	2,633,500	125	10,251	1,281,375
Kentucky	52	41,451	2,155,452	23	57,167	1,314,841
Louisiana	22	63,171	1,389,762	35	114,050	3,991,750
Maine	115	18,408	2,116,920	43	11,017	473,731
Maryland	41	57,444	2,355,204	41	9,934	407,294

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Massachusetts	78	81,130	6,328,140	50	58,027	2,901,350
Michigan	145	160,305	23,244,225	145	42,675	6,185,265
Minnesota	130	38,510	5,006,300	105	18,116	1,902,180
Mississippi	50	44,445	2,222,230	50	82,867	4,143,350
Missouri	40	64,646	2,585,840	40	93,188	3,727,520
Montana	58	6,552	380,036	29	3,029	87,841
Nebraska	100	12,024	1,202,400	100	7,255	725,500
Nevada	58	4,773	276,834	52	3,063	109,270
New Hampshire	85	5,861	498,185	70	4,604	322,280
New Jersey	100	109,919	10,991,900	75	20,497	1,537,275
New Mexico	47	16,187	760,789	37	8,422	311,614
New York	105	355,491	37,326,555	75	115,428	8,657,100
North Carolina	62	47,215	2,927,330	72	35,139	2,530,008
North Dakota	72	4,364	314,208	62	4,234	262,508
Ohio	96	130,512	12,529,152	58	50,275	2,915,950
Oklahoma	40	30,237	1,209,480	30	66,125	1,983,750
Oregon	54	25,218	1,361,772	42	7,450	312,900
Pennsylvania	86	173,592	14,928,912	65	50,018	3,251,170
Puerto Rico	20	53,693	1,073,860	20	20,302	406,040
Rhode Island	80	14,051	1,124,080	80	3,997	319,760
South Carolina	40	26,304	1,157,376	35	17,343	607,005
South Dakota	95	6,246	593,370	100	3,723	372,300
Tennessee	33	54,666	1,803,978	33	48,852	1,612,116
Texas	33	117,971	3,893,043	33	207,000	6,831,000
Utah	75	12,619	946,425	36	2,823	101,628
Vermont	104	5,259	546,936	104	4,097	426,088
Virgin Islands	16	755	12,080	12	317	3,804
Virginia	95	44,055	4,185,225	95	14,665	1,392,225
Washington	91	45,097	4,103,827	61	19,251	1,174,311
West Virginia	38	20,319	772,122	33	13,013	429,429
Wisconsin	130	40,097	5,212,610	130	20,257	2,633,410
Wyoming	100	2,052	205,200	65	1,348	87,620
Total (monthly)			275,163,579			108,621,906
Total (annual)			3,301,962,948			1,303,462,872
Total (both programs)						4,605,425,820

*Figure not reported; imputation based on California estimate since California need standard is most comparable need standard.

**Figure not reported; imputation based on Puerto Rico estimate, since Puerto Rico need standard is most comparable need standard.

Source: Department of Health, Education, and Welfare, National Center for Social Statistics.

Other Federal Policies Affecting the Housing Market

Labor Policy

With the passage of the Davis-Bacon Act in 1931—an anti-Depression measure—the Federal Government embarked on a course that has significantly affected housing construction costs through the years.

The act established a policy of protecting local wage rates—initially on all Federal construction projects, and later on federally assisted housing construction as well. Today it is applied to almost every major Federal housing program with the exception of one- to four-family units constructed under federally insured or subsidized home mortgages.

The act requires that wages to laborers on

problems obviously could be alleviated by administrative solutions, it was also apparent that the programs might contain basic structural flaws that would make effective administration impossible.

This chapter presents an assessment of the costs and benefits, the equity, and the impact of major subsidized housing programs on recipients' welfare: low rent public housing, the Section 235 homeownership, the Section 236 rental assistance, the rent supplement, the Section 502 interest credit and noninterest credit rural homeownership, and the Section 504 rural home repair assistance programs. The programs are evaluated as national programs; therefore, the data and the results are generalized at the national level: this means that the findings are not always applicable to a specific region, locality, or project.

The chapter begins with a discussion of criteria for a nationwide evaluation and then presents the major findings and conclusions. A description of overall program equity, some evidence of social impact, and an analysis of the individual subsidy programs follows. The final section of this chapter discusses several special issues.

Table 3. Units Committed For Subsidy,[1] 1961–1972
(Units in Thousands)

Year	New	Existing or Rehabilitated	Total
1961	33.8	4.0	37.8
1962	42.9	3.4	46.3
1963	60.3	5.1	65.3
1964	65.2	4.3	69.5
1965	54.1	9.4	63.5
1966	72.2	26.7	98.9
1967	107.8	40.5	148.3
1968	139.5	57.9	197.3
1969	184.3	65.2	249.5
1970	366.1	79.7	445.7
1971	367.3	63.4	430.7
1972[2]	352.0	83.9	435.9

Note: Detail may not add to totals because of rounding.

[1] Includes units with mortgage insurance written for assistance under the Home Section 235(i), Multifamily Housing Sections 236, 235(j), below market interest rate programs, and rent supplement programs not elsewhere counted; units financed by direct loans under Section 202; low rent public housing units with assistance contracts executed; units financed by initial loans or grants made under Section 502 Low and Moderate Income Program, and Sections 515, 521, 514, 516 Family Housing Programs.

[2] Preliminary.

Source: Department of Housing and Urban Development; Department of Agriculture.

Criteria For A Nationwide Evaluation

A thorough and fair assessment of the Federal Government's subsidized housing programs must begin with the selection of an appropriate set of expectations against which to gage performance. A logical starting point is to identify whom the programs serve and how the programs affect these and other groups. Costs and benefits—or, more precisely, the relationship between costs and benefits—also are important concerns. This section sets forth relevant considerations for judging subsidized housing programs. Every effort has been made to state the issues in a way that makes statistical analysis both possible and meaningful. All important issues appear to be simple extensions of three basic questions:

1. Equity: Are the subsidized housing programs serving the appropriate people?

2. Impact: Are the programs having the desired effect on those served, and on the community at large?

3. Efficiency: How do the benefits compare to the costs incurred?

Each of the criteria provides a different perspective on the subsidized housing programs. A program should not be judged on the basis of a single criterion to the exclusion of others. In addition, poor program performance with respect to any one criterion should be weighed against the potential of alternative programs to perform better under the same criterion.

Equity

Shelter, along with food, clothing, and medical care, is considered a basic necessity of life. The subsidized housing programs evolved

from public recognition that adequate housing is not available to all families. "Adequate" housing may be unavailable in two ways: either a family's dwelling fails to satisfy certain minimal standards of safety and sanitation, or the family does have satisfactory housing but at a price that severely limits the family's ability to afford other necessary goods and services. Expressed in this way, the housing problem is essentially an income problem. A low income family either must forgo satisfactory housing or, if possible, purchase it by sacrificing other important needs.

In this chapter, the subsidized housing programs will be judged by the extent to which they, singularly and in combination, channel assistance to those most in need—families with low income. This criterion is consistent with congressional intent. All the subsidized programs have income limits designed to restrict assistance to lower income families. The limits vary by program and by area. The Section 235 and Section 236 limits are higher than those for the public housing and rent supplement programs, but Congress clearly did not intend for these programs to exclude those with low incomes. The statute requires both programs to be administered in a manner that establishes a preference for families having incomes "within the lowest practicable limits."

In 1972, HUD, to protect Section 236 projects from financial difficulties, attempted to limit admission to those families who could afford the rent with an expenditure of less than 35 percent of their adjusted income.[5] A Federal district court found this requirement to be inconsistent with the goals of the program.[6] The court declared that "the Section 236 program is aimed at lower income families including those eligible for public housing and that the two programs envision substantial overlap." Furthermore, the court pointed out that HUD was severely criticized at the outset of the congressional debates over Section 236 for directing prior housing projects toward moderate rather than lower income families.

This criterion is also in accord with public opinion. In a recent survey of attitudes toward Federal Government assistance, the public supported governmental help for housing for low income families by a margin of 68 percent to 12 percent, while rejecting similar assistance to families of moderate income by 59 percent to 27 percent.[7]

The similarity between a family's having a housing problem and having low income is not exact. Differences in the cost of housing in different areas imply that a family income sufficient to afford adequate housing in one locality may be insufficient in another locality. It is possible that market imperfections could make adequate housing available only at excessive prices in some localities so that a family would need a substantial annual income to afford adequate housing. In general, however, a family's level of income is a good indicator of its housing need.

Three measures have been selected to indicate the extent to which the subsidized housing programs, singularly or in combination, provide assistance to low income families. First, attention is given to the distribution of program recipients by income. One would expect that the majority of recipients would be found in the low income range and that a relatively small percentage would be found in the higher income brackets. The second measure is the number of families earning less than a certain income who receive no housing assistance from any Federal program. This measure provides an approximate estimate of the unserved need. The third measure is the average subsidy per recipient household at various income levels. One would expect the average subsidy to decline from the lower income brackets to the higher income brackets, especially if housing assistance is designed to enable families to obtain adequate but not deluxe housing.

There is no clear dividing line between low and moderate incomes. For illustrative purposes, $5,000 was chosen as an arbitrary dividing line between the most needy and those less in need.[8] In order to obtain a full perspective on the equity issue, however, one should

[5] HUD Circular No. 4442.18.

[6] *Findrilakis, et al.* v. *Romney*, U.S.D.C., N.D. Calif., C.A. No. C-72-801 RFP (1973). *Larson, et al.* v. *Romney, et al.*, U.S.D.C., N.D. Calif., C.A. No. C-71-2429 RFP (1973).

[7] Louis Harris and Associates, Inc., "A Study of Public Attitudes Toward Federal Government Assistance for Housing Low Income and Moderate Income Families," prepared for the National Housing Policy Review, July 1, 1973.

consult the tables which accompany the analysis. The conclusions of the chapter with regard to program equity are not significantly altered by reasonable variation in one's choice of a dividing line between those families most in need and those less in need.

The foregoing discussion of equity considers distinctions between income classes on the presupposition that subsidized housing programs should treat people differently depending on their income—the concept of "vertical equity."[9] These programs also should provide equal treatment to those who have approximately equal income. This dimension of the equity question is called "horizontal equity." In other words, the programs should not provide extensive benefits to one family and no benefits to another family with identical income. One special case of horizontal equity—called geographical equity—determines whether families in one section of the country have a higher probability of being served than families with identical income in other sections of the country.[10]

These various tests of vertical and horizontal equity were performed for each of the subsidized programs and for all five programs combined. The assessment of overall equity is particularly important because the more relevant consideration is how well the programs function together to meet the observed need.

It should be emphasized that almost any housing assistance program—indeed, virtually any program of assistance to anyone—will have some inequities. The major question is whether alternative housing programs or alternative policies for addressing the low income problem will perform better or more poorly in terms of the equity criteria.

[8] A Bureau of Labor Statistics study (Press Release of June 15, 1973) indicates that in 1972 annual renter costs for a family of four on a "lower budget" averaged $1,205 over the United States. A family with income over $5,000 annually could afford such a unit with an expenditure of less than 25 percent of income. The BLS "lower budget" renter costs are for a unit which provides more than minimally adequate housing.

[9] This assumes that other relevant characteristics are similar, such as family size.

[10] In applying the equity criteria to the programs, it was impossible to adjust for differences in the cost of housing and other goods in various parts of the country.

Impact

Impact criteria measure whether the subsidized programs have the desired effect on those served and on the community at large. Many separate issues are subsumed under this concept. The subsidized housing programs have a common structure: The recipients are provided housing units, they make payments (either rent or mortgage), and the Government makes subsidy payments on their behalf.

The Federal Government's payment is designed to allow the recipients to receive more housing than their payments alone could buy.[11] One impact measure, then, is the amount of "extra housing" received by the beneficiary. The difference between the amount paid by a family for a subsidized unit and the market value of that unit (the price it would command on the open market) is the extra housing received by the subsidized family.[12]

A second impact measure is the extent to which the beneficiaries of the subsidy programs actually live in better housing than they would have otherwise. This can be determined by relating the market value of subsidized units to the cost of housing the family would have occupied in the absence of the program. The percentage improvement in the quality of the subsidy recipient's housing can be derived from this relationship. If one assumes that low income households have very little or nothing to put into savings, then the percentage of change in expenditures on goods and services other than housing can also be derived.

In part, the special emphasis placed on housing by society reflects society's expectation that better housing benefits the occupants in important ways such as improved health, greater family stability, better school performance by children, etc., or benefits society in

[11] It is useful to picture a housing unit as providing a quantity of housing services. These services depend on the size of the unit; its amenities, such as whether it has air conditioning; its design; and its location. The more amenities or the better the location, the more housing services provided by the unit. In comparing the quantity of housing services provided by two different units, it may be perceived that the poorer location of one may be offset by a larger number of amenities.

[12] This assumes a competitive housing market.

terms of lower crime rates, achievement of racial or economic integration, or other societal goals. A special section of this chapter will review existing research and other information on the social impact of better housing.

Another impact issue concerns the extent to which the welfare of the average family is increased by participating in the subsidized housing programs. All five programs studied provide benefits "in-kind" rather than "in-cash": in other words, the family is given a unit rather than money. With an unrestricted cash grant, the family could choose the particular housing, or the combination of housing and other goods, that it most prefers. Under the subsidized housing programs, the family has a much narrower range of choice. It is useful to determine the extent to which this constraint tends to decrease the value of the subsidy to the family. One way to measure this effect is to estimate the amount of the cash grant that the family would accept in lieu of participation in the subsidy program. This cash grant represents the actual dollar benefit to the recipient of the subsidy received through the program.

Efficiency

Efficiency criteria measure the relationship of benefits to costs. If benefits are high relative to costs, the program is efficient, and vice versa. There are several possible efficiency measures, depending on the cost or benefit concepts utilized. In general, the measurement of costs cannot be limited merely to the Federal Government's direct subsidy payment but also must include any other costs incurred by Government as a result of the program—for example, administrative costs, taxes forgone, default costs exceeding mortgage insurance premiums, and any special Government interest rate subsidies. In this evaluation, an efficiency measure of 1.0 means that the total Government costs are transformed into benefits of equal magnitude. A measure less than 1.0 means the benefits are less than the costs. For example, an efficiency measure of 0.75 means that $1 of total Government cost produced 75 cents worth of benefits.

One important efficiency measure is the extent to which the extra housing provided under the program—the difference between what the family would have to pay for an unsubsidized unit and the amount paid for a similar subsidized unit—relates to the costs incurred by the Government in providing the extra housing. This ratio is defined as "Production Efficiency," i.e., the ratio at which the Government transforms tax dollars into extra housing.

Production Efficiency depends upon several factors: one of them is the cost of construction. If the prices paid for Government-subsidized construction are higher than those paid by conventional builders, then Production Efficiency will be low. The relationship between the total development cost of a project built conventionally and an identical project built through Government subsidy programs is a measure of "Construction Efficiency."

Housing consists of more than just structure. Location, design, financing, and operating costs all enter into total costs as well. The price paid by occupants and by all levels of Government for construction, operation, and all other cost factors involved in a housing unit, divided into the price of a similar unit in the private market, is a measure of "Technical Efficiency."

It was noted in the section on impact that the occupant family may not value its extra housing as highly as its market price because the in-kind nature of the transfer restricts its flexibility in choosing between various housing options and other goods. The value to the family can be measured by the size of the unrestricted cash grant that it would accept in lieu of the subsidy. The ratio of this cash grant to the market value of the subsidy (the extra housing provided) is defined as "Transfer Efficiency."

Transfer Efficiency is calculated in this study by comparing how subsidy recipients spend their income after receipt of the subsidy with how they spent their income before they entered the program, and then estimating through statistical techniques how much the subsidy added to their overall economic well-being. The measure is based on an observation of consumer behavior rather than on a program participant's subjective evaluation of the cash value of the housing subsidy.

Transfer Efficiency almost always will be

less than 1.0 in programs that provide subsidies-in-kind instead of unrestricted cash grants. Furthermore, the particular statistical estimation technique utilized will produce an estimate smaller than 1.0. Nevertheless, from the subsidy recipient's viewpoint, the higher the numerical value of the measure, the more efficient the program.

An overall efficiency measure is the ratio of the increase in the occupant's welfare measured in terms of an unrestricted cash grant to the total costs incurred by Government to achieve that increase in welfare. This measure is defined as "Program Efficiency."

If Program Efficiency is considerably less than 1.0, the program may still be a worthwhile Government expenditure. Although Program Efficiency is determined from the viewpoint of the subsidy recipient, the taxpayer may have other reasons for wishing the recipient to have better housing (e.g., new subsidized housing may stabilize declining neighborhoods or some members of society simply may achieve satisfaction because some low income families are living in better housing than they would otherwise).[13]

Similarly, there may be costs in addition to the measurable governmental costs. Some of these costs are simply redistributional—that is, one person's gain is exactly counterbalanced by another's loss. If Federal construction raised construction wages throughout an area, new home buyers would be hurt while construction workers would be helped. Other costs represent a net loss to society. One example would be overcrowding of school facilities by the introduction of a large federally subsidized project into a neighborhood.[14]

If one could measure all these costs and benefits, then a comparison could be made of total program benefits received by occupants and others to total program costs. This ultimate measure could be termed "Social Efficiency." Social Efficiency, however, is inherently unquantifiable. What can be said, nevertheless, is that if Program Efficiency has a value significantly less than 1.0, then the social benefit of the program must be extensive to justify it, or policymakers should seek more efficient ways of achieving their objectives.

[13] Stimulation of the economy is sometimes given as a justification for the programs. This position is discussed in the "Stimulating the Economy" subsection in the "Special Issues" section of this chapter.

[14] The term "externalities" is frequently used by economists to describe such effects because the costs or benefits are experienced by those not directly involved in the activity.

Program Viability

Although equity, impact, and efficiency embrace almost all relevant considerations in the evaluation of the subsidized housing programs, there is another important issue: Subsidized housing programs must be economically viable. If, given the intended level of occupant rents or mortgage payments, the subsidies established by the programs are insufficient to cover all housing costs, then the project will necessarily become bankrupt or the single-family mortgagor will be unable to make the required payments. This will prematurely terminate the benefits provided by the unit and may impose additional unanticipated costs on the Government. Experience with present and similar past programs was used to predict the possible magnitude of this problem.

Interpretation of Results

While referring to the analyses that follow, readers should be cautioned that almost every statistic is based either on sample data or computer simulations. Simulations reported are based on the best judgment of reasonable assumptions; different assumptions could lead to different numerical values. Accordingly, the statistics should be viewed as approximations. In other words, the true value lies within a range of the estimated value. A separate technical report will set forth in detail the assumptions on which these estimates rest and precisely how the estimates were derived.

Major Findings and Conclusions

The first part of this section describes the main impact of the subsidy programs. The next part presents the benefits in relation to the costs and an analysis of equity aspects of the

programs. The third part contains conclusions based primarily on the individual program analyses contained in later parts of the chapter.

Impact

A total of almost 2.8 million dwelling units have been provided since 1937 through Government-subsidized housing programs for low and moderate income families. Many beneficiaries of housing subsidy payments were previously housed in substandard housing, or paying excessively high rent relative to their incomes in standard housing. Table 4 provides indicators of some of the impacts of the subsidized housing programs, and the following is a summary of these impacts:

1. The improvement in the housing of recipients ranged from a high of 92 percent for the beneficiaries of the Section 502 rural homeownership interest credit program, to 35 percent for the recipients of Section 235 homeownership dwellings. The improvement in housing is the difference between the value of housing occupied under the program and the value of housing that would have been occupied in the absence of the program.

2. Increased expenditures on nonhousing goods and services as a result of the housing subsidies ranged from a high of 16 percent for recipients of public housing, to minus 9 percent for recipients of the Section 504 homeownership repair program. In each of the FmHA programs analyzed, expenditures on other goods declined, indicating that the subsidy programs induced households to spend more of their own income on housing than previously.

Table 4. Estimated Impact of Subsidized Housing Programs*

Impact (Average)	Low Rent Public Housing	236	Rent Supplement	235	502 Interest Credit	502 Non-interest Credit	504
Percentage improvement in recipients' housing	71	51	NA	35	92	57	54
Percentage increase in expenditures on other goods	16	0	NA	8	−3	−7	−9
Annual benefit to each recipient household	$912	$499	$607	$857	$567	$30	NA
Annual direct subsidy to each recipient household	$702	$907	$1,133	$948	$695	$92	$75
Annual total Government cost for each recipient household	$1,650	$1,051	$1,310	$1,051	$813	$190	NA
Annual benefit as percentage of income	24	9	23	13	10	Less than 0.5	NA
Annual direct subsidy as percentage of income	21	17	43	14	12	1	3

NA = Not available.

*236, Rent Supplement, and 235 data are for 1972. 502 and 504 data are for fiscal year 1972. Low rent public housing data are for 1971 and include conventional and Turnkey Methods of providing public housing.

Source: Department of Housing and Urban Development, National Housing Policy Review.

3. The annual benefit measures the value in unrestricted cash of the extra housing which the subsidy has provided to the recipient. The annual benefit ranged from a high of $912 for the beneficiaries of the low rent public housing program, to $30 for those receiving a Section 502 noninterest credit subsidy.

4. The annual benefit as a percentage of income ranged from a high of 24 percent for beneficiaries of the low rent public housing program to little change for Section 502 noninterest credit participants.

5. About 60 percent of the subsidized units were provided to families having annual incomes of less than $5,000. The low rent public housing program served the great majority of these recipients.

6. Minority families were served by the housing programs to a considerably greater degree—as a percentage of total eligible—than other low and moderate income families.

7. There is some evidence that Government-subsidized housing programs increase opportunity for the geographical dispersion of central city inhabitants, particularly minorities, to suburban areas. There is also some evidence that the programs contribute to racial balance within some communities. However, the potential contribution of subsidized production is limited; even in the years of highest production, subsidized housing accounted for only about 5 percent of the total new and existing housing stock marketed.

8. Almost seven of every 10 households in the public housing and rent supplement programs are headed by females. These households are more likely to be poor than are their male counterparts, and are generally subject to discrimination in the housing market.

9. The FmHA has provided access to credit for housing purchases and home repair for many families in rural areas; this has improved the housing of low and moderate income households.

10. The Section 235 and Section 502 homeownership programs have enabled a number of low to moderate income families who desire to own homes to achieve their objective. Nationally, only a third of homeowners have annual incomes below $7,000; nearly two of every three beneficiaries of these programs have incomes below that level.

Efficiency, Costs, and Equity

The impact of the Government-subsidized housing programs is achieved at the cost of serious program inefficiency and inequity. (See Table 5.) The costs of the accomplishments are greater than the benefits, including the observable benefits to society. Improvements are possible through administrative changes, but substantial inefficiencies and inequities are inherent in the programs. A summary of efficiency and equity problems is presented below:

1. Production Efficiency is the ratio of the market value of the extra housing provided under the program to the total costs incurred by Government in providing the extra housing. The Production Efficiency of the subsidized housing programs ranges from a high of 0.90 for the Section 235 homeownership program, to 0.48 for the Section 502 noninterest credit program.

2. Construction Efficiency is the ratio of the total development costs of a conventionally built project to the total development costs of an identical subsidized project. For every $1 of total development cost for a Section 236 project only 83 cents would be spent for an identical project in the private sector. Part of this difference represents the cost of special Government requirements, such as construction standards, affirmative action, and environmental clearance; special financial and builder inducements and higher wage rates also play a role.

3. Technical Efficiency compares the cost of providing housing in the private market with the full cost of providing it under a Government program. Here, the term "cost" refers to both construction and operating costs. Technical Efficiency ranged from a high of 0.94 for the Section 235 and Section 502 programs, to a low of 0.85 for low rent public housing.

4. Transfer Efficiency measures how much the recipient values the housing assistance provided by the Government relative to its

market value. A ratio of less than 1.0 indicates that the recipient would prefer an unrestricted cash grant of an amount smaller than the market value of the housing subsidy. The Transfer Efficiency ranges from a high of 0.90 for the Section 235 homeownership program to 0.33 for the Section 502 noninterest credit homeownership program. (Reasons for the low efficiency of this program are discussed below.)

5. Program Efficiency is a measure of the overall efficiency of each program from the recipient's viewpoint. The effects of Construction Efficiency, Production Efficiency, and Transfer Efficiency are all reflected in this measure. Program Efficiency ranges from a high of 0.82 for recipients of the Section 235 program, to 0.16 for recipients of the Section 502 noninterest credit program. The program with the next lowest Program Efficiency is the rent supplement program with 0.48. This means that for the rent supplement program about 52 cents of every $1 spent by Government does not increase the occupant's welfare (from the occupant's viewpoint).

6. The Section 236, rent supplement, and Section 235 programs all give evidence of substantial problems of failure as reflected in mortgage assignments to HUD and foreclosures. The cost of such failures is reflected in the efficiency measurements above.

Approximately 30 percent of all Section 221(d)(3) market-interest rate rent supplement projects, and 20 percent of all Section 236 projects, are expected to fail during their first 10 years.

Rapid decay of Section 235 units in some neighborhoods or financial setbacks suffered by owners often lead to abandonment, defaults, and foreclosures. It is currently projected that about 16 percent of all Section 235 units will fail during their first 10 years. Although the insurance fund for the Section 235 program was actuarially sound through 1972, recent foreclosure rates for Section 235 units are above actuarial expectations.

FmHA programs, on the other hand, experience comparatively low foreclosure costs, but those savings are offset by FmHA's relatively high administrative costs.

Table 5. Measures of Efficiency in Government-Subsidized Housing Programs [1]

Subsidy Program	Production Efficiency	Construction Efficiency	Technical Efficiency	Transfer Efficiency	Program Efficiency
Low Rent Public Housing	0.74	NA	0.85	0.75	0.55
236	0.70	0.83	NA	0.71	0.50
236 Rent Supplement	0.83	0.83	NA	0.64	0.53
Rent Supplement	0.74	0.83	NA	NA	0.48[2]
235	0.90	1.00	0.94	0.90	0.82
502 Noninterest Credit	0.48	1.00	0.94	0.33	0.16
502 Interest Credit	0.85	1.00	0.94	0.82	0.70
504	NA	NA	NA	NA	NA

NA = Not available.

[1] 236, Rent Supplement, and 235 data are for 1972. 502 and 504 data are for fiscal year 1972. Low Rent Public Housing data are for 1971 and include conventional and Turnkey Methods of providing public housing.

[2] Derived by assuming that transfer efficiency is the same as that found in the 236 Rent Supplement program.

Source: Department of Housing and Urban Development, National Housing Policy Review

7. Evidence indicates that most subsidized housing starts replace private housing starts. However, the groups that would have been served by unsubsidized private construction would differ in most instances from those served by subsidy programs. Moreover, the location of the units often would have been different.

8. Subsidized housing has not provided significant indirect benefits by opening up better unsubsidized housing at the same or less cost than tenants were previously charged. As seen in studies of the "housing filtration" process made for this report, families moving into dwellings vacated by those moving into subsidized units usually moved into better quality housing, but also paid higher rents than they had paid previously. Under these circumstances, it is unclear whether filtration lowered the cost of housing to the nonsubsidy recipients.

The fact that a family moved into a unit vacated by a subsidy recipient does not in itself establish that there are indirect filtration benefits because:

- The family might have moved into another unit in the absence of the program;
- The subsidized housing programs probably provide few net additions to the housing stock; and
- Even if there were shortrun drops in housing costs or rents for units vacated by subsidized families, these would probably be offset by long-term declines in housing quality.

9. The subsidy programs have relatively small budget impact in the year funds are committed for housing units. However, the programs commit the Federal Government to a relatively high level of "runout costs" over a program's life—up to 40 years in some instances.

These include both direct Government payments and some indirect costs such as forgone taxes. Table 6 presents estimated runout costs of the housing subsidy programs for commitments through fiscal year 1973. The table also shows runout costs discounted at 5 percent and 7.5 percent. A discount rate expresses the present value of costs that will be incurred in future years.

Table 6. Estimated Run-Out Costs of Subsidized Housing

(Dollars in Billions)

Program	Total	Total Discounted at 5%	Total Discounted at 7½%
Section 235	$2.5	$2.1	$1.9
Section 236	14.0	8.0	6.0
Rent supplement	8.0	3.0	2.0
Low rent public housing	58.3	25.9	19.4
Section 502	2.9	1.6	1.3
Total	$85.7	$40.6	$30.6

Note: Based on estimated number of units with contract commitments through fiscal year 1973, except low rent public housing, which is based on June 1973 estimates of commitments through fiscal year 1974. These include all methods of providing public housing.

Source: Department of Housing and Urban Development, National Housing Policy Review.

10. Combined, the subsidy programs have provided, to date, a slightly greater probability of serving low income than higher income families. However, more than one-third of all subsidized units, or almost 700,000, provide services to households earning more than $5,000 annually. At the same time, more than 16 million households with annual incomes of less than $5,000—about 94 percent of the total households in this income category—receive no assistance whatsoever.

11. The great majority of households at each income level is not served. Moreover, a household's geographical area of residence significantly affects its chances of obtaining subsidized housing. This kind of inequity would be reduced by the production of more subsidized units.

12. The total Government cost of the subsidized housing programs (about $2.4 billion in calendar year 1972) was about $1.0 billion greater in 1972 than benefits received by recipients (Table 7). The benefits shown in Table 7 are measured in terms of the cash grant the family would accept in lieu of participation in the subsidy program.

One way to account for some of the inefficiency measured in this manner (i.e., excess of total Government costs over the benefits as viewed by the recipients) is that some of these costs are offset by benefits to nonsubsidy recipients.

Conclusions

Government-subsidized housing programs contain a number of problems that result in subsidized housing programs (about $2.4 billion in calendar year 1972) was about $1.0 billion through legislative changes. Legislative correction of one problem, however, often tends to aggravate or create others. More importantly, while administrative changes would marginally improve the efficiency and equity of production programs, serious problems of inefficiency and inequity inherent in using production as the basic approach would remain.

Existing programs require the construction of new or substantially rehabilitated units. Thus, where existing decent older housing is available, programs diverting lower income families to new and better housing require a larger subsidy per family than a strategy which emphasizes greater use of the existing stock.

Evidence indicates that the average low rent public housing unit is as good as the average unit available for rent in the private sector. In both the Section 236 and the rent supplement programs, units are substantially better than the average existing private sector unit. Most program beneficiaries could be well served by a less expensive unit in the existing housing stock or a cash transfer of lesser value than the current subsidy. Although these families would not have housing of a quality as high as under a production program, the objective of a "decent home" would be met in most cases. Most importantly, the lower cost per family would allow the Government, within a given budget, to make better housing available for more low income families.

The production programs, except for low rent public housing, depend primarily upon the initiative of private builders and sponsors. Profit inducements must be provided to insure that participation is forthcoming. The inflexibility of the system means that the same opportunities for profit are given to sponsors serving the suburban elderly as to those serving the ghetto poor. Building greater flexibility into the incentive system, however, would be extremely difficult if not impossible.

Other characteristics of Government production programs that may result in higher costs (reduced efficiency) include affirmative action activities and environmental considerations and probably higher wage costs. These factors increase society's well-being but at the cost of reduced Program Efficiency viewed from the more narrow standpoint of assistance to the occupant of the subsidized housing.

Increasing the amount of subsidy for beneficiaries—"deepening the subsidy," in other words—would allow the programs to serve the more needy, but within the framework of a production assistance strategy, these modifications would entail trade-offs with other aspects of program performance. Increasing the number of beneficiaries from the present low proportion of eligibles served would also entail trade-offs.

Table 7. Excess of Costs Over Benefits to Recipients (Based on 1972 Occupancy Records)
(Dollars in Millions)

Program	Total Estimated Government Costs	Total Benefits to Recipients	Excess Costs
Low rent public housing	$1,609	$885	$724
Section 236	114	56	58
236 Rent supplement	40	22	18
Rent supplement	110	52	58
Section 235	390	319	71
502 Noninterest credit	85	14	71
502 Interest credit	91	64	27
Total	$2,439	$1,412	$1,027

Source: Department of Housing and Urban Development, National Housing Policy Review estimates based on data from Department of Housing and Urban Development and Department of Agriculture.

Deepening the subsidy or increasing the number of beneficiaries would result in the following trade-offs:

1. The cost of the programs to Government and losses through inefficiency both would rise substantially.

2. The failure rate (i.e., assignments and foreclosures) might well rise because, generally speaking, the lower the income of the recipient, the greater the risk.

3. Local opposition probably would increase as more sites were required, especially in suburban areas. Notwithstanding current efforts toward deconcentration, this could lead to concentration of projects as well as to large projects located on poor site locations—better housing but in a less desirable living environment.

4. Greater concentration of the very poor in each multifamily project may well lead to higher operating costs and emphasize the negative image of Government-subsidized housing projects, thereby reinforcing local opposition.

Legislative changes to improve the efficiency of programs could include modification of tax incentives for private enterprise, but predicting in advance of field experience the nature and extent of the inducements required to attract private enterprise is very difficult because of differences in location, tenant characteristics, and national and local economic situations. Substitution of Federal for private lending might lower direct costs, but the impact of increased Federal borrowing on overall interest rates and debt payments on Federal borrowings as a whole could offset this gain. Although elimination of administrative determination of wage rates might reduce costs in some cases, gains in Program Efficiency through cessation of administratively determined wage rates would be relatively minor, given the inherent structural problems in the programs.

Overall Program Equity

Although the subsidy programs have somewhat different and overlapping target groups, it nevertheless appears to be Congress' intent that, taken as a whole, these programs should serve equitably the housing needs of lower income households. This section analyzes how equitably the programs actually have served lower income households. The analysis includes the following programs: low rent public housing, rent supplement, the Section 235 homeownership, the Section 236 rental assistance, the Section 502 interest credit rural homeownership, and the Section 504 rural housing repair programs.

Under most circumstances only families or elderly individuals can occupy federally subsidized housing; single individuals under 62 are excluded by law. Table 8 computes the number of eligible households by income level by adding persons over 62 living away from their families to the Census count of families. For the purposes of presenting the analysis, $5,000 was selected as a dividing line between low and moderate income.

There are almost 18 million households with incomes less than $5,000 a year, of which 15.5 million are considered eligible households. Some of these households, through their own efforts or because of Federal, State, or local

Table 8. Estimated Households Eligible for Participation in Subsidized Housing Programs as of December 31, 1972

Gross Income	Total Households	Eligible[1] Households
$0– 999	1,800,000	1,500,000
1,000–1,999	3,800,000	3,400,000
2,000–2,999	4,300,000	3,900,000
3,000–3,999	4,000,000	3,400,000
4,000–4,999	3,800,000	3,300,000
5,000–5,999	3,800,000	3,100,000
6,000–6,999	3,600,000	3,100,000

[1] Includes all families and elderly unrelated individuals. Excludes individuals under 62 who live away from their families. Does not take account of income limits or other program eligibility requirements.

Source: Department of Housing and Urban Development, National Housing Policy Review estimates based on data from Department of Commerce, Bureau of the Census. *Current Population Reports, Series P-60, numbers 83, 84, 87,* and *1970 Census of Population.*

housing subsidy programs, have decent housing at a 25 percent or less shelter cost-to-income ratio. In 1970, however, half of the eligible households earning less than $5,000 lived in overcrowded conditions, paid more than 25 percent of their income for rent, lacked adequate plumbing, or occupied very old low-cost units.

Table 9 shows the total number of households served by the subsidized housing programs, and the percentage of total households served. Combined, the subsidy programs provide a slightly higher probability of serving low income than moderate income households.

The distribution of benefits within any income level is uneven. Furthermore, most low income households are not being served. Only 349,000 (about 6 percent) of 5.6 million households with incomes less than $2,000 are served. Similarly, about 4 million households out of 4.3 million earning between $2,000 and $3,000 annually receive no housing subsidy.

Much of the inequity is inherent in the structure of the programs. An important reason behind this inequity is that the subsidies allowed, except in low rent public housing and the rent supplement program, are not deep enough to serve most low income families. These families are excluded simply because they cannot pay the minimum rents required for subsidized units at reasonable rent-to-income ratios.

Second, the programs, in accordance with the statutes, rely principally on new construction or substantial rehabilitation. They are not keyed toward maximum use of the existing stock of housing, which would be less expensive. Therefore, relatively few households receive high quality units, and no housing subsidies are given to the remaining lower income population. Greater use of the existing housing stock would allow more low income families to be served with the same expenditure of Government funds.

A third structural cause of the unequal distribution of assistance in the various programs is that low cost units cannot exist in some localities because of zoning or other

Table 9. Distribution of Households Served by Rent Supplement, Low Rent Public Housing, Sections 235, 236, 502 Interest Credit, and 504, by Income Class, as of December 31, 1972

Gross Income	Households Served	Total Households	Households Served as Percent of Total Households
$0– 999	29,000	1,800,000	2%
1,000–1,999	320,000	3,800,000	8
2,000–2,999	293,000	4,300,000	7
3,000–3,999	244,000	4,000,000	6
4,000–4,999	230,000	3,800,000	6
5,000–5,999	230,000	3,800,000	6
6,000–6,999	198,000	3,600,000	5
7,000–9,999	227,000	11,200,000	2
10,000 or more	25,000	32,300,000	Less than 0.5
Total	1,795,000	68,500,000	3%

Note: Detail may not add to totals because of rounding. This table is not exactly comparable to Tables 10 and 12 because of differences in program coverage or year of census data.

Source: Department of Housing and Urban Development, National Housing Policy Review estimates based on data from Department of Housing and Urban Development, Department of Agriculture and Department of Commerce, Bureau of the Census, *Current Population Reports*, Series P-60, Nos. 84 and 87, and *1970 Census of Population*.

restrictions. Moreover, low rent public housing and rent supplement units require specific local approval.

Fourth, because builders' profits, professional fees, and tax incentives depend on the total development cost, there is an incentive to maximize this cost. To the extent this results in more expensive units, fewer families are able to afford them.

In an effort to maintain the financial solvency of projects and to respond to the recommendations of experienced managers, HUD has published regulations requiring a "cross section" of tenants to be admitted to many of its rental projects. However, this policy has meant that fewer very low income tenants can be served.

A special facet of the unequal distribution of assistance within similar income groups is that a household's geographic place of residence significantly affects its chances of obtaining subsidized housing. Table 10 shows—at two different income levels—the percentage of each region's households receiving subsidized housing. At both these levels, a family in the South has a much greater chance of being served than a family of equal income has elsewhere. In the Far Western, Mountain, Plains, and Middle Atlantic States, families at each income level have less than an average chance of being served. The results are similar for other income levels.

The reasons for geographical inequity differ among the various programs. For certain programs, the combination of high construction costs and low mortgage limits reduces building within a particular area. Low rent public housing has been limited in the Plains and Mountain States by a lack of local housing authorities. Another cause of geographic inequity in the programs is that some parts of the country have not had many private developers using the programs.

Table 10. Percent of Households Served By Subsidized Housing For Selected Income Ranges, By HUD Region, as of December 31, 1972

HUD Region	Gross Income	
	$1,000–1,999	$5,000–5,999
I	7%	5%
II	7	5
III	6	4
IV	10	10
V	8	4
VI	9	8
VII	4	3
VIII	5	6
IX	2	5
X	7	6
Total	7%	6%

Note: Subsidized households are as of December 31, 1972. Total households are as of the 1970 Census. This table is not exactly comparable to Tables 9 and 12, because of differences in program coverage or year of census data. The states and territories are included in HUD regions as follows:

I	Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont.
II	New Jersey, New York, Puerto Rico, Virgin Islands.
III	Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, West Virginia.
IV	Alabama, Florida, Georgia, Kentucky, Mississippi, North Carolina, South Carolina, Tennessee.
V	Illinois, Indiana, Michigan, Minnesota, Ohio, Wisconsin.
VI	Arkansas, Louisiana, New Mexico, Oklahoma, Texas.
VII	Iowa, Kansas, Missouri, Nebraska.
VIII	Colorado, Montana, North Dakota, South Dakota, Utah, Wyoming.
IX	Arizona, California, Hawaii, Nevada, American Samoa, Guam, Trust Territory of the Pacific Islands.
X	Alaska, Idaho, Oregon, Washington.

Source: Department of Housing and Urban Development, National Housing Policy Review estimates based on data from the Department of Housing and Urban Development, Department of Agriculture and Department of Commerce, Bureau of the Census, *1970 Census of Population*.

Social Impact

An underlying purpose of Government-subsidized housing is to improve the social conditions not only of the poor but also of the communities in which they live.

What is Social Impact?

Social impact is important, but by its very nature it tends to be difficult to measure. Basically, it involves the question of how communities and neighborhoods and their inhabit-

ants are influenced and affected by the provision of better housing for the poor. The social impact of better housing may be divided into two categories:

1. Direct, or "first order" effects upon the occupants of subsidized housing. Improved housing may modify the characteristics of the occupants. Thus, in assessing the direct effects, the following questions may be asked: Does improved housing increase family stability? Does better housing improve the mental and physical health of the occupants? Do the occupants show a greater incentive to provide for themselves and improve their economic status? Do their children manifest a greater security and willingness to advance in schooling?

2. Indirect, or "second order" effects upon a community. Does improved housing reduce crime rates, lower welfare rolls, raise educational levels? Do communities become more stable? Does improved housing for the poor have the effect of raising property values in adjacent areas?

Direct and Indirect Impact

There is a relationship between the direct, first order effects of improved housing and its indirect, second order effects. The first order effects are felt primarily by the recipients of the improved housing. To the extent that the physical environment is improved, subsidized housing obviously has had an important social impact. In turn, the community may feel some direct benefits and effects from the improved housing. In terms of social cohesiveness, a community may feel better off because its poor are better housed.

The chief impact of improved housing upon a community, however, derives from indirect, or second order effects: Improved housing may reduce rodent infestation, for example. To that extent, the community benefits through the better health of its citizens. Moreover, if improved housing increases family stability or physical health, a community will benefit through reduced costs for welfare and health care. Similarly, society benefits if improved housing leads to less crime, less juvenile delinquency, less drug addiction, improved educational achievement in the schools, or increased property values.

In judging the social impact of subsidized housing, however, it is also necessary to show that the improved conditions result from better housing and not from other factors. This is not a causal relationship that can be proved or disproved easily. The improved conditions in one section of a community may result from the characteristics of the families drawn to subsidized housing; in that event, the improved housing may lead merely to the transfer of conditions from one location to another in a community. Similarly, the improved conditions may result from other factors such as improved police protection, better health care, or community services other than housing.

Summary of Selected Case Histories on the Social Impact of Housing

The most comprehensive study of the impact of housing on the welfare of people was performed in Baltimore in 1962 by Daniel M. Wilner, Rosabelle Price Walkley, Thomas C. Pinkerton, and Matthew Tayback.[15] In their study, groups of poor people from slum areas, some of whom moved into public housing (test group) and some of whom stayed in slum housing (control group), were compared over a period of time. The purpose of the study was to evaluate the first order effects of improvements in housing conditions on health; on behavior, attitudes, and psychological characteristics; and on children's school performance.

The study indicated that subsidized housing provided few social benefits. Illnesses among the families in the test group were only slightly reduced and little difference between groups was noted in their levels of aspiration. The school performance of children in the test group improved only marginally. This small improvement was attributed to fewer accidents and fewer days of illness because of the better housing. In general, persons over 35 years of

[15] Daniel M. Wilner, et al., *The Housing Environment and Family Life*, Baltimore: Johns Hopkins Press, 1962. For a thorough review of the evidence regarding the impact of housing on health, see Stanislav V. Kasl, "Effects of Housing on Mental and Physical Health," a report prepared for the National Housing Policy Review, 1973.

age experienced very few social benefits. Rehoused families, however, did significantly increase interactions with neighbors. These minimal first order effects indicated that other households in the neighborhood were unlikely to benefit from the improvement of housing for the few assisted households.

Several studies have attempted to determine whether improvements in housing produce second order benefits. These studies have attempted to measure the effect of new housing on property values, for example. Property values of subsidized housing and neighboring sites were studied over periods of time. Unexplained changes in property values—the amount that people were willing to pay to live in a certain area—were used as an indicator of social impact. If changes in property values could not be related to inflation, direct property improvements, or other factors, then they could be attributed to the market value of social impact.

One study compared the trends in prices of property located in areas two to three blocks wide surrounding three public housing projects in St. Louis with three control neighborhoods, over a period spanning 1937 to 1959.[16] The three public housing areas contained eight public housing projects. The time span began before the first public housing was constructed and ended after completion of the last public housing project. The study found no significant difference between the indices of property value in each of the public housing and control areas, except for one year, during this period.

Another study compared the trends in value of houses around a newly built Section 221(d)(3) (below market-interest rate) project with trends in a control area without subsidized housing.[17] Both the test and control areas were located in Los Angeles and included mainly white middle income families. The housing project consisted of 132 units built prior to 1965. The study found that the impact of the project on property values in the immediate area was insignificant. Since the socioeconomic mix was the same in the project and the test and control areas, the study findings reflect the impact, or lack of it, of the project itself and are free of the effects of class mixing.

These studies indicate that the introduction of subsidized housing into a neighborhood does not appear to affect property values. Thus, to the extent that change in "property value" is an indicator of the market's perception of social impact, subsidized housing does not seem to have significant second order effects. This does not mean there are no spillover effects from housing: It is possible that a large-scale, sustained rebuilding effort may raise property values.

Public Reaction to Subsidized Housing

Because of its intangible and often indirect effects, it is difficult to determine whether subsidized housing is having a desirable social impact. Ultimately, the answer must rest upon the collective judgment of the community affected and the reaction of individual citizens. In this respect, the evaluation of the social effects of improved housing becomes complicated by the adverse public reaction that often follows the introduction of Government-subsidized housing into a community.

Government-subsidized housing has acquired a poor reputation in many communities, especially in suburban areas, where it is often perceived as a negative social influence that lowers educational and property values and transplants the social problems of the inner cities to the suburbs. To many, subsidized housing represents the intrusion of the Federal Government into the affairs of local communities. Government-subsidized housing often is viewed as a potential social burden because it may overload schools, highways, sewage facilities, and other community services.

To the collective negative reactions of a community must be added the individual's reaction that there is an inherent inequity in subsidized housing. The individual's reactions come primarily from those who are better off economically than those who benefit from subsidized housing. They claim inequity because they are faced with living side-by-side with individuals, who, because of Government subsidies, pay

[16] Hugh Nourse, "The Effect of Public Housing on Property Values in St. Louis," *Land Economics*, November 1963.

[17] Robert Shafer, "The Effects of BMIR Housing on Property Values," *Land Economics*, August 1972.

less for equivalent (and in some cases newer or even better) housing.

Real or perceived inequities probably are inevitable in a subsidy program for housing. An "inequity" to one family may be a "salvation" to another. The problem for the Government is to weigh the equities or inequities and to come up with a solution that best benefits society.

Impact of Subsidized Housing Programs on Patterns of Racial Mixing

The legislative history of the Housing Act of 1968 provides little insight into how the Congress intended the new subsidized housing programs to affect racial mixing. The preamble to the 1968 act defined as its purpose:

> . . . to assist in the provision of housing for low and moderate income families, and to extend and amend laws relating to housing and urban development.

Section 223(e) of the National Housing Act, as amended in 1968 (authorizing the Secretary to insure mortgages on property "located in an older, declining urban area . . ."') may be regarded as a Congressional intent that assistance housing programs were not to be withheld from the central city. Section 3 of the 1968 act further emphasizes this point by requiring that, in administering the subsidized housing programs, there must be opportunities for employment and training of lower income persons residing in the area. Apart from these sections, there is no clear intent as to the location of subsidized housing in the 1968 act.

A separate enactment—the Civil Rights Act of 1968—required the Secretary of HUD to administer affirmatively the Department's programs to further the policy of fair housing. But the act did not provide the Secretary with specific guidance as to the location of subsidized housing. Although HUD had developed a site selection policy for low rent public housing, no such policy had been developed for other subsidized housing programs. The *Shannon* decision on December 30, 1970,[18] officially ordered the Department to develop an institutionalized method for reviewing site locations for all low and moderate income subsidized housing that would take racial concentrations in local communities into account prior to approval. The court opinion criticized HUD's failure to establish an official policy for the location of subsidized housing projects and concluded that the lack of a policy on this matter had caused greater racial impaction, thereby violating, in the court's view, the Civil Rights Acts of 1964 and 1968:

> The essential substantive complaint is that the location of this type of project on the site chosen will have the effect of increasing the already high concentration of low income black residents in the East Poplar Urban Renewal Area. The essential procedural complaint preserved on appeal is that in reviewing and approving this type of project for the site chosen, HUD had no procedures for consideration of and in fact did not consider its effect on racial concentration in that neighborhood or in the City of Philadelphia as a whole.

In the most recent decision (September 11, 1973) in the continuing consolidated litigation of *Gautreaux* v. *Romney* and *Gautreaux* v. *Chicago Housing Authority,* the court has ordered HUD to lend its best efforts to assisting the Chicago Housing Authority to carry out the court's order requiring placement of public housing in white neighborhoods within the city limits. This order implemented the earlier opinion of the Seventh Circuit Court of Appeals that HUD had violated the fifth amendment of the U.S. Constitution and Title VI of the Civil Rights Act of 1964 in approving the location of public housing principally in black neighborhoods.

In June 1971—after the *Shannon* decision but before the *Gautreaux* decision—HUD published draft Project Selection Criteria, which stated the Department's policy toward racial and economic concentration of subsidized housing projects. Criterion 2—Minority Housing Opportunities—exemplified how the Department responded to the Shannon decision. The objectives of this criterion are:

1. To provide minority families with opportunities for housing in a wide range of locations.

2. To open up nonsegregated housing opportunities that will contribute to decreasing the effects of past housing discrimination.

[18] *Shannon* v. *United States Department of Housing and Urban Development,* 436 Fed.2d 809 (1970).

The objective of dispersing minorities out of the central city tends to make the legislatively formulated production goal of 6 million subsidized units more difficult.

Achievement of both these goals together may to some extent speed deterioration of housing in the central cities, rather than preventing it; this, of course, runs counter to another explicit goal of the 1968 act. Dispersing residents out of central cities reduces the demand in those cities for housing, and discourages maintenance by landlords; this eventually may lead to abandonment. A policy to achieve racial dispersion may tend also to increase the cost of subsidized housing through project delay and additional costs of administering the guidelines.

Two studies undertaken by HUD provide some insight into the way subsidized housing programs have affected racial dispersion, but neither study specifically evaluates the Project Selection Criteria policy because of the time frame and the nature of the study samples. Only 2 years have passed since the Project Selection Criteria were implemented—many subsidized housing projects were in the "pipeline" and thus were not affected before the policy was announced—and many projects approved under the Criteria still have not been completed.

One 1972 HUD study of the Section 236 rental assistance program in the Washington, D.C., metropolitan area showed that in the central city the proportion of blacks in Section 236 projects was always higher than the already high proportion in the census tract. (See Table 11.) This would indicate that the Section 236 program—at least in the Washington metropolitan area—was unable to affect racial concentration trends prevalent in the central city. On the other hand, Section 236 projects in suburban areas did appear to contribute to racial balance across neighborhoods. In almost every instance, the proportion of blacks in the Section 236 projects in suburban areas was considerably higher than in surrounding neighborhoods.

The study also reviewed the locations of the former homes of a number of the black residents to determine whether the higher proportion of blacks in the suburban Section 236 projects resulted from (1) drawing blacks from other suburban locations, or (2) drawing blacks from central city locations. The latter case would indicate that the Section 236 projects in suburban Washington were contributing to racial dispersion. About 21 percent of the minority residents in the suburban projects had formerly resided in the Washington central city; practically all the others came from within the same county (52 percent) or from another suburban county (23 percent). If blacks who were located in the central city moved into the former suburban residences of those blacks who occupied the units in the Section 236 projects, further dispersive effects may have resulted.

Table 11. 1970 Black Population as Percent of Project, Block and Tract, Washington Metropolitan Area

Project and Location	236 Project	Census Block	Census Tract
Washington, D.C. (Central City)			
Project A	100%	100%	92%
B	100	98	89
C	100	93	67
D	100	98	94
E	100	99	69
Maryland Suburbs			
Project F	82	3	1
G	31	20	4
H	96	26	25
I	22	NA	7
J	45	2	2
K	60	13	17
L	17	3	8
M	0	2	1
N	15	NA	2
Virginia Suburbs			
Project O	45	NA	2

NA = Not available.

Note: The Bureau of the Census publishes data by census tract and block. The average tract has about 4,000 residents; census blocks are usually city blocks.

Source: Department of Housing and Urban Development; Department of Commerce, Bureau of the Census, *1970 Census of Population and Housing*.

However, the study did not follow the "chain-of-moves" of the residents to determine whether this was in face the case.

The National Housing Policy Review analyzed how the Sections 235 and 236 programs affected social dispersion in the Far Western, Southwestern, and Middle Atlantic regions of the country (HUD Regions III, VI, and IX). The study showed that the programs had indeed provided suburban housing opportunities to minorities. Of significance is the fact that 18 percent of blacks moving within Standard Metropolitan Statistical Areas into subsidized housing within each of the three regions moved from the central city to suburban areas. (Nationally, only about 7 percent of blacks relocated to the suburbs between 1965 and 1970.) The rate for all races moving into suburban subsidized housing from the central city was also higher in the programs analyzed by the study than the national rate between 1965 and 1970—20 percent compared to 15 percent. Subsidized housing thus appeared to be providing suburban housing opportunities to some central city low and moderate income families, particularly blacks.

One additional question is whether minority households are served by the housing subsidy programs as frequently as other low income households. In fact, the evidence indicates that they are served more. Table 12 shows the percentage of the households served at several income levels, for the Nation as a whole and for two minority groups. Both minorities—but especially blacks as compared to Spanish Americans—have higher shares of subsidized units compared to other low income families in the same income level. At each low income level, the fraction of blacks who live in subsidized housing is about three times the fraction of all households who do.

These studies indicate that the subsidized housing programs tend partially to increase the opportunity for the dispersion of central city inhabitants—particularly minorities—to suburban areas. There is also some evidence that the programs contribute to racial mixing. The significance of the contribution of subsidized housing to racial dispersion is small, however, in comparison to the amount of racial imbalance that exists.

Table 12. Percent of Households Served by HUD Subsidy Programs, by Income and Minority Group, as of December 31, 1972

Gross Income	Total U.S.	Black	Spanish American
$0– 999	1%	2%	Less than 0.5
1,000–1,999	7	19	9
2,000–2,999	7	20	10
3,000–3,999	6	18	11
4,000–4,999	6	17	11
5,000–5,999	5	14	10
6,000–6,999	4	11	9
7,000–7,999	3	7	6
8,000–9,999	1	4	3

Note: Excludes programs administered by the Farmers Home Administration. Subsidized households are as of December 31, 1972. Total Households are as of the 1970 Census.

Source: Department of Housing and Urban Development, National Housing Policy Review estimates based on data from Department of Housing and Urban Development and Department of Commerce, Bureau of the Census *1970 Census of Population*

The Section 235 Program

The Section 235 homeownership assistance program,[19] established in the 1968 legislation, is the largest subsidy program through which the Department of Housing and Urban Development specifically attempts to provide homeownership. The HUD Section 235 Handbook, issued in January 1973, states the objectives of the program succinctly:

> The program is intended not only to produce more homes, but to enable lower income families to become owners of homes and thereby experience the pride of possession that accompanies homeownership. In this way,

[19] In the analyses of each of the subsidized programs, extensive use is made of the concepts developed in the section, "Criteria for a Nationwide Evaluation." Precise definitions of the technical terms used can be found on pages 87 through 91.

the program can be a vital influence in promoting personal responsibility and social stability.

The Section 235 program is basically production-oriented both in terms of the stated goals of the program and in its structural and administrative makeup. The program was designed to help achieve the target of 6 million new or substantially rehabilitated units for low and moderate income families by 1978. The subsidy is attached to the house and not to the occupant family. If the occupant family should move, it would lose the subsidy.

The subsidy formula is calculated as the lesser of either (1) the difference between (a) 20 percent of monthly adjusted income and (b) the total monthly payment under the mortgage for principal, interest, mortgage insurance premium, taxes, and hazard insurance; or (2) the difference between (a) the monthly payment for principal, interest, and the mortgage insurance premium, and (b) the payment to principal and interest at a 1 percent interest rate.

Viewed one way, the subsidy places a special burden on some Section 235 families. Those receiving the maximum subsidy under the second formula—usually the lower income Section 235 families—must bear increases in taxes and insurance without increased assistance. The higher income families, who usually are subsidized under the first formula, have their subsidy raised to cover the entire increase in taxes or insurance until the second formula subsidy limit is reached.

A builder/sponsor under Section 235 usually has a strong demand for its product if it builds according to HUD regulations. A family must be lucky enough to be the one-out-of-50 income-eligible Section 235 families (on average) selected for homeownership by the builder/sponsor and the mortgagee.

For many of the Section 235 families whose shares of mortgage payments are based on 20 percent of adjusted gross incomes, there is no incentive to be concerned about whether a higher price represents more "house," since they do not pay the additional price themselves. Thus, the builder faced with strong demand may be able to "capture" some of the Government subsidy by encouraging the family to purchase an expensive house, with the higher cost covered by a higher Government subsidy.

This counterproductive incentive structure highlights the crucial role that HUD appraisers and inspectors must play in order to hold down excess profits and to protect the interests of the Government. Abuses and fraud, however, are an inherent and demonstrable danger of such an incentive structure.

For the Section 235 homeowner family, the subsidy is typically large (equal to about one-eighth of the family's average income). There is little financial risk to the homeowner here because his or her initial equity frequently is less than the deposit on an apartment, while the Government assumes almost all the risk of a Section 235 home by providing insurance for the mortgagee. In the past, HUD has not sought deficiency judgments to recover costs against Section 235 homeowners whose homes have been foreclosed.

The income and mortgage limits predetermine most of the characteristics of the participants and the units produced. The mortgage limits range from $18,000 to $24,000, depending on family size and location, and the income limits are set at 135 percent of local housing authority income limits. However, there is a significant exception to this general rule. Twenty percent of the contract authority may assist households with incomes up to 90 percent of the Section 221(d)(3) below-market-interest-rate income limits. The income limits from this program allow higher income families to enter the Section 235 program.

In contrast to such legislatively determined upper limits, the lower mortgage and income limits are set administratively by HUD's Minimum Property Standards for the unit and by mortgage credit standards for the applicant. Given local building costs, the setting of Minimum Property Standards has the effect of establishing minimum cost and, therefore, the minimum mortgage amount: the higher the standards, the more expensive the home. The mortgage amount and the stringency of the mortgage credit standards determine the effective lower income limits. A general rule is that the mortgagor's share of the total mortgage payment, under ordinary circumstances, should not exceed 35 percent of net effective family income. Some major characteristics of the Section 235 program are presented in Table 13.

Major Findings

1. The Section 235 homeownership program has not made significant progress toward achieving equity. Only 12.6 percent of the families served have incomes of less than $5,000 annually. Yet families with annual incomes of less than $5,000 live more often in substandard and low quality housing than families earning more than $5,000 annually. In the income class with greatest participation ($6,000–$6,999), only 2.7 percent of eligible families are served. A household is 5 times more likely to be served if it resides in the South than in the Northeast or Middle Atlantic regions.

2. Subsidies received by recipients actually increase as gross family income increases.

3. The program provides substantial benefits to its recipients. Housing quality of recipients improved by 35 percent and nonhousing expenditures increased by 8 percent.

Table 13. Characteristics of the Section 235 Program, 1972

Units assisted through December 31, 1972 (home insurance written)	398,000
Total mortgage amounts through December 31, 1972 (home insurance written)	$7.0 billion
Maximum annual subsidies permitted by law through fiscal year 1973 (contract authority released in appropriations)	$665 million
Median mortgage amount per unit	$18,500
Median buyer income	$6,500
Racial and ethnic composition of buyers:	
Nonminority white	66%
Black	22%
Spanish American	11%
Other	2%

Source: Department of Housing and Urban Development.

4. Total Government costs are about 10 percent greater than the cost of the subsidy. Forgone taxes and administrative costs account for most of the difference.

5. A dollar spent by Government on the Section 235 program results in only 82 cents worth of benefits to the recipient.

6. Counterproductive program incentives may reduce the efficiency and equity of the program. These structural "incentives," aimed at builders and developers rather than the intended beneficiaries, may lead to more expensive homes and higher default and foreclosure rates.

7. This study did not demonstrate that Section 235 housing costs more than comparable privately produced units.

8. The insurance fund for Section 235 appeared to be actuarially sound through 1972, but recent trends in foreclosures and assignments throw this conclusion into doubt.

9. The main problems appear to be structural problems inherent in the production subsidy in-kind approach. Some administrative changes could reduce the counterproductive incentives.

Equity: Table 14 shows the distribution of Section 235 participants by gross-income class, and other information on the equity aspects of the program. The table makes apparent the serious horizontal inequity in the program. Very few of the income-eligible families in each income class receive Section 235 benefits. In addition, the average subsidy actually increases in the upper income range. This happens because higher income families tend to be larger, so they have lower adjusted incomes than smaller families with the same gross income, and because higher income families tend to purchase more expensive homes both because of their larger families and their greater financial expectations: The decrease in the Government subsidy that might be expected because of their higher income is more than offset by the more expensive homes that higher income families purchase.

The vertical inequity in the program is best

ment is estimated to be about 35 percent for participants in the Section 235 program.

Not all of the subsidy is taken in the form of better housing. To the extent that a family has flexibility in its spending habits—despite the fact that it must purchase a given amount of housing to participate in the program—it will allocate the funds previously spent on housing for nonhousing commodities. The subsidy is not a simple add-on to their previous housing budget: a figure of 8 percent has been estimated as the increase in nonhousing expenditures for Section 235 families compared to the control group.

Because a Section 235 homeowner family is constrained to purchase a certain type and quality of housing with its subsidy dollars, these funds have less value to the family than do unrestricted dollars. The measure of the value of the subsidy to the recipient is termed the benefit to the recipient. For the Section 235 program, the $948 annual subsidy is valued by the average family at $857 ($71 per month).

Costs: There are five types of costs that the Federal Government must bear in order to provide the services of the Section 235 program. The costs were estimated over the life of the program, using assumptions of income and cost growth rates, based on past experience, of 5.7 and 6 percent, respectively. Where there were startup costs, the costs were amortized over the projected 11-year life of the program, using a 6 percent discount rate.

By far the most important cost to the Federal Government is the direct subsidy cost paid by HUD to the mortgagee. In 1972, the estimated average direct subsidy was $948.

A second important cost to the Federal Government is the taxes that are forgone (not paid) because of the program. Homeowners may deduct mortgage interest payments and property taxes from their taxable income. This cost, however, was not counted, because all homeowners are entitled to this deduction. But Section 235 homeowners—unlike other homeowners—also are entitled to deduct the interest and property taxes that the Government pays by means of the subsidy. The cost to the Government of this entitlement was calculated to be $61 for the average family occupying Section 235 housing in 1972.

The administrative cost of the program was divided into endorsement, maintenance, and settlement costs, and spread over the "expected" life of the units subsidized. For 1972 these costs amounted to $34 per unit. This is an overestimate, however, because the mortgage insurance premium—part of which is paid by the Government to itself—is used to offset administrative expenses connected with the program as well as the specific mortgage losses borne by HUD because of default terminations. This offset was estimated at $15 per unit for 1972 and was subtracted from the total administrative costs.

Based on an admittedly questionable assumption, the special risk insurance fund for Section 235 was found to be actuarially sound in 1972, and no additional adjustments were made to account for foreclosure losses. Specifically, the predicted final default termination rate and average loss per mortgage plus administrative costs were assumed to be equal to the income generated by the 0.5 percent mortgage insurance premium.

Finally, the Government National Mortgage Association (GNMA) from time to time provides an additional subsidy to support Section 235 mortgages when the FHA interest ceiling is below the market interest rate. GNMA issues commitments under the Tandem Plan to buy mortgages at 97 percent of par, and, in turn, sometimes sells them for a lower price. Actual Section 235 Tandem Plan losses for fiscal years 1972 and 1973, and projected losses for fiscal year 1974, were amortized at 6 percent over the "expected" life of the program and allocated evenly over each year. The estimated cost for 1972 was about $24 per mortgage. The estimated total 1972 cost of the program to the Federal Government was $1,051 per unit, or approximately $391 million for the total program.

Efficiency: The efficiency measures relate benefits and costs to estimate an overall evaluation of the program in relation to the private market. An important part of the efficiency aspect of the program is whether counterproductive incentives, departmental red tape, quality standards, and delays increase the cost of subsidized housing in relation to comparable housing in the private market. Theoretically, this

might be expected to be the case if the private market were competitive. Several factors mitigate this conclusion, however. First, a Section 235 house is not actually designated as such until an eligible buyer is certified. Thus, the builder is not always assured of subsidy benefits and is more likely to build competitively. Second, HUD's appraisals and cost analyses tend to keep the selling price of Section 235 units in the range of the approximate "market value."

The empirical evidence gathered for almost 2,000 units in nine cities did not show that the average Section 235 house costs more than similar privately constructed housing. This does not necessarily imply that Section 235 construction is as efficient as conventional construction. Alternate explanations are that Section 235 units are located on less desirable and, consequently, lower cost land, or that Section 235 builders accept a lower profit margin because of the lower risk involved in selling subsidized housing.

One significant qualification in this cost study is that there appears to be almost no non-FHA housing in urban areas constructed within the Section 235 mortgage limits apart from mobile homes. Although the cost study attempted to adjust for differences in amenities, it is doubtful that all housing quality as well as neighborhood differences were taken into account in the adjustments. Nevertheless, the net effect on construction costs of the findings is to produce a Construction Efficiency Index of 1.0; consequently, the market value of the subsidy is equal to the dollar value of the subsidy.

Production Efficiency is a measure that depends on the relation between the costs of subsidized housing construction and the costs of identical unsubsidized housing construction, and on the indirect costs of the program. For this program, indirect costs such as taxes forgone, administrative costs, and the Governmental National Mortgage Association Tandem Plan, produce an efficiency of less than 1.0.

$$\text{Production Efficiency} = \frac{\$\ 948}{\$1051} = .87$$

A family is constrained in its use of a subsidy when it is provided in-kind—that is, in actual housing rather than in dollars paid directly to the recipient. It is generally agreed that because of the inherent restriction of choice, an in-kind transfer usually is not worth as much to an individual as is an outright cash grant. Transfer Efficiency is a measure that takes this factor into account. The estimate is based on a sample of 329 families in the Section 235 program in 10 cities, and on an estimate that measures the "utility" of the subsidy to the average family. Transfer Efficiency is defined as the ratio of the cash value of the subsidy in-kind related to the market value of the subsidy. In the Section 235 program the market value of the subsidy is assumed to be equal to the dollar amount of the subsidy, because the aforementioned study did not indicate a difference between the construction cost of Section 235 housing and identical, conventionally financed housing.

$$\text{Transfer Efficiency} = \frac{\$857}{\$948} = .90$$

The overall measure of the efficiency of the program is a combination of Production Efficiency and Transfer Efficiency, called "Program Efficiency." Program Efficiency is the ratio between the cash value of the subsidy to the recipient and the total Federal costs.

$$\text{Program Efficiency} = \frac{\$\ 857}{\$1051} = .82$$

This measure represents the net benefits to the private individual relative to the total cost incurred by the Government in providing that benefit. The continuation of the program may be questioned if benefits of $194 per year (the difference between the cash value to the recipient and the total Federal cost) are not provided to the rest of society by the provision of a Section 235 home. Because social benefits are almost impossible to measure, however, this estimate can be used by policymakers as a benchmark to determine the amount of social benefits required in order for the program to be Socially Efficient. Overall, the Section 235 program would have had to produce about $71 million in social benefits in 1972 to be deemed Socially Efficient.

Program Viability: The latest simulations conducted for the program, based on 4 years of experience—and on the last 26 years of the Section 203(b) basic mortgage insurance program—indicated that the insurance fund for Section 235 was actuarially sound but at the

break-even point. A final default termination rate of 18.6 percent has been calculated and an average life expectancy of 16.1 years generated.

Other data indicate that the average loss to HUD from a default termination is now $4,350 per unit, a figure at the maximum of the 25 percent loss rate sustainable by the mortgage insurance premium given a final default termination rate of 18.6 percent. Therefore, as long as foreclosures and acquisition losses do not increase beyond present estimates, the Section 235 program can be regarded as actuarially sound. The most recent data on foreclosures and acquisition costs, however, have indicated that the fund may become actuarially unsound.

The Section 236 Program

The Section 236 rental and cooperative housing program authorized by the 1968 act involves the Government in three activities: stimulating housing production; subsidizing housing for rental by low and moderate income families; and insuring multifamily mortgages. The first and third of these activities are designed to promote the second, which is the ultimate goal of the program.

All Section 236 projects are privately owned and financed. FHA mortgage insurance encourages the participation of private lenders by greatly reducing their risks. When the FHA interest ceiling is below the market interest rate, an additional subsidy (GNMA Tandem Plan) is often necessary to obtain private financing. Any nonprofit organization, tenant cooperative group, corporation, partnership, or individual may become the sponsor (owner) of a project. An individual, or profitmaking corporation or partnership, must limit its cash return to 6 percent of invested equity. For this reason, profitmaking entities are called limited dividend sponsors. In addition to their allowed rate of return, investors in limited dividend projects also benefit from special tax advantages and other opportunities for profit during the development of a project. In exchange for its direct regulation of rents and a general determination of tenant eligibility, the Federal Government agrees to subsidize a Section 236 project by paying the difference in monthly installments between (a) amortization of the mortgage at the FHA ceiling interest rate plus FHA insurance premium and (b) amortization at 1 percent.

To be eligible for a Section 236 subsidy, a family's income must be no more than 135 percent of the income limit for low rent public housing in that particular area at the time of initial occupancy. Income is adjusted for family size and limited exceptions to this income rule are permitted. Two rents are associated with each program unit. The "market rent" is equal to the sum of operating expenses, amortization of that portion of the mortgage associated with the unit at the FHA ceiling interest rate, and the mortgage insurance payment. The "basic rent" is equal to operation expenses plus amortization at 1 percent interest. The tenant family must pay the "basic rent," or 25 percent of its adjusted monthly income, whichever is greater. In no case is it required to pay more than the "market rent." The sponsor must turn over to HUD all rent receipts in excess of "basic rent."

A limited percentage of Section 236 families can receive an additional rent supplement subsidy. This "piggybacking" of subsidy benefits substantially increases the depth of the subsidy, with minimum tenant rent falling to 30 percent of the basic rent.

Table 16 provides some general information on the program: its magnitude, project types, and tenant characteristics.

Major Findings

1. The Section 236 program provides sizable Federal housing subsidies, mainly to moderate income households.

2. The Section 236 program serves less than 1 percent of all households earning less than $8,000 per year.

3. Tenants occupy units that are about 50 percent better than the housing they would have occupied in the absence of the program. Expenditures on nonhousing goods have changed little.

4. The "market rent" of a Section 236 unit is higher, on average, than the rent charged for an identical unit in the private market.

5. On average, Section 236 units cost about 20 percent more to construct than comparable privately financed units.

Table 16. Characteristics of the Section 236 Program, 1972 (Including Projects with Units Under Rent Supplement)

Units assisted through December 31, 1972* (Finally endorsed)	142,000
Total mortgage amounts through December 31, 1972* (Finally endorsed)	$2.2 billion
Maximum annual subsidies permitted by law through fiscal year 1973 (Contract authority released in appropriations)	$700 million
Units in process and units finished processing at the end of fiscal year 1973* (Reservations and obligations of contract authority)	451,000
Units completed, by sponsor type:	
Limited dividend	62%
Nonprofit	31%
Cocperative	7%
Median mortgage amount per unit	$16,700
Median income of new tenants	$5,300
Racial and ethnic composition of new tenants:	
Nonminority white	76%
Black	20%
Spanish American	3%
Other	1%

*Excludes units financed through State and local programs and not insured by FHA (see Chapter 5).

Source: Department of Housing and Urban Development.

6. Federal costs exceed the market value of the housing provided to the tenant by approximately 40 percent in the regular program and approximately 20 percent in the Section 236 rent supplement "piggyback" program.

7. The main reason Federal costs exceed market value is that Section 236 units are not rent-competitive with identical private units and so the direct subsidy is spent inefficiently. The additional costs of forgone tax revenue, administrative overhead, and foreclosure losses also contribute to the excess of costs over housing value.

8. A Section 236 subsidy is worth only 65 to 70 percent as much to a tenant as its market value because the subsidized unit provided is better housing than he would choose if given a cash grant equal to the subsidy.

9. Tenant welfare is increased by only about 50 cents for every dollar spent because Federal costs are higher than the value of the housing provided and because the tenant places a lower value on the transfer in-kind benefit than on an unrestricted cash grant.

10. Approximately 20 percent of all Section 236 units are expected to fail in the first 10 years of operation. The program does not appear to be actuarially sound.

Equity: Table 17 shows the distribution of Section 236 tenants on the basis of unadjusted family income. The percentages are based on recent tenant admissions, but earlier admissions show a similar pattern. Unadjusted income was used to allow for comparisons with Census data.

Almost three-quarters of all Section 236 tenant families have annual incomes in the $4,000 to $8,000 range. This distribution is the result of the program's predominant reliance on newly constructed units and the limited size of the subsidy.[23] Another factor has also dimin-

[23] HUD program data indicates that the great majority of all Section 236 tenants pay only the basic rent. Reliable information as to whether the combination of Section 236 and rent supplement benefits has enabled lower income families to afford Section 236 units is unavailable.

ished the extent to which the program has been able to serve those earning below $4,000: Sponsors have an incentive to serve families that have steady income and are able to afford the rent easily. They may also avoid "problem" tenants. This policy reduces management problems, insures a steady flow of rent receipts, and allows flexibility in raising rents when operating costs increase.[24] Limited dividend sponsors may be more responsive to these incentives. A random sample of projects revealed that the average income of tenants in limited dividend projects is higher by 28 percent than the average income of tenants in nonprofit projects.

The probability of receiving a Section 236 subsidy increases with income through the $5,000 to $6,000 annual income range and declines beyond that (Table 17, column 4). The differences between these percentages are small, however, and may be simply the result of normal variation.

Column 5 of Table 17 delineates the number of Census households in each income group who, although eligible to participate in the programs, are not residents of federally subsidized housing and who earn less than the lower limit of that income group. Although 57 percent of all Section 236 program units are occupied by families with gross annual incomes in excess of $5,000, there are 16.7 million households with lower incomes who do not receive any housing subsidy whatsoever. There are also 13.1 million households earning less than $4,000 who are not living in subsidized housing. In considering these figures, two facts must be noted. Not all households would acept subsidized housing if it were offered to them. Secondly, many of the Section 236 households with incomes above $4,000 or $5,000 may be more needy than some of the unserved households with lower incomes, because of larger household size, limited future income prospects, fewer assets, or because of other reasons. Unfortunately, the data cannot be ad-

[24] When confronted with a potentially serious mortgage default problem, HUD acquiesced in such selectivity and tried to limit participation in the program to families who could afford the basic rent with less than 35 percent of their monthly income. This regulation was negated by a court ruling.

Table 17. Distribution of Section 236 (Including 236 Rent Supplement) Housing, by Income Class, as of December 31, 1972

(1)	(2)	(3)	(4)	(5)	(6)
Gross Income	Households Served by 236		236 Households as Percent of all Households	Residual Need*	Direct Annual Subsidy Per Household Served
	Number	Percent Distribution			
$0– 999	220	0.2%	0.01%	—	$956
1,000–1,999	3,200	2.3	0.08	1,800,000	974
2,000–2,999	11,590	8.2	0.27	5,300,000	1,081
3,000–3,999	16,980	12.0	0.43	9,300,000	1,021
4,000–4,999	28,370	20.1	0.74	13,100,000	980
5,000–5,999	33,710	23.9	0.90	16,700,000	1,011
6,000–6,999	26,290	18.6	0.73	20,300,000	1,093
7,000–7,999	13,590	9.6	0.35	23,700,000	1,233
8,000–9,999	6,410	4.5	0.09	27,400,000	1,455
10,000 or more	640	0.5	Less than 0.005	34,600,000	1,189

*Number of households living in unsubsidized housing earning less than lower limit for that income class, as given in column 1.

Source: Department of Housing and Urban Development, National Housing Policy Review estimates based on data from Department of Housing and Urban Development, Department of Agriculture and Department of Commerce, Bureau of the Census, *Current Population Reports*, Series P-60, Nos. 84 and 87, and *1970 Census of Population*.

justed to account for these factors. For the same reason, however, some of the unserved households may even be more needy than their income suggests.

The overwhelming majority of all Section 236 tenants earn less than the national median household income ($9,689 in March 1973). The direct benefits accrue chiefly to the $4,000 plus group. Other subsidized housing programs—rent supplement and low rent public housing—serve lower income groups. Deeper subsidies and simpler units explain the differences in population served.

Column 6 of Table 17 indicates that the average Section 236 program subsidy increases slightly and irregularly with income. This result is surprising, because the rent formula indicates that tenant rent increases with income. Most Section 236 program families received the maximum benefits for which they are eligible, i.e. the full difference between market rent and basic rent. The size of this maximum benefit depends upon land and construction costs per unit. Total development costs also determine the income groups that can afford to live in the projects: All tenants, except those with rent supplements, must legally pay at least the basic rent. As a result, projects with high total development costs have higher maximum benefits and serve higher income people; projects with lower total development costs can serve lower income persons but also have lower maximum benefits. Given this interpretation, local differences in development costs could produce the effects noted in Column 6.

Column 4 shows the percentage of households served in each income group. The Section 236 program provides housing for less than 1 percent of families in each income group, even those in the $5,000 to $7,999 range. The ability to serve a large percentage of the needy depends on the average cost per family and on the total level of program funding. Benefits per household under Section 236 are substantial; the average annual subsidy being $907 for a regular unit and $1,757 for a rent supplement piggyback unit. The units are generally more expensive than the average unsubsidized unit. Table 18 compares average Section 236 market rents in five cities with the mean private rent in 1970 and with the Bureau of Labor Statistics estimates of renter costs in its lower budget for a family of four. The national data show a similar pattern. If simpler units could be provided at a smaller subsidy cost per family, then more families could be served from the same

Table 18. Monthly Rent Comparison [1]

Location	Census Mean Gross Rent, 1970	Renter Costs Family of Four BLS Lower Budget, 1972	Average 236 Market Rent, 1972–1973	
			New	Rehab.
Boston	$135	$124	$272	$225
Washington, D.C.	134	117	239	219
Pittsburgh	110	90	251	238
St. Louis	97	94	249	NA
San Francisco	144	130	249	NA
National average	$118	$103[2]	$208[3]	

NA = Not available.

[1] Including utilities.

[2] Metropolitan areas only.

[3] Based on new admissions, October 1, 1971 to September 30, 1972.

Source: Department of Housing and Urban Development, National Housing Policy Review estimates based on data from Department of Housing and Urban Development, Department of Commerce, Bureau of the Census, *1970 Census of Housing* and Department of Labor, Bureau of Labor Statistics.

budget. Even taking into account that the market rent frequently overstates the quality of the unit (see below), Section 236 units are of higher quality than the average private unit.

Impact: The strategy of the Section 236 program is to relieve housing problems of lower income families by offering them units that provide more housing services than they could purchase with the same rent in the private rental market.[25]

How much "extra housing" does the average tenant family receive? This quantity is measured by the difference between what the Section 236 unit would rent for in the open market and the rent paid by the tenant.

The average subsidy is $907 per year. The average subsidy when the piggyback mechanism of rent supplement is applied is $1,757. These figures, in effect, for the reasons noted above, measure the average difference between market rents (the cost of constructing and operating a unit) and tenant rents. It may cost more, however, to provide a subsidized unit than a conventional unit. Therefore, the stated market rent of a unit may be more than the actual rent that could be demanded for that unit on the open market. In that case, the average subsidy exaggerates the "extra housing" received by the tenant. In fact, the analysis for the Section 236 program establishes that the average tenant in a Section 236 unit without rent supplements receives $703 in extra housing services per year. In the Section 236 piggyback program, the average quantity of extra housing consumed is $1,537.

Another important issue is whether the tenant family is living in better housing under the program than it would have in the absence of the program. On the basis of a sample of tenants and information on how low income persons spend their incomes, it is possible to determine how the program affects the tenant's level of housing. This computation was performed only for the Section 236 program, without rent supplement. In this computation, the average tenant family improves its housing services 51 percent under the program. Expenditures on other goods, however, are virtually unaffected. These results indicate that the program is having the desired impact on the families served—at least in terms of housing. These families are receiving a substantial quantity of "extra housing" and this addition represents a major shift in the quality of housing they occupy, without loss of other goods.

Although society as a whole may benefit from this sharp improvement in housing relative to other goods, the individual Section 236 family may prefer instead a subsidy that consists of somewhat less housing and more other goods. For example, if the tenant family were given a cash grant equal to the housing subsidy, it might elect to spend only 30 percent on housing and the other 70 percent on other goods. The inflexible nature of the transfer-in-kind mandated under the program results in the subsidy being worth less than its cash value to the tenant. The average cash grant equivalent for Section 236 families is approximately $499, which is roughly 70 percent of the market value of the extra housing provided. The cash grant that the tenant would require in exchange for his Section 236 rent supplement subsidy is substantially larger in dollar terms, but is not larger when measured against the extra housing provided. The estimated cash grant is $984—64 percent of the market value of the extra housing provided to Section 236 rent supplement families.

Costs: Besides direct subsidy payments, there are four other costs that must be considered in determining the actual total cost to the Federal Government of a Section 236 unit (Table 19). In the case of limited dividend sponsors, the tax shelter inducements reduce Federal tax revenues and thus impose a budgetary cost. The GNMA Tandem Plan subsidy and HUD administrative costs also must be taken into account. Finally, the insurance losses caused by the financial failure of projects must be measured. Many of these costs occur irregularly. To facilitate cost-benefit analysis, a fair share of these costs should be allocated to the year being studied. The technique used is to determine the extent of the irregular costs over the life of a project, to discount those costs to the initial year, and, finally, to amortize the sum of those costs over the life of the project.

[25] The term "housing problems" refers either to having inadequate housing or to paying an excessive share of the family budget for adequate housing.

Table 19. Annual Costs Per Section 236 Unit, 1972

Cost Item	236	236 Rent Supplement
Direct subsidy (Including insurance premium)	$907	$1,757
Foreclosure costs (Net of insurance income)	$29	$29
Administrative costs	$16	$16
Subtotal	$952	$1,802
Tax revenue forgone (Limited dividends only)	$99	$99
Total	$1,051	$1,901

Source: Department of Housing and Urban Development, National Housing Policy Review.

Table 20. Production Efficiency of the Section 236 Program, 1972

236 without Rent Supplement	
Nonprofits and cooperatives	0.74
Limited dividends	0.67
236 Rent Supplement	
Nonprofits and cooperatives	0.85
Limited dividends	0.81

Source: Department of Housing and Urban Development, National Housing Policy Review.

For units completed through 1972, GNMA Tandem Plan losses were relatively small and may be ignored. This situation may change in the future because of recent deviations between the FHA ceiling and the going market rate of interest for mortgages. Administrative expenditures are also small. It costs $139 in HUD personnel time and overhead to initiate a program unit under Section 236. It costs another $6 a year to monitor the unit. Amortized at a 6 percent discount rate over 35 years (the estimated subsidy life of a typical unit), administrative costs are only $16 a year.

Tax revenue losses for Section 236 projects are a result of several tax shelter inducements. First, certain construction period expenses can be taken as immediate deductions rather than capitalized in the project mortgage for future depreciation. Second, during the operation of the project, the cost basis of the project may be depreciated on an accelerated basis.[26] This usually results in an artificial loss that can shelter other income of the taxpayer-investor. The high loan-to-value ratio and low cash equity required for a Section 236 project provide the investor-taxpayer with a greater ratio of depreciation dollar losses to equity invested than for a conventional project. Third, upon transfer of a Section 236 project, the rate of taxation of gain can be more favorable than for other real property. Moreover, the tax on such gain can be deferred if the project owners transfer it in accordance with the "rollover provision" of the Internal Revenue Code. (For a fuller discussion of this, see Chapter 2.)

Estimates of the tax revenue forgone to induce the participation of limited dividend sponsors have been made.[27] The estimates vary with the assumptions about the availability and rate of return of other tax shelters and the typical point at which a sponsor will sell a

[26] The Administration's new tax proposal would diminish sharply the advantages of taking accelerated depreciation. Although this change would reduce the revenue loss of limited dividend projects, it would also eliminate a major inducement for participation in the program, because sponsors depreciate their investments rapidly in the first few years, thereby substantially offsetting income from the project or, more importantly, other investments or activities.

[27] The tax revenue forgone from all tax shelter advantages, including those available to the conventional builders, was estimated. It was assumed that, in the absence of the program, other tax shelter activity would not have expanded. This overstates to some extent the taxes forgone by reason of the program because in the absence of the program investors would have sought other tax "shelter."

project to maximize its returns. A reasonable estimate is that forgone tax revenue—or, from the standpoint of the sponsors, tax savings—for a typical Section 236 limited dividend unit may total $1,446.[28] Amortized at 6 percent over 35 years, the average annual tax loss per limited dividend unit was $99 (Table 19).

Estimates of the losses due to insurance claims on the FHA Special Risk Fund also were made. If these losses are allocated over all units and amortized, the annual cost per unit is $86. Adding this loss to other program costs would involve some double-counting, however. The direct subsidy payment includes an insurance payment that the Government, in essence, makes to itself. Adjusting for this premium income, the annual net foreclosure cost per unit is $29.

Efficiency: Is subsidized housing competitive in price? In 1971, HUD's audit office reviewed Section 236 projects in 21 cities. Each project was matched with two similar conventional projects, and the "market rents" for the Section 236 units were compared to rents of conventional units with the same number of bedrooms. The rents were adjusted for differences in amenities. The survey's data indicate that the market rents of the Section 236 units were 10 percent higher than conventional rents. No adjustments were made for differences in neighborhood quality, but it was the opinion of those conducting the survey that such adjustments would have increased the disparity in rents.

The HUD audit survey is consistent with the results of a special study of construction costs in three regions undertaken in June 1973. This study shows that it cost $3 per square foot, or 20 percent more, to build a subsidized unit than to construct a similar conventional unit.

With information on both costs and benefits, it is possible to determine the efficiency of the program. One important question is how much cost is incurred by the Government to provide the "extra housing" to the tenant. That relationship, which has been defined as Production Efficiency, will differ between Section 236 units with rent supplement payments and regular Section 236 units, and between units in limited dividend projects and units in nonprofit projects. Results of all four possibilities are reported in Table 20.

As Table 20 shows, Production Efficiency varies from 0.67 to 0.85. The lower efficiency for limited dividend sponsors may not be accurate because limited dividend projects seem to have better foreclosure experience. It was not possible to make separate foreclosure cost estimates for limited dividend sponsors.

Production inefficiency can arise from two sources: (1) the indirect costs that accompany the subsidy payments, such as administrative costs and forgone tax revenue, and (2) inefficiency in transforming the subsidy payment into extra housing for the recipient. The second source accounts for approximately 60 percent of the total Section 236 inefficiency.

Earlier it was noted that the "market rent" of Section 236 units is approximately 10 percent more than the rent of similar conventional units. This inefficiency is magnified by a production strategy that requires a family to move into a newly constructed unit rather than to upgrade its present unit. For example, consider a family living in a $120 apartment; society wishes this family to be housed in a unit worth $200. If its present unit could be satisfactorily improved by repairs and modernization with $80, an inefficiency of 10 percent in making such improvements would make the direct cost to the Government $88. The Section 236 program, however, does not improve housing in this way. Instead, the family moves into a subsidized project where a unit that would cost $200 if built for the conventional market costs the Government $220. If the family continues to pay a rent of $120, then the direct cost to the Government to improve the family's housing by $80 is $100. The inefficiency is 25 percent, rather than 10 percent.

The Production Efficiency estimates for the Section 236 rent supplement program are lower because of the deeper subsidy. In the above example, the unit costs the Government $20 more than it is worth. If the subsidy were deeper (for example, if the family's rent were only $90), then this absolute loss would be spread over a larger transfer. It would cost the Government $130 to provide $110 worth of housing, an inefficiency of only 18 percent.

The Transfer Efficiency estimates show that the average Section 236 tenant family

[28] Future income was discounted in computing the sum.

implicitly values its transfer-in-kind at only 71 percent of its market value and the average Section 236 rent supplement tenant family implicitly values its transfer-in-kind at only 64 percent of its market value.

Finally, Program Efficiency indicates how much overall benefit tenants receive in relation to the costs incurred by the Government (Table 21). This ratio ranges from 0.47 to 0.55. In other words, for every $100 in expenditures or tax revenues forgone, the Federal Government improves tenant welfare only $47 to $55.

Program Viability: It is difficult to predict with accuracy what experience the Section 236 program will have with respect to mortgage foreclosures and assignments. Data exist on the program's 5 years of operation, and other data can be obtained for a similar program (Section 221(d)(3) below-market-interest-rate rental housing) through the first 10 years of operation. After that point, forecasts must be based on the experience of an unsubsidized FHA multifamily program (Section 207). The evidence available suggests that approximately 20 percent of all units will fail within the first 10 years. Over 40 years—the life of mortgages issued under the program—the failure rate may be 30 percent or more. This longer-run prediction is obviously less reliable because it is based on the experience of a nonsubsidized FHA program (Section 207).

As of December 31, 1972, HUD owned six Section 236 projects and held assigned mortgages on 60 more—about 2 percent of all insured projects. No foreclosed Section 236 projects had as yet been sold, so estimates of loss in turnover must be based on the experience of another subsidized program. For the Section 221(d)(3) below-market-interest-rate program, the average loss on the acquisition and sale of a unit was approximately 45 percent of the acquisition costs. These projects were held for periods of up to 3 years, and, on the average, rental receipts failed to cover operating costs and maintenance expenditures.

Table 21. Section 236 Efficiency, 1972

Type of Sponsor	Production	Transfer	Program
236 without Rent Supplement			
Nonprofits and cooperatives	.74	.71	.52
Limited dividends	.67	.71	.47
236 Rent Supplement			
Nonprofits and cooperatives	.85	.64	.55
Limited dividends	.81	.64	.52

Source: Department of Housing and Urban Development, National Housing Policy Review.

The Rent Supplement Program

Although not a production program itself, the rent supplement program always is used in conjunction with Government housing production programs. These include the Section 221(d)(3) market-rate program; Section 236; Section 221(d)(3) below-market-rate; and Section 231 insurance for multifamily projects serving the elderly or handicapped. Section 236 piggybacks were discussed earlier, and because the Section 221(d)(3) below-market-rate and Section 231 combinations are rare, this section will deal exclusively with the combination of rent supplement and the Section 221(d)(3) market-rate program.

The Section 221(d)(3) market-rate program does not subsidize, by itself, the production of multifamily housing. It does provide, however, important inducements to build such housing—a high loan-to-value ratio, a 40-year mortgage, mortgage insurance, special tax advantages, and, in some cases in the past, Tandem Plan assistance.

The rent supplement provides the subsidy in the form of a contract through which the Government agrees to make monthly rent payments on behalf of the tenant. In exchange, the landlord agrees to obtain HUD's approval of rent changes. To be eligible for a rent supplement subsidy, a family must earn, at initial

occupancy, less than the local limit for admission to low rent public housing. In addition, the family must satisfy one or more hardship criteria such as (1) having an elderly or handicapped household head or spouse; (2) having a veteran or member of the armed forces; or (3) having been displaced from an urban renewal location.

Each unit has an "economic rent," which is the sum necessary to cover the operating and capital costs associated with that unit. The tenant family is required to pay 25 percent of its income or 30 percent of the "economic rent," whichever is greater. Income is adjusted for family size and tenant rent cannot exceed the "economic rent."

Table 22 provides some basic background information on the program.

Major Findings

1. The rent supplement program serves mainly low income households.

2. Sizable subsidies are provided to rent supplement tenants while many low income households receive no assistance. The rent supplement program serves less than 1 percent of all households earning less than $4,000 per year.

3. There is evidence that the "economic rent" for a Section 221(d)(3) market-rate rent supplement unit is higher than rents for similar units in the private market.

4. Federal costs exceed the market value of the housing provided by approximately 30 percent in the Section 221(d)(3) market-rate rent supplement program.

5. The main reason Federal costs exceed market value is that Section 221(d)(3) market-rate rent supplement units are not rent-competitive with identical private units and therefore the direct subsidy is spent inefficiently. Forgone tax revenue, administrative costs, and foreclosure costs also contribute to the excess of costs over housing value.

6. Forecasts indicate that about 30 percent of all Section 221(d)(3) market-rate rent supplement units will fail in the first 10 years. The program does not appear to be actuarially sound.

Equity: Tabie 23 shows that most tenants benefiting from the rent supplement program have very low incomes, 82 percent of them below $4,000 in annual income. The probability of being served by the program (Column 4) declines as income increases, but the differences probably are too small to be significant. The rent supplement program is able to serve low income groups for two reasons. First, the subsidy formula allows the Government to subsidize a larger share of the rent, thus requiring

Table 22. Characteristics of the Rent Supplement Program, 1972

Units assisted through December 31, 1972 [1] (finally endorsed)	77,000
Total mortgage amounts through December 31, 1972 [1] (finally endorsed)	$1.0 Billion
Maximum annual subsidies permitted by law through fiscal year 1973 (contract authority released in appropriations)	$280 Million
Units in process and units finished processing at the end of fiscal year 1973 [2] (reservations and obligations of contract authority)	119,000
Median income of new tenants	$2,400
Racial and ethnic composition of new tenants:	
Nonminority white	44%
Black	44%
Spanish American	6%
Other	6%

[1] Excludes units in Section 236 projects. Excludes units financed through State and local programs and not insured by FHA (see Chapter 5). includes all units in other rent supplemented projects even where some units may not receive a rent supplement.

[2] Excludes units in Section 236 Projects. Excludes units financed through State and local programs and not insured by FHA (see Chapter 5).

Source: Department of Housing and Urban Development.

a smaller contribution on the part of the tenant. Secondly, units built under the Section 221(d)(3) market-rate program are simpler in amenities than the typical Section 236 unit. In 1971, the average Section 221(d)(3) market-rate mortgage was $13,818, compared to $16,304 under Section 236.

Column 6 of Table 23 shows that the average subsidy increases slightly and irregularly with income.

Horizontal equity is again a problem in the sense that the rent supplement program provides extensive benefits to relatively few families while most receive no assistance. Table 23, Column 5 shows that there are 13.1 million families unserved with annual incomes of less than $4,000. There are two ways to solve this equity problem—either the rent supplement program can be funded at a substantially higher level, or an alternate technique can be found that will provide assistance to more families but at less cost per family. Table 24 indicates, for a sample of four cities, the extent to which the "economic rent" for the typical Section 221(d)(3) market-rate unit exceeds the rent for the average private unit or the unit satisfying the housing needs specified in the Bureau of Labor Statistics lower budget for a family of four. Even taking into account that the economic rent frequently overstates the quality of the unit (see below), these units are of higher quality than the average private unit.

Impact: The average rent supplement subsidy in combination with the Section 221(d)(3) market-rate program is $1,133 per year. This deeper subsidy, combined with a less costly unit, results in the Government's paying a larger share of the total unit rent than is the case under Section 236—55 percent compared to 40 percent.

One notable consequence of the deeper subsidy is that the tenant receives more housing services. The average annual transfer-in-

Table 23. Distribution of Rent Supplement (Excluding 236 Rent Supplement) Housing, by Income Class, as of December 31, 1972

(1)	(2)	(3)	(4)	(5)	(6)
Gross Income	Households Served By Rent Supplement		Rent Supplement Households as Percent of all Households	Residual Need*	Direct Annual Subsidy Per Household Served
	Number	Percent Distribution			
$0– 999	2,150	2.8%	0.13%	—	$1,342
1,000–1,999	24,200	31.9	0.63	1,800,000	1,427
2,000–2,999	19,740	26.0	0.46	5,300,000	1,503
3,000–3,999	15,870	20.9	0.40	9,300,000	1,511
4,000–4,999	8,850	11.7	0.23	13,100,000	1,582
5,000–5,999	3,540	4.7	0.09	16,700,000	1,773
6,000–6,999	1,170	1.5	0.03	20,300,000	1,845
7,000–7,999	330	0.4	Less than 0.005	23,700,000	1,744
8,000–9,999	120	0.2	Less than 0.005	27,400,000	1,738
10,000 or more	30	Less than 0.05	Less than 0.005	34,600,000	1,392

Note: Detail may not add to totals because of rounding.

*Number of households living in unsubsidized housing earning less than lower limit for that income class, as given in column 1.

Source: Department of Housing and Urban Development, National Housing Policy Review estimates based on data from Department of Housing and Urban Development, Department of Agriculture and Department of Commerce, Bureau of the Census, *Current Population Reports*, Series P-60, Nos. 84 and 87, and *1970 Census of Population*.

kind is $948. In other words, the family receives about $80 more housing per month than it purchases with its own rent. It cannot be determined, however, how much the rent supplement subsidy alters the normal consumption pattern of a recipient family. Data comparable to those used in the Section 236 analysis do not exist. Similarly, there is no information on how much value the family attaches to its subsidy; as a result, it cannot be determined how much impact the program has on the family's welfare.

Table 24. Monthly Rent Comparisons [1]

Location	Census Mean Gross Rent, 1970	Renter Costs Family of Four BLS Lower Budget, 1972	Average 221(D)(3) MR Economic Rent 1972—1973[2]
Boston	$135	$124	$205
Washington, D.C.	134	117	186
Pittsburgh	110	90	163
St. Louis	97	94	191

[1] Including utilities.
[2] New construction only.

Source: Department of Housing and Urban Development, National Housing Policy Review estimates based on data from Department of Housing and Urban Development, Department of Commerce, Bureau of the Census, 1970 *Census of Housing*, and Department of Labor, Bureau of Labor Statistics.

Table 25. Annual Costs Per Section 221(D)(3) Market-Rate Rent Supplement Unit, 1972

Cost Item	Amount
Direct subsidy (Including insurance premium)	$1,133
Foreclosure costs (Net of insurance income)	70
Administrative costs	15
Subtotal	$1,218
Tax revenue forgone (Limited dividends only)	92
Total	$1,310

Source: Department of Housing and Urban Development, National Housing Policy Review.

Costs: In addition to the direct subsidy, there are four other costs that must be considered in calculating the total costs to the Federal Government in providing this transfer-in-kind. These are: (1) Tandem Plan subsidies; (2) administrative costs; (3) insurance claims; and (4) forgone tax revenue (Table 25).

Here, as in the Section 236 program, all cost and benefit data refer to projects completed prior to December 31, 1972. For those projects, GNMA Tandem Plan subsidies were minimal and can be ignored. HUD's internal reporting system collects information on administrative costs for the Section 221 program as a whole. Because this includes data on unsubsidized projects, and because of certain other shortcomings, it seems better to rely on the Section 236 administrative cost data as an indication of costs under the Section 221(d)(3) market-rate program.

Computer simulation of the rent supplement program suggests that the subsidy will be in effect for the full 40 years of the contract. Therefore, the initial administrative costs have been amortized over 40 years. These costs plus the annual monitoring costs total only $15 per year.

Because of a higher failure rate, insurance claims are projected to be larger under the rent supplement Section 221(d)(3) market-rate program than under Section 236. The extra 5 years of subsidy life temper this increase somewhat. The annual per unit allocation of foreclosure costs is $115. After adjustment for premium income, the annual per-unit cost is $70. Here, as in the case of the Section 236 program, the foreclosure calculations imply that the present insurance premium is not large enough to cover anticipated losses over the life of the program.

Limited dividend sponsors of Section 221(d)(3) market-rate enjoy the same tax advantages given to Section 236 sponsors. Because of the lower development cost per unit and the longer period over which to amortize the cost, the average annual cost estimate for

forgone tax revenue under the Section 221(d)(3) market-rate program is $92, compared to $99 under Section 236.[29]

Efficiency: The rent supplement program always is combined with a production program, usually either Section 221(d)(3) market-rate or Section 236. Therefore, the effectiveness of the rent supplement program depends on the price competitiveness of the Government-sponsored housing program that it supplements.

As reported in analyzing the Section 236 program, construction costs average 20 percent more for federally subsidized multifamily projects than for conventional units of equal quality. This estimate was obtained from a sample that included both Section 236 and Section 221(d)(3) market-rate units.

The most useful measure of competitiveness is a rent comparison. The "economic rent" of a rent supplement unit is the monthly income necessary to cover the cost of building and operating the unit. If the economic rent is higher than the rent for an identical unit on the private market, then the production program is inefficient and the impact of the rent supplement subsidy is reduced. To make this rent comparison, data on Section 221(d)(3) market-rate units in four cities were collected and compared with private rents for similar units in these cities. These results suggest that Section 221(d)(3) market-rate units are as competitive as Section 236 units. Therefore, the audit finding that Section 236 rents are 10 percent higher than rents on the private market could be applied to the Section 221(d)(3) market-rate rent supplement program as a reasonable approximation.

A series of factors may explain the higher rents observed in both the Section 236 and the Section 221(d)(3) market-rate programs. FHA processing, as a result (at least in part) of the numerous statutory requirements, involves significant paperwork and causes delays at the initial stage, adding to costs. There are undoubtedly instances where the Government has permitted higher land costs or service fees than are typical in conventional building. The Davis-Bacon requirement may increase labor costs in some markets. Concentration of low income families may raise operating costs. Better loan terms, particularly with regard to length of mortgage, partially offset these other factors.

Lack of price competitiveness has a double impact on the rent supplement program. First. the Government subsidy buys less housing. Second, the tenant's own rent contribution is inefficient. Accordingly, part of the subsidy payment must reimburse the tenant family for the loss of efficiency in its own payment. The remaining subsidy is used to buy extra housing for the family.

Having estimated the extra housing provided and the various costs incurred, it is possible to measure Production Efficiency. For nonprofit and cooperative sponsors, the costs incurred were those involving the direct subsidy, administrative costs, and foreclosure costs. These totaled $1,218, which—when divided into the extra housing provided ($948)—yield a Production Efficiency of 0.78. In the case of limited dividend sponsors, forgone tax revenue was also included among the costs. The Production Efficiency ratio then became 0.72. Thus, for every $100 in tax revenue (expended directly or forgone indirectly), the Government could provide between $72 and $78 of extra housing under the Section 221(d)(3) market-rate rent supplement program.

It was not possible to estimate Transfer Efficiency for the rent supplement program. If the estimate obtained for Section 236 rent supplement (0.64) were used, the overall Program Efficiency could be estimated. The ratio of benefits (determined on the cash-grant-equivalent basis discussed earlier) to total cost is in the range of 0.46 to 0.50. This means that through the rent supplement Section 221(d)(3) market-rate program, the Government increased tenant welfare by only $46 to $50 for every $100 in costs or forgone taxes.

Program Viability: The longer operating experience of the Section 221(d)(3) market-rate program provides a better data base for estimating foreclosures than was available for the Section 236 program. It is estimated that during the first 10 years of insured life, approximately 30 percent of all Section 221(d)(3) market-rate projects will fail. Projections further into the future must rely on the experience of unsubsi-

[29] Forgone tax revenue was estimated in the same manner as in the case of the Section 236 program.

dized FHA multifamily housing and, therefore, may be much less reliable. The percentage of financial failures over 40 years—the full term of a Section 221(d)(3) mortgage—is estimated to be approximately 40 percent.

As in the case of the Section 236 program, no foreclosed Section 221(d)(3) market-rate property had as yet been sold. To estimate the Government's loss in the acquisition and sale of foreclosed properties, it was necessary to use the experience of another subsidized program, Section 221(d)(3) below-market-interest-rate. The Government loses approximately 45 percent of the acquisition price on the turnover of these properties. As in the case of the Section 236 program, rent receipts from foreclosed projects are insufficient to cover their operating costs and maintenance expenditures.

The high failure rates reflect the riskiness of the undertaking. Concentrating low income families in one project tends to create problems that add to the costs of operating and maintaining a multifamily structure.

Low Rent Public Housing

The low rent housing program had its origins in the United States Housing Act of 1937—although Federal involvement in the field began somewhat earlier, basically as an anti-Depression measure to stimulate employment.

Under the provisions of the 1937 act, the Government and local housing authorities (known as LHA's) were responsible for all aspects of developing and operating the project. The Government's role was to provide the amounts necessary to amortize the full capital costs of the projects. Tenant rents were to pay for the full cost of operating the project. Such costs included only a payment-in-lieu-of-taxes because the project was exempt from local property taxes.

In recent years, however, Congress has amended the original statute to authorize additional Federal payments in the form of operating subsidies, in order to meet deficits caused by the statutory limitations on tenant rent discussed below, and by increasing operating costs.

Several other significant changes have been made in the development of public housing. Under Section 23 of the 1937 act, added in 1965, local housing authorities were permitted to lease private units, which they, in turn, sublet to public housing tenants. Some of these leases cover existing units. Others cover newly constructed units built on the basis of lease commitments.

Another modification in the development of public housing projects was implemented in 1967 when the local authorities were authorized, after advertisement, to purchase a project located on a site selected by the developer and built by the developer according to its specifications. Since 1970, more than half of all public housing units entered the program through this so-called "turnkey" mechanism.

In addition, HUD in 1967 developed a program to provide additional annual contributions to amortize the cost of modernizing older public housing projects.

The most significant recent change in the public housing program came through a statutory amendment in 1969 that limits the rent a tenant family may pay for a public housing unit to 25 percent of its annual adjusted income, no matter how low that may be. This amendment and accompanying provisions regarding the computation of income have been partly responsible for multiplying the Federal Government's operating subsidy payments ninefold, from $31 million in fiscal year 1970 to $280 million in fiscal year 1973.

By the end of 1971, there were about one million public housing units occupied by more than three million persons. In 1971, the cost of the services provided by public housing units was about $2.3 billion. Public housing tenants paid 26 percent of this cost; Federal and local governments bore the remaining 74 percent. Only 42 percent of the cost borne by government appears explicitly in HUD appropriations and expenditures records. Another 36 percent of the cost to government is attributable to the tax exempt status of the interest earned on local authority bonds, and another 22 percent is attributable to the difference between full local property taxes and the smaller payments made by local housing authorities to local governments in lieu of taxes.

Major Findings

1. Families served by public housing are, on the average, poorer than those not served. Most of the families in the lowest income groups, however, are not served, while many families with higher incomes are served.

2. Among families living in public housing, average benefits tend to be larger for the poorest families; however, there is great variation in the value of the program to families having similar incomes.

3. The average public housing unit is almost as good as the average private rental dwelling in a sample of seven major cities. Many public housing units are worse than the average private rental unit but an almost equal number are better.

4. The overwhelming majority of public housing tenants occupy better housing and are able to purchase more other goods than they would in the absence of the program.

5. Taxpayers incurred an average annual cost of $1,650 per household in public housing.

6. Tenant welfare is increased by only about 55 cents for every dollar spent because resource costs to produce public housing are greater than those required to produce comparable conventional housing, and because tenants place a lower value on the transfer-in-kind than a cash grant.

7. In 1971, it cost $1.03 to produce a dollar's worth of housing services under the leased program, $1.23 under the "turnkey" program, and $1.40 under the conventional program.

Effects on Consumption Patterns: One of the most important effects of any government housing program is its effect on the quality of the housing occupied by participants. How much better or worse housing do public housing tenants occupy than they would occupy in the absence of the program?

In an effort to provide an answer, the market values of public housing units—the rents they would command on the open market—and the market rents of private housing units that the occupants would have occupied in the absence of the program were estimated. The estimates were based on three different samples. One sample consisted of data collected on 1,388 families living in conventional public housing in seven cities. The second sample was drawn from six cities with 326 families living in conventional public housing and 30 families living in "turnkey" public housing. A third sample consisted of 120 families living in conventional public housing, 120 in existing leased housing, 47 in new leased housing, 24 in new Turnkey units, and 24 in existing units acquired for public housing in five cities. All data were for 1971.

The estimates of the effects of public housing on the quality of housing based on

Table 26. Effect of Low Rent Public Housing on Tenant Housing Consumption, 1971

Sample Name	Seven Cities	Six Cities	Five Cities	Combined
Sample Size	(1,388)	(356)	(335)	(2,079)
Mean monthly market value of public housing units	$146	$157	$156	$149
Mean monthly housing expenditure in the absence of the program	$80	$92	$98	$85
Percentage increase in housing	82%	71%	59%	75%

Source: Department of Housing and Urban Development, National Housing Policy Review.

these samples are shown in Table 26. The similarity of the results from the different samples is striking. The analysis shows that public housing tenants, on the average, occupy significantly better housing than they would in the absence of the program. The percentage of improvement in housing (valued at market rates) ranged between 82 percent and 59 percent for the three different samples. The overwhelming majority—87 percent in the five-cities sample and 92 percent in the six-cities sample—experienced improvement in their housing.

The rent that a family in public housing pays may be more or less than the amount that it would have spent on housing in the absence of the program. Hence, the family's expenditure on other goods may be affected by the public housing program. (See Table 27.) The three studies provide information estimating the effect of public housing on the expenditures for other goods and services. Estimates of increased expenditures on nonhousing goods and services ranged from 5 percent to 19 percent. A majority—76 percent in the five-cities sample and 92 percent in the six-cities sample—increased their expenditures on nonhousing goods.

Value of Public Housing to its Occupants: Table 28 shows that the average benefit to occupants of public housing ranged between $76 and $52 per month. The average benefit as a percentage of income ranged from 11 percent to 26 percent, demonstrating that public housing tenants receive considerable benefits from the program.

Cost of Public Housing to the Government: On the basis of the six-cities sample, estimated costs of providing such benefits per dwelling unit were $193 per month. The mean rent paid by tenants was $56 per month. Therefore, the cost to taxpayers per dwelling unit was $137 per month. This cost includes the forgone taxes attributable to the tax exempt status of the interest earned on local authority bonds and the exemption of these projects from

Table 27. Effect of Low Rent Public Housing on Tenant Nonhousing Expenditures, 1971

Sample Name	Seven Cities	Six Cities	Five Cities	Combined
Sample Size	(1,388)	(356)	(335)	(2,079)
Average monthly expenditure on nonhousing goods and services by public housing tenants	$166	$258	$376	$216
Average monthly expenditure on nonhousing goods and services if the tenants were not in public housing	$140	$222	$357	$189
Percentage increase in expenditures on other goods	19%	16%	5%	14%
Mean monthly tenant rent in public housing	$54	$56	$79	$58
Mean monthly income	$220	$314	$455	$274

Source: Department of Housing and Urban Development, National Housing Policy Review.

local property taxes. Cost data are only available for the six-cities sample. Therefore, all cost-benefits comparisons for public housing are based on the six-cities sample, rather than on the combined samples.

Discrepancy Between the Cost of Public Housing to Government and its Value to Tenants: Government provides $137 per month per family in public housing to support the low rent public housing program. However, the benefit as viewed by the public housing tenant is $76 per month, meaning that Program Efficiency is 0.55. This discrepancy results from a number of factors. First, $9 per unit per month is required to administer the program, excluding management costs that would be incurred by private producers of housing service. Second, an additional $27 per month is due to technical inefficiency in producing housing service under the public housing program. Finally, another $25 per month is lost because tenant welfare is not increased commensurately with the dollars spent, because the subsidy forces tenants to purchase housing and other goods in combinations they would not choose in the absence of the program.

Technical Efficiency: An estimated $184 per month per dwelling unit is spent on providing housing service under the program without considering administrative costs. It is also estimated that the structural characteristics and city location (excluding neighborhood considerations) are such that the mean market value of the unit is $157 per month. In other words, public housing tenants, on the average, would find private housing with a rent of $157 per month as satisfactory as their public housing units. Therefore, under this measure, public housing authorities spend $1.17 to produce one dollar's worth of housing, meaning that Technical Efficiency is 0.85. This technical inefficiency in producing housing service accounts for $27 per month per dwelling unit of the discrepancy between the cost of public housing to taxpayers and its value to tenants.

There are marked differences in the efficiency with which housing services are produced under the various types of public housing. A study published by the Joint Economic Committee of Congress estimated that the full cost per dwelling unit per month of leased, Turnkey, and conventional public housing in 1971 was $154, $211, and $219, respectively.[30] Pooling the data from two other samples designed by the National Housing Policy Review, the market values per dwelling unit per month

[30] Frank de Leeuw and Sam H. Leaman, "The Section 23 Leasing Program," in Joint Economic Committee of Congress. *The Economics of Federal Subsidy Programs, Part 5—Housing Subsidies*, Washington, D.C.: Government Printing Office 1972. The de Leeuw-Leaman study does not take into account any differences in average desirability of the public housing units provided by the three different methods.

Table 28. Magnitude of Benefits to Low Rent Public Housing Tenants and Costs to Taxpayers, 1971

Sample Name	Seven Cities	Six Cities	Five Cities	Combined
Sample Size	(1,388)	(356)	(335)	(2,079)
Mean monthly benefit to public housing tenants	$57	$76	$52	$59
Mean monthly income	$220	$314	$455	$274
Percentage increase in real income	26%	24%	11%	22%
Monthly cost to taxpayers	NA	$137	NA	NA

NA = Not Available.

Source: Department of Housing and Urban Development, National Housing Policy Review.

were estimated at $149, $172, and $156, under the leased, "turnkey," and conventional public housing programs, respectively. Based on those data, it costs $1.03 to produce a dollar's worth of housing service under the leased program, $1.23 under the "turnkey" program, and $1.40 under the conventional program. The relative efficiency with which housing service is produced under the leased program can be attributed to its use of the existing stock.[31]

Administrative Cost: Any housing subsidy program has administrative costs in addition to the management costs of providing housing services. The cost of checking the eligibility of applicants for public housing is an example of such an administrative cost. The cost of administering the program, as opposed to managing the housing, is estimated at $9 per month. These costs result in no benefits to public housing tenants, in terms of housing.

Transfer Efficiency: Public housing tenants, on the average, occupied housing with a market value of $157 per month and spent $258 per month on other goods. Hence, the average market value of all goods consumed by these families was $415 per month. Since the average income of these families was $314 per month, the public housing program resulted in an increase of $101 per month per family in the market value of all goods consumed. Since the cost to Government is $137 per month per family in public housing, the Production Efficiency is 0.74.

Under the public housing program, the consumer is not free to choose among all combinations of goods with the same market value as the combination actually produced by the public housing program. As a result, the value of the program to tenants averages $76 per month rather than $101. Technical inefficiency aside, the public housing program is only 75 percent as efficient as unrestricted cash grants in providing benefits to its occupants. The Transfer Efficiency is 0.75, which accounts for $25 per month per dwelling unit of the discrepancy between the cost of public housing to the Government and its value to tenants.

Equity: Families served by public housing are, on the average, poorer than those not served by public housing. In 1971, the median annual income of all families in the United States was about $10,000, while at the same time it was about $3,000 for families occupying public housing. Furthermore, among families living in public housing, average benefits tended to increase as family income decreased. This is indicated in Table 29.

Approximately 50 percent of the families in public housing had annual incomes of more than $3,000 (Table 30). Meanwhile, 95 percent of all families in the United States with annual incomes of less than $3,000 were not served by the program.

Among low income families that do occupy public housing, there is a large variation in the value of the program. About one-third of families having similar incomes receive benefits of $30 per month more or less than the average benefits. For example, if the average benefit for a similar group of families is $70 per month, then about one-third of the families would

Table 29. The Distribution of Benefits Among Low Rent Public Housing Tenants, by Income Class, 1971

Gross Income	Mean Annual Benefit To Public Housing Tenants
$0– 999	$696
1,000–1,999	900
2,000–2,999	1,044
3,000–3,999	1,008
4,000–4,999	972
5,000–5,999	648
6,000–6,999	708
7,000–7,999	504
8,000 or more	624

Source: Department of Housing and Urban Development, National Housing Policy Review.

[31] Estimates of the relative efficiency of leased public housing include construction-for-leasing units and existing leased units. Data limitations did not permit measurements of the relative efficiency of each program type separately. The average $1.03 cost to produce a dollar's worth of housing services under the leased program likely understates the cost of construction-for-leasing units while it overstates the cost of existing leased units.

receive benefits of less than $40 or more than $100 per month.

Table 31 compares estimates of the average market values of public housing units with estimates of the average market value of all housing in several cities. The value of the average public housing unit is almost equal to that of the average private rental dwelling. The average public housing tenant is occupying housing at least equivalent to that occupied by lower middle income families. Furthermore, this improvement in the housing of public housing tenants rarely occurs at the expense of their consumption of other goods. On the contrary, the tenants typically have more to spend on nonhousing goods and services.

A study by the Rural Housing Alliance and the Housing Assistance Council indicates that large differences occur in the ratio of public housing units to the number of poverty level households according to the degree of urbanization in an area. In metropolitan counties with high population densities there is a public housing unit for every five poverty level households.[32] In high-density nonmetropolitan counties, there are nine households in poverty for every public housing unit. The discrepancy is greater still for those metropolitan counties with lower population densities. They have, on the average, about 11 poverty level households for every public housing unit. Most pronounced is the gap in nonmetropolitan counties with low population densities, where such counties have more than 16 poverty level households for every public housing unit. Essentially, the same disparities occur between the number of public housing units and the number of units that lack complete plumbing and/or are overcrowded.

Farmers Home Administration Sections 502 and 504 Programs

The FmHA has the responsibility under the Housing Act of 1949 to provide "safe, decent, and sanitary" housing for rural residents. It tries

[32] Rural Housing Alliance and Housing Assistance Council, *Public Housing: Where It Is and Isn't*, Washington, D.C., December 1972.

Table 30. Distribution of Low Rent Public Housing by Income Class, as of December 31, 1972

Gross Income	Total Households	Households Served by Public Housing	Public Housing Households as Percent of all Households
$0– 999	1,800,000	25,910	1.5%
1,000–1,999	3,800,000	283,120	7.4
2,000–2,999	4,300,000	248,520	5.8
3,000–3,999	4,000,000	183,860	4.7
4,000–4,999	3,800,000	124,290	3.2
5,000–5,999	3,800,000	73,260	2.0
6,000–6,999	3,600,000	45,760	1.3
7,000–7,999	3,800,000	27,900	0.7
8,000 or more	39,600,000	42,420	0.1
Total	68,500,000	1,055,050	1.5%

Note: Detail may not add to totals because of rounding.

Source: Department of Housing and Urban Development, National Housing Policy Review estimates based on data from Department of Housing and Urban Development and Department of Commerce, Bureau of the Census, *Current Population Reports*, Series P–60, Nos. 84 and 87, and *1970 Census of Population*.

to meet this objective largely through the Section 502 homeownership program and the Section 504 homeownership repair program. The Section 502 program accounts for about 96 percent of all FmHA housing outlays. The Section 515 rural rental and Section 514/516 farm labor housing programs are not reviewed here because of the limited data available.

The Section 502 loan program provides loans to rural families who indicate they cannot obtain credit from conventional sources to build new homes or to buy or improve existing houses. Loans made during fiscal year 1972 bore a 7.25 percent interest rate with an amortization period of up to 33 years. Interest credit loans were made to lower income families (less than $7,000 adjusted annual income). The amount of interest credit granted depended upon the size and income of the family and the amount of the loan. The family must pay at least 1 percent interest. In 1972, the maximum interest credit was 6.25 percent. Because FmHA lends at 7.25 percent and borrows at a different rate—determined by the going rates in secondary mortgage markets where it sells notes—there can be an additional interest premium subsidy both to interest credit borrowers and moderate income noninterest credit borrowers. In fiscal year 1972, the estimated average annual interest credit subsidy was $658, and the estimated average interest premium subsidy was $152. The major characteristics of the Section 502 program are shown in Table 32.

The Section 504 loans are made to owner-occupants to make minor home repairs in order to remove hazardous living conditions. These loans are for "below standard" housing, in contrast to the standard housing financed under Section 502 loans. Section 504 loans bear an

Table 31. Monthly Rent Comparisons, 1970*

Location	Low Rent Public Housing Market Values	Census Mean Gross Rent
Baltimore	$113	$116
Boston	125	135
Los Angeles	117	128
Pittsburgh	92	110
St. Louis	103	97
San Francisco	133	144
Washington, D.C.	136	134

*Including utilities.

Source: Department of Housing and Urban Development, National Housing Policy Review estimates based on data from Department of Housing and Urban Development and Department of Commerce, Bureau of the Census, *1970 Census of Housing*.

Table 32. Characteristics of the Section 502 Program, Fiscal Year 1972

Characteristics	Non-Interest Credit	Interest Credit
Family characteristics:		
Mean income	$7,900	$5,400
Mean number of persons	3.7	4.2
Mean age of head	32	36
	Percent of Total	
Racial and ethnic composition:		
Nonminority white	87%	68%
Black	11	26
Spanish-speaking	2	5
Purpose of loan:		
Build or purchase new	49	85
Repair or purchase old	41	15
Type of waste disposal:		
Individual waste system	75	66
Public sewer	25	34
Location:		
Open country	52	52
Towns up to 2,500	26	24
Towns 2,500–5,499	14	15
Towns 5,500–9,999	8	9
Farm	4	
Nonfarm	96	

Source: Department of Housing and Urban Development, National Housing Policy Review based on data from Department of Agriculture.

interest rate of 1 percent and are repayable in up to 10 years. The maximum loan is $3,500. In fiscal year 1972, the estimated average interest subsidy was $75 per loan.

Major Findings

1. Taken separately, the income group most likely to be served by Section 504 was $1,000–$1,999, by Section 502 interest credit $4,000–$4,999, and by Section 502 noninterest credit $8,000–$8,999.

2. Current financing methods result in an interest premium subsidy on all Section 502 loans, not just on interest credit loans.

3. The Sections 502 and 504 programs result in substantial improvements in housing quality. The recipients substantially increase their expenditure on housing and decrease their expenditures on other goods and services.

4. The annualized administrative cost of making and servicing a Section 502 noninterest credit loan was approximately 60 percent of the estimated subsidy.

5. The Section 502 interest credit program increases borrower welfare on a cash-grant-equivalent basis by approximately 70 cents for every dollar of Federal cost.

6. The FmHA's provision of counseling, appraisals, inspections, closing services, and loan servicing results in low foreclosure losses, but relatively high administrative costs.

7. Although current programs could serve a proportionately greater number of lower income

Table 33. Distribution of Sections 502 and 504 Loans, by Income Class, Loans Made Fiscal Year 1972[1]

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
				Households Served by 502 IC[3] Loans			Households Served by 502 NIC[4] Loans			Households Served by 504 Loans		
Gross Income	Number of Rural Families	Cumulative Number of Rural Families	Percent Distribution of Rural Families[2]	Number	Percent Distribution	Concentration Ratio (Col. 6 ÷ Col. 4)	Number	Percent Distribution	Concentration Ratio (Col. 9 ÷ Col. 4)	Number	Percent Distribution	Concentration Ratio (Col. 12 ÷ Col. 4)
$0– 999	450,000	450,000	5.1%							95	3.1%	0.6
1,000–1,999	726,000	1,176,000	8.3	3,575	6.1%	0.3	260	0.6%	< 0.05	1,216	39.1	4.7
2,000–2,999	838,000	2,014,000	9.6							960	30.8	3.2
3,000–3,999	873,000	2,887,000	10.0	7,187	12.3	1.2	504	1.1	0.1	467	15.0	1.5
4,000–4,999	873,000	3,760,000	10.0	12,857	22.1	2.2	1,194	2.5	0.3	233	7.5	0.8
5,000–5,999	981,000	4,741,000	11.2	13,608	23.3	2.1	2,804	6.0	0.5	83	2.7	0.2
6,000–6,999	999,000	5,740,000	11.4	11,701	20.1	1.8	6,341	13.5	1.2	35	1.1	0.1
7,000–7,999	1,044,000	6,784,000	11.9	7,508	12.9	1.1	11,800	25.2	2.1	17	0.5	< 0.05
8,000–8,999	1,048,000	7,832,000	12.0	1,727	3.0	0.2	15,165	32.3	2.7	6	0.2	< 0.05
9,000–9,999	930,000	8,762,000	10.6	131	0.2	< 0.05	6,506	13.9	1.3	0	0.0	0.0
10,000 or more	—[2]	—[2]	—[2]	0	0.0	—	2,307	4.9	—	0	0.0	—
Total	—	—	100.0%	58,294	100.0%	—	46,881	100.0%	—	3,112	100.0%	—

Note: Detail may not add to totals because of rounding.

[1] Covers 48 contiguous States.

[2] No families are shown in the $10,000 or more class in order to allow suitable comparisons with the subsidized programs.

[3] Interest credit.

[4] Noninterest credit.

Source: Department of Housing and Urban Development, National Housing Policy Review estimates based on data from Department of Agriculture and Department of Commerce, Bureau of the Census, *1970 Census of Population*.

families within the range of income groups now being served through administrative action by FmHA, the basic problems inherent in the production and subsidy in-kind approach would remain.

Equity: Table 33 shows the distribution by annual family income of Section 502 interest credit, Section 502 noninterest credit, and Section 504 loans. Legislative intent is not specific regarding the particular income groups to be served by the programs.

As seen in program data from fiscal year 1972, the Section 504 program serves income groups in the $1,000 to $4,000 income classes.

The concentration of Section 502 interest credit loans is in the $4,000 to $7,000 income range, with the greatest concentration in the $4,000 to $5,000 income group. However, 2.9 million rural families with annual incomes of less than $4,000 cannot be served, because of the present Section 502 program structure and the rural income distribution. Of these, approximately 2.5 million families (86 percent) are occupying substandard housing, according to Department of Agriculture estimates. Families earning less than $4,000 annually can be served by the Section 502 interest credit program in the Southeast and Southwest, where housing costs and taxes are comparatively low, and elsewhere by utilizing rehabilitated or existing units that cost approximately $2,000 less, on the average, than new units on a nationwide basis. But if the program experiences increasing construction costs and continues to emphasize new units, the $4,000 income class will be the lowest class served effectively by the program.

The concentration of Section 502 noninterest credit loans is in the $7,000 to $9,000 annual income range, and the concentration begins falling for incomes above the $9,000 level. If the $6,000 level can be taken as an effective limit, there are approximately 4.7 mil-

Table 34. Percent of Eligible Families Served by Sections 502 and 504 Loans, Loans Made Fiscal Year 1972 [1]

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Gross Income	Number of Rural Families	502 IC[2] Households		502 NIC[3] Households		504 Households		502 and 504 Households as Percent of all Rural Families (Cols. 4+6+8)
		Number Served by Loans	As Percent of all Rural Families	Number Served by Loans	As Percent of all Rural Families	Number Served by Loans	As Percent of all Rural Families	
$0– 999	450,000					95	0.02%	
1,000–1,999	726,000	3,575	0.18%	260	0.01%	1,216	0.17	0.30%
2,000–2,999	838,000					960	0.11	
3,000–3,999	873,000	7,187	0.82	504	0.06	467	0.05	.93
4,000–4,999	873,000	12,857	1.47	1,194	0.14	233	0.03	1.64
5,000–5,999	981,000	13,608	1.39	2,804	0.29	83	0.01	1.68
6,000–6,999	999,000	11,701	1.17	6,341	0.63	35	< 0.005	1.81
7,000–7,999	1,044,000	7,508	0.72	11,800	1.13	17	< 0.005	1.85
8,000–8,999	1,048,000	1,727	0.16	15,165	1.45	6	< 0.005	1.61
9,000–9,999	930,000	131	0.01	6,506	0.70	0	0.00	0.71
10,000 or more	—[4]	0	—	2,307	—	0	—	—
Total	—	58,294	—	46,881	—	3,112	—	—

[1] Covers 48 contiguous States.
[2] Interest credit.
[3] Noninterest credit.
[4] No families are shown in the $10,000 or more class in order to allow suitable comparisons with the subsidized programs.

Source: Department of Housing and Urban Development, National Housing Policy Review estimates based on data from Department of Agriculture and Department of Commerce, Bureau of The Census, *1970 Census of Population*.

lion families that cannot be served by the noninterest credit program.

The percentage of any income class that is served by the program is a measure of horizontal equity. Table 34 indicates that for the combined programs, the highest percentage of eligible recipients served by loans made in 1972 is 1.85 percent for the $7,000 to $8,000 annual income class. Using only loans made in 1972 does not account for those served by the program before fiscal year 1972, but because the fiscal year 1972 loan volume accounted for a substantial proportion of all loans ever made, it is apparent that only a small percentage of those eligible could have been served over the years.

Overall, the Sections 502 and 504 programs are concentrated in the Southwest and the Southeast, as indicated in Table 35. A ratio of concentration greater than 1.0 indicates that a larger percentage of loans goes to a region than the percentage of eligible population that the region contains.

The inability of the current programs to serve lower income levels, more families at any given income level, and a wider geographic base, results in part from budgetary levels, the depth of the subsidies, and the administration of the program. But the failure lies more

Table 35. Sections 502 and 504 Regional Distribution, Loans Made Fiscal Year 1972 [1]

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
		502 Interest Credit Loans		502 Noninterest Credit Loans		504 Loans	
HUD Region	Percent of Rural Families[2]	Percent Distribution	Concentration Ratio (Col. 3 ÷ Col. 2)	Percent Distribution	Concentration Ratio (Col. 5 ÷ Col. 2)	Percent Distribution	Concentration Ratio (Col. 7 ÷ Col. 2)
I	5.1%	4.3%	0.8	3.0%	0.6	2.2%	0.4
II	6.2	1.9	0.3	4.0	0.6	0.5	0.1
III	13.4	10.1	0.8	9.8	0.7	7.7	0.6
IV	24.7	38.5	1.6	29.8	1.2	39.8	1.6
V	21.2	12.4	0.6	20.5	1.0	2.8	0.1
VI	10.5	13.6	1.3	14.9	1.4	38.3	3.6
VII	7.7	6.2	0.8	8.1	1.1	5.9	0.8
VIII	3.4	2.7	0.8	4.4	1.3	2.2	0.6
XI	4.1	6.0	1.5	2.2	0.5	0.4	0.1
X	3.7	4.3	1.2	3.4	0.9	0.3	0.1
Total	100.0%	100.0%	1.0	100.0%	1.0	100.0%	1.0

Note: Detail may not add to totals because of rounding. See Table 10 for State composition of the regions.

[1] Covers 48 contiguous States.

[2] Includes families in all income classes.

Source: Department of Housing and Urban Development, National Housing Policy Review estimates based on data from Department of Agriculture and Department of Commerce, Bureau of the Census, *1970 Census of Population.*

fundamentally within the program structure and the emphasis on the production of new units. The present programs provide relatively large amounts of housing services to a limited number of families.

Table 36. Impact—Consumer Welfare, Fiscal Year 1972

Impact	502		504
	Interest Credit	Non-interest Credit	
Percent change in housing	85	48	NA
Percent change in nonhousing	−3	−7	NA
Mean monthly benefit	$47.21	$2.47	NA
Mean annual benefit	$567	$30	NA
Percent change in real income	10.8	0	NA

Impact—Market Evaluation, Fiscal Year 1972

Impact	502		504
	Interest Credit	Non-interest Credit	
Percent change in housing	92	57	54
Percent change in nonhousing	−3	−7	−9
Mean monthly subsidy	$57.92	$7.67	$6.28
Mean annual subsidy	$695*	$92*	$75.30
Percent change in real income	11.8	1.2	3.2

NA = Not Available.

*These estimates from a sample survey are below Department of Agriculture estimates from National Program Data of $810 and $152, respectively.

Source: Department of Housing and Urban Development, National Housing Policy Review.

Impact: Table 36 presents estimates of the extent to which the Section 502 and the Section 504 programs have improved the quality of housing, the effects of the programs on nonhousing consumption, and the amount of benefits and subsidies transferred by the Government to Section 502 and 504 borrowers. Evaluated on the basis of whether there was an increase in housing quality, each program was successful. The improvement in housing conditions in terms of consumer welfare ranged from 48 percent for the noninterest credit program to 85 percent for the interest credit program.

An improvement in housing sometimes comes at the expense of expenditures on other goods. This happened in each of the FmHA programs; the decrease in expenditures on nonhousing goods and services ranged from minus 3 percent in the Section 502 interest credit program to minus 9 percent in the Section 504 program. Upon entering the programs, recipients generally increased the share of their income spent on housing to such an extent that they had less left over for nonhousing expenditures.

Inevitable in any transfer-in-kind strategy is the difference between the market value of the subsidy transferred and the recipient's evaluation of the worth of the subsidy. Table 36 shows, first, how much the recipient family values the subsidy it receives, and, second, how much the market values it.

In the case of the noninterest credit Section 502 borrower, the actual subsidy dollars ($92) were little valued ($30) by the consumer, yet the borrower family gave up 7 percent of its expenditures on other goods upon entering the program. This indicates that while the subsidy dollars themselves provide little housing value to the Section 502 noninterest credit borrower, the ability to obtain credit on better terms than otherwise available may be of more consequence than the subsidization of that credit. It further may imply that prior to having access to FmHA credit, the family was unable to purchase as much housing as it would have desired if credit were available at rates and terms similar to FmHA rates and terms. The estimated value to the consumer does not measure the value of the access to credit and thus may not be a full measure of benefit.

Anotner question raised in evaluating the

impact of the Section 502 program is whether there are indirect benefits for those not receiving direct subsidies. A National Housing Policy Review survey was undertaken in four rural areas, two of which were growing in population and two of which were not, to assess whether there were indirect benefits accruing to occupants of housing units previously occupied by Section 502 borrowers.[33] Indirect benefits would result if successive occupants obtained better quality housing for the same or less rent than previously paid. It also would be necessary to show that the benefits would not have occurred without the program.

The results of the survey did not substantiate the existence of indirect benefits for the programs in the areas sampled. There was no significant difference between the incomes of those in succeeding links of the chain at three of the four sites surveyed. There also was no significant change in housing quality without a simultaneous increase in expenditure for housing. Consequently, recipients did not receive higher quality housing without paying more.

Costs: In addition to the average direct interest subsidy of $658 and the average interest premium subsidy of $152, the FmHA incurs two other costs: losses from foreclosure, and administrative costs of the program.

The FmHA charges no insurance premium either to Section 502 interest credit or Section 502 noninterest credit borrowers. Consequently, any losses on foreclosure are absorbed by the Rural Housing Insurance Fund. The yearly cost of foreclosures is estimated to be approximately $7 per Section 502 noninterest credit unit and $5 per Section 502 interest credit unit. The administrative costs have been estimated at $91 per year for a Section 502 noninterest credit loan and $113 per year for a Section 502 interest credit loan. Included in these costs are the amortized costs of appraisal, inspection and closing, and the annual cost of servicing the loan.

Efficiency: The Technical, Production, Transfer, and Program Efficiencies for the Section 502 program are computed below. The subsidy estimates used for the calculations were derived from a sample of 200 Section 502 loans in each of the 10 regions. The National Housing Policy Review subsidy estimates are lower than the FmHA estimates from national data. Other Government costs were derived from national data. The market value of a unit was estimated as the sum of the borrower's payment and the interest credit and interest premium subsidies.

Technical Efficiency is the relationship between the market value of the unit and the cost to the Government, including subsidy, foreclosure losses and administrative costs, plus the payment by the individual. It is assumed that the market value and the cash cost to produce the unit are identical—that is, that there are no inducements in the program leading to excessive construction costs.

Technical Efficiency =

$$\frac{\text{Market Value of Unit}}{\text{Total Gov't Cost} + \text{Occupant Cost}}$$

502 Interest Credit	502 Noninterest Credit
$\frac{\$1719}{\$1837} = 0.94$	$\frac{\$1604}{\$1702} = 0.94$

Production Efficiency is the ratio of the market value of the subsidy to the cost to the Government of providing it. For the Section 502 noninterest credit program, Production Efficiency is relatively low because the administrative cost per year is large relative to the subsidy. For the Section 502 interest credit program, the administrative cost is similar but provides a much larger subsidy, so its Production Efficiency is higher.

Production Efficiency =

$$\frac{\text{Market Value of Subsidy}}{\text{Total Government Cost}}$$

502 Interest Credit	502 Noninterest Credit
$\frac{\$695}{\$813} = 0.85$	$\frac{\$\ 92}{\$190} = 0.48$

Transfer Efficiency is the relation between the cash-grant-equivalent value to the recipient of the Government subsidy and the actual amount of that subsidy. The low Transfer

[33] Louis, Bowles, and Grove, Inc., "The Filtering Effects of Subsidized Rural Housing," a study prepared for the Department of Housing and Urban Development, National Housing Policy Review, July 20, 1973.

Efficiency reported for the Section 502 noninterest credit program is the best estimate available but is not as statistically reliable as the estimates reported for the other programs.

Transfer Efficiency =

$$\frac{\text{Cash Value of Subsidy}}{\text{Subsidy}}$$

502 Interest Credit	502 Noninterest Credit
$\frac{\$567}{\$695} = 0.82$	$\frac{\$30}{\$92} = 0.33$

Program Efficiency is the product of Production and Transfer Efficiency. Section 502 noninterest credit has low Program Efficiency because both Production and Transfer Efficiencies are low. Therefore, the foregoing qualification on the reliability of Transfer Efficiency also applies to Program Efficiency.

Program Efficiency =

$$\frac{\text{Cash Value of Subsidy}}{\text{Total Government Cost}}$$

502 Interest Credit	502 Noninterest Credit
0.70	0.16

These estimates indicate that one dollar of Government expenditure is worth 16 cents in the Section 502 noninterest credit program and 70 cents in the 502 interest credit program as evaluated by the measures defined above. For these programs to be more efficient, other benefits must be present. As noted above for the Section 502 noninterest credit program, one of these benefits may be the increased availability of credit.

Special Issues

Impact on the Housing Stock

Of crucial importance in evaluating the success of the subsidized housing programs is the effect of the housing programs on the quantity and quality of the housing stock.[34] The main statutory objective of the housing programs—to provide a "decent home and a suitable living environment for every American family"—can be met in only two ways: either by increasing the total stock of housing, or by redistributing the housing available from those who have more than a "decent home" to those who do not.

Production programs attempt to increase the stock of housing and reduce the effective price of housing to certain low income families. The housing conditions of the subsidized population are certainly improved. Not every subsidized unit, however, represents a net addition to the Nation's housing stock for the following reasons:

1. The production of subsidized housing requires private mortgage credit (in the case of public housing, bonds are issued), and some portion of the credit for subsidy programs is bid away from unsubsidized buyers who must, therefore, reduce their consumption of housing.

2. The subsidy itself must be financed either by raising additional taxes or by increased Government borrowing. Both financing methods tend to reduce consumption or investment elsewhere in the economy and some of the reduction in spending will be at the expense of other (unsubsidized) housing.

3. The analysis of the subsidized housing programs shows that subsidized housing is inefficiently provided. If it were provided more efficiently, fewer resources would be drawn from the mortgage market, and fewer taxes or less Government borrowing would be necessary. Therefore, additional resources would be available for subsidized and unsubsidized construction.

In summary, the provision of housing subsidies undoubtedly increased the quantity and quality of housing for those relatively few who were subsidized, while it reduced the construction of new housing units for everyone else. On balance, there has probably been a net addition to the housing stock because of the subsidies, but the addition is equal only to a portion of the total number of units that were subsidized. The exact addition is difficult to estimate, but various analyses suggest that for every 100,000 units subsidized during the 1960's and early 1970's,

[34] For brevity the term "housing stock" will be used on the following pages to denote both the quantitative and qualitative dimensions of housing.

perhaps as few as 14,000 represent net additions to the housing stock.[35] Housing construction expenditures probably are increased proportionately less than the total number of subsidized units constructed because these units tend to be smaller than the average unit constructed in the economy. Thus, the subsidy programs probably provide little stimulus to aggregate housing expenditures in the economy as a whole.

Stimulating the Economy

The subsidized housing programs were created to enable lower income families to enjoy decent housing at a reasonable price. In this chapter, each program has been evaluated in terms of its success in achieving this goal. Some secondary impacts have also been identified and analyzed, such as the impact of subsidized housing on racial integration.

Another issue is the contribution, if any, that subsidized housing makes to maintaining a high level of economic activity. Simply stated, the thesis implicit (and sometimes explicit) in housing legislation enacted to date is that the production of subsidized housing provides jobs and increased income in the construction industry and, subsequently, in other industries as the initial increase in income is spent. The net effect is, allegedly, a higher level of economic activity than would have existed in the absence of the program.

This reasoning is faulty, however, because it attributes to one small section of the Federal budget a characteristic of the entire budget. By its management of taxes and expenditures, the Federal Government does have a stimulating or depressing effect on the level of economic activity. This effect, however, depends on the overall budget deficit or surplus and not on the individual tax or expenditure items that make up that deficit or surplus. The argument fails to consider what could happen in the absence of the subsidized housing programs. Presumably, other Federal expenditures would have been made, taxes reduced, or less debt issued, thereby reducing pressure on credit markets. All of these alternatives would also have stimulated economic activity and, therefore, there need be no net increase or net decrease in national income simply because the Government chose to subsidize or not to subsidize housing.[36]

The Federal Government's choice between subsidized housing and other expenditures, or a tax reduction, may have an impact on the level of activity in the construction industry. If, instead, the Federal funds had been spent on educational aids for schools in low income areas, the initial employment and income effect would have occurred in the school supply industry rather than the construction industry. The overall effect would be the same, the only difference being the point of incidence.[37]

Homeownership for the Poor

Although homeownership has long been encouraged by a variety of Federal laws, no major programs offering homeownership to the poor in the 20th century were enacted until the 1960's. Since that time, the problems that have arisen from the operation of those programs—principally the Section 235 and Section 221(d)(2) programs—are so serious that they raise questions about the validity of the concept itself.

If homeownership for the poor is a feasible concept, a principal justification for Government programs to achieve this objective would be the existence of significant market imperfections in the economy which prevent the low income

[35] Craig Swan, *op. cit.*, Frank de Leeuw, "Market Effect of Moderate Income Construction Subsidies," a report prepared for the National Housing Policy Review, 1973. The Swan paper estimated that the net addition was 14,000 units for every 100,000 units subsidized. The analysis did not explicitly take into account the need to finance the subsidy with tax increases or debt issues, although the need to finance subsidies may have had an effect on the results. The de Leeuw paper implicitly considered financing for the 235 and 236 programs and estimated that this effect alone reduced unsubsidized starts by an amount equal to one-half of the number of subsidized starts (e.g., 50,000 net addition for each 100,000 units subsidized).

[36] The theory of the "Balanced-Budget Multiplier" argues that a tax reduction matched by an equal reduction in Government spending would reduce national income. But more detailed analysis suggests that national income may be affected either way depending on the exact composition of spending and on tax distribution.

[37] The analysis in this section assumes that subsidized housing programs do not replace conventional residential building. To the extent that this assumption is false, the stimulating impact on the construction industry is diminished. If there were an overall impact on the economy, it would also be lessened.

family from purchasing the optimum quantity and quality of housing. Building codes, racial discrimination, deed restrictions, zoning, and taxes all discourage low income families from buying homes.

The housing strategy embodied in the existing housing statutes does not permit low-cost homes to be produced or even legally to exist in many areas.[38] In addition, the deductibility of mortgage interest and property taxes biases the advantages of homeownership in favor of higher income families because of their higher marginal tax rates. A case can thus theoretically be made that a proper role of Government is to redress this imbalance and to create incentives for low income families to purchase their own homes.

In the 1930's, books with such titles as *Homeownership: Is It Sound?* were written questioning the desirability of homeownership. Even today, major textbooks in real estate are careful to point out that homeownership is not appropriate for every family, especially if its income is low. And when one carefully delineates the multidimensional commodity or investment called a "home" and examines each dimension in light of the needs and characteristics of the poor, no clear answer emerges as to whether homeownership is a net benefit or a net burden to low income families.[39]

Housing as an investment for low income individuals is illiquid and risky, requires complex management, and has high maintenance costs. A savings account is a safer and more liquid investment and one which requires little monitoring and expertise. Low income families, because their incomes tend to be less stable and because of high transaction costs, especially benefit from flexible tenure. In addition, their smaller levels of discretionary time and management skills put them at a disadvantage relative to higher income families.

Ownership also exposes the owner-occupant to the hazards of unexpectedly expensive repairs, especially in low cost new housing in which, too often, longrun durability has been sacrificed for low initial cost.[40] To some extent, rental tenancy spreads such hazards over many families. Hypothetically, a landlord will compute its average maintenance and repair expenditures over the anticipated period of its ownership, divide by the number of units and the number of months, and charge that amount per month for maintenance. While hardly an insurance policy, the risk is nevertheless spread out among a number of units, and funded over an extended period of time.

There is little empirical support for the often expressed view that a new homeowner acquires a new dignity or that becoming a homeowner automatically transforms a person in other intangible ways. The evidence of the social and psychological impact of homeownership is mostly anecdotal, especially when it concerns low income families. The favorable impact may sometimes occur; the point is that studies to date do not verify such a phenomenon as the usual social result. In addition, no research has separated the ownership aspect from associated dimensions including, among others, single-family dwelling unit and location.[41]

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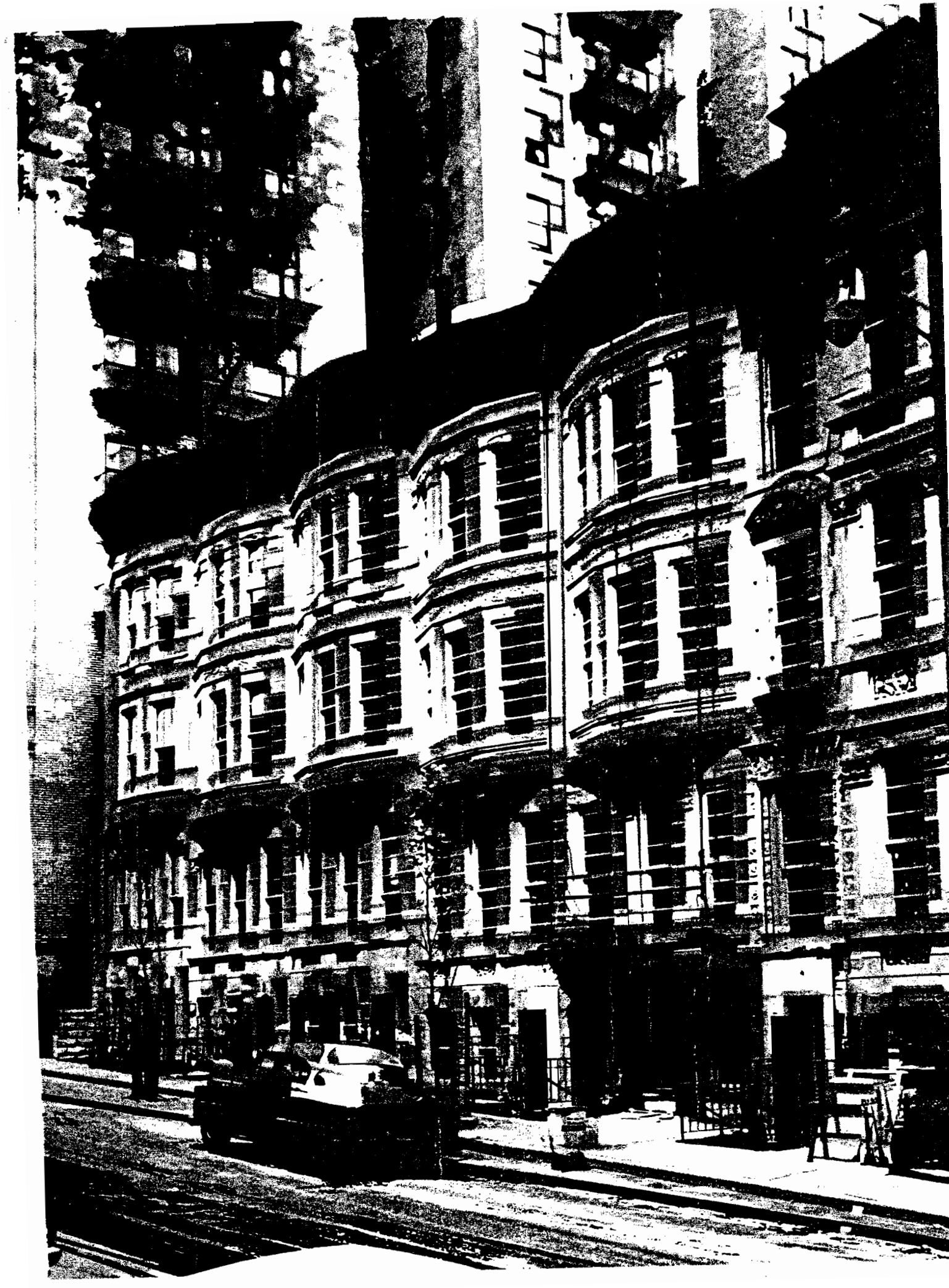
[38] See, for a discussion on how the U.S. housing strategy differs from strategies adopted in other countries, Anthony Downs, "Housing the Urban Poor: The Economics of Various Strategies," *American Economic Review*, September 1969, pp. 646–656.

[39] For a more complete discussion see Peter Marcuse, "Homeownership for Low-Income Families: Financial Implications," *Land Economics*, May 1972, pp. 134–143.

[40] Committee on Housing Research and Development, *Families in Public Housing*, Urbana: University of Illinois, 1972.

[41] For a summary of what is known on the social benefits of homeownership for the poor, see Georges Vernez and Robert K. Yin, Rand Corporation, "Social Aspects of Federal Low-Income Housing Programs," a report prepared for the National Housing Policy Review, August 1973.



5 Housing Activities of State and Local Governments

Introduction

In the early years of this century, the location, character, and quantity of housing in the United States were almost exclusively a matter of individual determination; housing was regulated—if at all—by local government jurisdictions acting increasingly—as such devices became popular—through planning and zoning boards.

The Depression dealt a traumatic blow to the tradition of exclusive local control and private responsibility for housing; it brought about the participation of the Federal Government, which began to promote the construction of housing first through indirect stimulants to home financing and then through direct programs of support.

Impelled by burgeoning demands for additional municipal services imposed by rapid growth and increasing concern about property tax rates, local governments in recent years have expanded their role in housing and community development. They have responded to the challenge of unrestricted growth by establishing growth limits, setting sewer moratoria and enacting exclusionary zoning ordinances to control further large-scale residential development while they evaluate the potential impact of this growth on the environment and the character of their communities.

Over the past decade, State governments have emerged as a significant force in the housing field through the formation of a variety of new State housing agencies holding broad charters to undertake a wide range of activities aimed at upgrading the living conditions of State residents. The States also have begun to reassert their authority in land use policy. Land use control, until recently, was almost entirely a local function, although in principle State governments have an inherent power to control and regulate the use of land as part of their mandate to protect public health, safety, and welfare. Municipalities, however, through the device of planning and zoning boards, which became popular in the second decade of this century, not only established construction criteria but also determined neighborhood characteristics, growth patterns, and the proportions of single-family detached homes, multiple family dwellings, stores, offices, and industrial facilities. As population growth intensified the competition for a variety of land uses and broadened the scale of that competition, a role for the States was clearly indicated.

Many States are adopting tough environmental control standards to preserve areas of natural beauty and maintain open space. Some are attempting to override local building and housing codes.

States' initiatives sometimes take the form of encouraging regional planning for future land use. In other cases, States have moved to exclude development on certain types of land, such as coastal wetlands. State activity has also encompassed the establishment of comprehensive development goals governing projects extending across several local jurisdictions. The Federal Government is now moving, through legislation under consideration in the Congress, to promote such State initiatives by providing assistance for State and regional development of land use policy.

The new coordinating role of State government also is illustrated in the field of building and housing codes. For some time it has been recognized that the maze of conflicting building and housing codes operated by local governments is an impediment to lowering the cost of housing construction. To remedy this, many States have adopted or are attempting to adopt uniform statewide code legislation, usually based on national or regional model codes. The States also have begun to offer their planning expertise and services to understaffed small and medium-sized communities so that they can better cope with the problems of community development.

Overall, what seems to be evolving is a new cooperation between Federal, State, and local governments in establishing and fulfilling the housing policies of the Nation. Moreover, intergovernmental financial relationships, which influence housing policies, also appear to be changing. Federal financial assistance—including revenue sharing—has added to the resources available to State and local governments, permitting them, if they choose, to expand their activities in housing assistance, regional planning, and environmental control.

But in spite of the significant expansion of

State and local roles in housing and community development, progress has been very uneven. The fact that some States and municipalities have progressed in these fields should not obscure the wide differences in achievement among the States. Indeed, the historical pattern of development of State and local public administration in the United States is that some jurisdictions tend to move relatively rapidly while others—even with strong Federal incentives—lag behind for prolonged periods.

State Government Activities in Housing

State Finance and Development Agencies

The emergence of State governments as a force in promoting the development of housing is a fairly recent phenomenon. Partially in response to Federal housing programs enacted in the latter part of the 1960's, the States have been establishing their own housing finance and development agencies and community affairs agencies to facilitate the planning and construction of housing within their borders and to deal with many of the concomitant factors involved in housing production.

As of 1960 New York had the only State Housing Finance Agency. In the late 1960's, 11 more were established. From 1970 to 1972, 14 additional States set up housing finance agencies. With the enactment of legislation this year in Colorado, Rhode Island, South Dakota, and Tennessee, there are now 30 States with housing finance or development agencies (New York now has two such agencies). Another 10 States are considering legislation to establish such agencies. (See Charts 1 and 1a.)

The primary function of State finance agencies has been to provide financial assistance for the construction of housing for low and moderate income families. Most of them play an active role in the development of housing, usually in partnership with private developers who do the actual building or rehabilitation work. Nevertheless, the finance agencies participate in site selection and acquisition, design review, and the determination of the size and number of units in a given project. They establish the nature and extent of supporting community facilities, and set standards for equal opportunity, employment, and marketing of the housing.

In general, State finance agencies have been given a broad range of authority in addition to financial assistance. All but six of the finance agencies are empowered to survey and evaluate statewide housing deficiencies and develop programs to correct the deficiencies. (See Table 1.) Thirteen of the 30 State agencies directly administer Federal housing subsidy programs; nearly all of the others will be empowered to do so when they become fully operational. Eighteen are authorized to acquire land by purchase or eminent domain. Apart from the nine States authorized to act as public housing authorities, only a few are permitted to construct or rehabilitate housing directly on their own.

Because most of the agencies are new and experiencing startup delays, only 15 of them have actually participated in the development of housing, and only 11 have issued bonds or notes. Nevertheless, between January 1, 1969 and March 1, 1973, 90,587 housing units were constructed or being completed under the direction of the State agencies. Of this total, more than two-thirds, or 65,994 units, were subsidized under Section 236 of the 1968 Housing Act. More than one-sixth of these, or 12,347, were eligible for rent supplement payments. Another 5,405 of the units were subsidized under other Federal programs. Only 19,188, or 21 percent, of the total units did not involve direct Federal subsidies, and most of them were financed by the New York State Agency (Table 2).

Lending and Finance Activity

The creation of State housing finance and development agencies is authorized by the State legislatures. The enabling legislation typically provides that the Governor include in his annual budget any amount necessary to satisfy deficiencies in meeting the debt service of the bonds utilized to finance projects. The State legislature, however, is not legally bound to appropriate such amounts. Thus the debt is-

sued by these agencies is said to have the "moral obligation" of the State in support of its repayment.

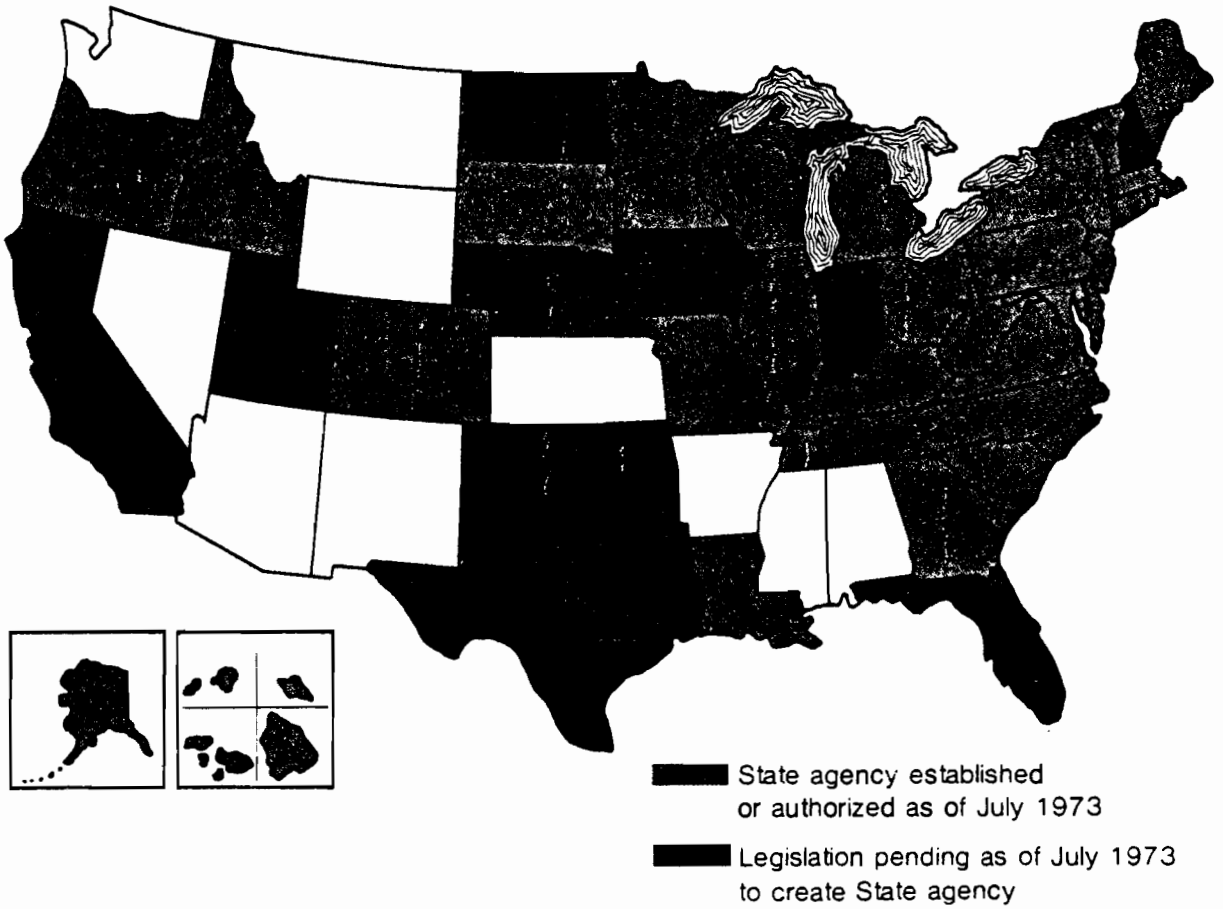
All but two of the State agencies are empowered to raise funds through the issuance of tax-exempt bonds. Authorized amounts range from $20 million to an unlimited figure. To date 11 agencies have issued bonds with an aggregate value of approximately $4.7 billion. The bonds are sold through private underwriters to private investors. The granting of unlimited bonding capacity is a privilege that has been given by the legislatures primarily to the agencies formed since 1971. Several of the more active agencies possess bonding capacities ranging between $500 million and $1.5 billion.

Because the bonds are exempt from Federal taxation, they usually have sold at net yields between 5.3 percent and 7 percent (Chart 2). Payments on the bonds generally are made from project revenues and Federal subsidies.

Through funds raised by bond issues—as well as those granted in the initial legislative appropriations—most of the finance agencies

Chart 1

State Housing Agencies Operating or Authorized as of July 1973



Source: Department of Housing and Urban Development, National Housing Policy Review, based on data supplied by state agencies.

Table 1. Housing Finance and Development Agencies Functions and Capabilities

	Organization			Programs		Administrative Capabilities			Development Activity		Lending Activity			Financial Activity			Units Financed or Developed
	Year Created	Bonding Capacity (Millions)	Bonds Outstanding (Millions)	Administer Fed Sub Hsg Prog	Public Housing Authority	Evaluate Statewide Housing Needs	Evaluate Housing Proposals	Provide Tech. Assistance to Developers	Acquire Land	Construct or Rehab. Hsg	Seed Money	Construction Loans	Mortgage Loans	Mortgage Income	Tax Abatement	Purchase Existing Mortgages	
Alaska Housing Finance Agcy	1971	No Limit	14	B	A	B	A	A	C	C	B	A	A	C	C	A	100
Colorado Hsg. Fin. Auth.	1973	50	None	B	C	D	B	B	C	C	C	B	B	C	D	B	0
Connecticut Hsg. Fin. Auth.	1969	No Limit	26	A	C	S	B	B	C	C	S	B	A	A	D	A	834
Delaware State Hsg. Auth.	1968	No Limit	None	A	B	A	A	A	B	B	A	A	B	B	C	C	1,344
Georgia Dev. Auth. for Hsg. Fin.	1972	N	N	N	N	N	N	N	N	N	N	N	N	N	N	N	0
Hawaii Housing Authority	1970	No Limit	100	A	A	B	A	A	A	A	A	A	B	B	B	B	1,552
Idaho State Housing Agency	1972	No Limit	None	B	B	B	B	B	A	B	B	B	B	B	C	B	0
Illinois Housing Dev. Auth.	1967	500	55	A	D	A	A	A	A	B	A	A	A	C	C	B	4,487
Kentucky Housing Fin. Agcy.	1972	200	None	B	C	C	C	B	B	C	B	B	B	C	C	B	0
Louisiana Dev. Auth. For Hsg. Fin.	1972	30	None	B	C	C	C	B	C	C	C	B	B	C	C	B	0
Maine State Housing Auth.	1969	20	20	A	B	A	A	B	B	B	B	B	B	B	B	A	664
Maryland Comm. Dev. Admin.	1970	No Limit	None	B	C	A	A	A	B	B	B	B	B	B	A	C	25
Massachusetts Hsg. Fin. Agcy.	1966	1,000	20	A	C	A	A	A	C	C	C	A	A	C	C	C	17,807
Michigan State Hsg. Dev. Auth	1966	600	110	A	C	A	A	A	B	B	A	A	A	C	B	C	7,933
Minnesota Hsg. Fin. Agcy.	1971	150	None	B	C	A	B	A	C	C	B	B	B	C	B	D	0
Missouri Hsg. Dev. Comm.	1969	100	13	A	C	A	A	A	B	C	B	A	A	B	C	C	931
New Jersey Hsg. Fin. Agcy.	1967	No Limit	160	A	C	A	A	A	B	B	A	A	A	C	B	B	9,338
New York City H.D.A.	1967	800	185	A	C	A	A	A	A	C	A	A	A	C	A	C	34,787
New York City H.D.C.	1971	800	185	A	C	A	A	A	C	C	C	A	A	C	C	A	34,787
New York State D.H.C.R.	1935	S	S		C	A	A	A	C	A	A	S	S	C	A	C	130,164
New York State H.F.A.	1960	5,150	3,382	C	C	A	A	C	C	C	C	A	C	C	A	C	130,164
New York State O.D.C.	1968	1,500	400	A	C	A	A	A	A	A	A	A	C	C	A	C	30,434
North Carolina Hsg. Corp.	1969	200	None	C	C	A	C	A	C	C	A	B	C	C	C	B	0
Ohio Housing Dev. Bd.	1970	None	None	B	C	A	B	A	A	C	A	C	B	B	C	C	0
Oregon Hsg. Dev. Dept. of Comm.	1971	200	None	B	C	A	B	A	C	C	A	C	C	B	C	B	290
Pennsylvania Hsg. Fin. Agcy.	1971	No Limit	None	B	C	B	A	A	C	C	S	B	B	C	C	B	105
Rhode Island Hsg. Mort. Fin. Corp.	1973	No Limit	None	B	C	B	B	B	C	C	S	B	B	C	A	D	0
South Carolina State Hsg. Auth.	1971	No Limit	None	C	A	A	A	A	B	B	B	B	B	C	A	D	100
South Dakota Hsg. Dev. Auth.	1973	No Limit	None	B	B	B	B	B	B	B	D	B	B	B	C	B	0
Tennessee Hsg. Dev. Agcy.	1973	150	None	B	C	B	B	B	Ltd.	C	B	B	B	C	C	B	0
Vermont Home Mort. Credit	1968	20	None	C	B	C	C	C	C	C	C	C	C	C	C	B	0
Virginia Hsg. Dev. Auth.	1972	No Limit	None	B	C	B	B	B	B	C	B	B	B	B	C	B	0
West Virginia Hsg. Dev. Fd.	1968	130	12	A	B	A	A	A	B	B	B	A	B	C	C	B	1,524
Wisconsin Hsg. Fin. Auth.	1972	150	None	B	C	B	B	B	B	C	B	B	B	C	C	B	0
																Total	242,419

Key

A—Agency Presently Performing Function
B—Saturday Authorization Not Implemented
C—No Statutory Authorization
D—Authority Unclear or No Information Available
N—Not Operational, Additional Legislation Pending to Broaden Powers of Agency
S—Performed by Related State Agency

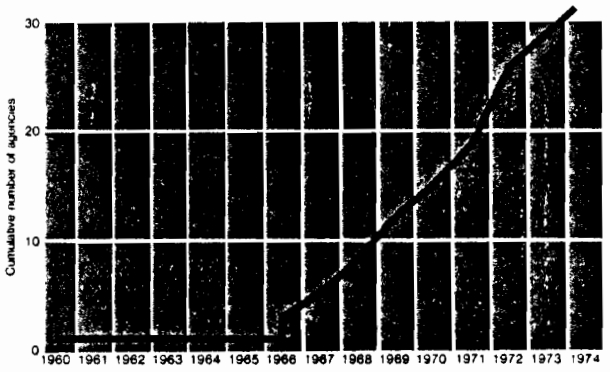
Legislation Pending to Create Agency
California
Florida
Indiana
Iowa
Nebraska
New Hampshire
North Dakota
Oklahoma
Texas
Utah

Source: Department of Housing and Urban Development, National Housing Policy Review, based on data supplied by State agencies.

are empowered to make "seed money" loans to nonprofit and public developers of housing. These loans are used to help offset the initial costs of such basic expenses as land clearance and preparation, as well as architectural and legal fees. The agencies are authorized to make construction loans, as well as permanent mortgage loans, to cover the entire project.

Chart 1a

Growth of State Housing Finance Agencies



Source: Department of Housing and Urban Development, National Housing Policy Review, based on data supplied by State agencies.

Normally the "seed money" loans are repaid from the construction loans.

About two-thirds of the agencies have the capacity to purchase existing mortgages. Almost one-third of them are able to grant abatement of property taxes to developers of projects constructed for low and moderate income housing.

Although agencies' lending practices vary considerably, most finance agencies make the advantages of their lower cost loans available to developers. Because of their tax-exempt borrowing power, the agencies often pay 2 to 2.5 percentage points less for money than conventional lending institutions charge on loans (5.5 to 6 percent vs. 8 percent). The agencies pass the savings on to the developer, who is either a nonprofit or limited profit sponsor entitled to a partial tax exemption. Higher loan-to-value ratios and longer mortgage terms than those provided by conventional lenders are provided by the agencies: 90 percent vs. 75 to 80 percent, and 40 years vs. 25 to 30 years. These favorable financing terms enable the developer to set rents within the means of moderate income families.

Only with the addition of subsidies—such as those provided under Section 235, Section 236, rent supplements, or similar State programs—are State housing finance agencies

Table 2. Housing Production Committed to be Financed by the State HFA'S

January 1, 1969—March 1, 1973

Year	Total Units Committed	Total Federally Subsidized Units	Section 236 Units
1969	4,367	838	838
1970	23,866	20,858	20,196
1971	29,936	24,913	22,803
1972	30,543	22,915	20,413
1973 (two months)	1,875	1,875	1,744
Total	90,587	71,399	65,994
January 1, 1973 projection for year 1973	61,881	49,327	46,662

Source: Department of Housing and Urban Development, National Housing Policy Review, based on data supplied by State agencies, excluding New York City agencies.

able to serve low income people. In rural areas where incomes are lower, the agencies have contributed only in a limited way toward solving housing problems. The same is true of the housing problems of the very poor in inner city slum areas.

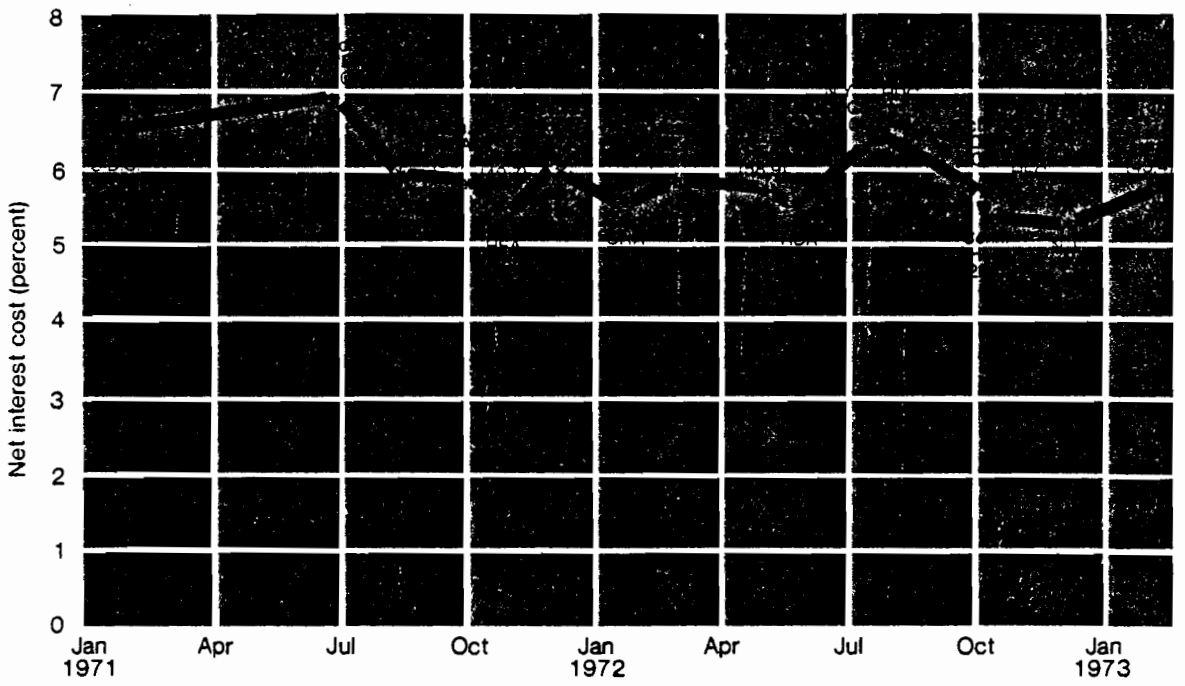
There are disadvantages, from the point of view of Federal fiscal policy, to tax-exempt bond financing when undertaken either by State housing finance agencies or by local housing authorities for public housing. This type of financing contains a concealed cost to the Federal Government. By not taxing the interest earned on tax-exempt housing bonds, the Government provides a subsidy through the tax system in the form of lower interest rates to the issuing agencies. In the case of federally assisted projects, however, these tax subsidies are largely offset by the lower direct mortgage interest subsidies that HUD pays on the Section 235 and 236 loans made with bond proceeds.

The tax subsidy is inefficient because it costs the Federal Government more in forgone tax revenues than the housing finance agencies save in lower interest rates. Some 34 bond issues sold since 1961 by State housing finance agencies will cost the Federal Government $1.62 billion in tax revenues forgone over the life of the bonds while saving the agencies $0.60 billion in interest expense. This repre-

Chart 2

Bond Issuances and Interest Rates
Housing Finance and Development Agencies

January 1971 - March 1973



* Issuing agency

( ) Issue amount, in millions of dollars

Source: Department of Housing and Urban Development, National Housing Policy Review, based on data supplied by First Boston Corporation.

sents a net loss of $1.02 billion over a 40-year period.

The inefficiency of tax-exempt bond financing for housing could be eliminated by providing a direct Federal interest subsidy to State and local agencies on taxable bonds. The net interest cost to the agency could remain roughly the same and the tax loss would be avoided.

The Administration's proposed Taxable Municipal Bond Act of 1973 probably would accomplish this objective. Under this act, taxable housing bonds would get a 30 percent interest subsidy (i.e., from 8 percent to 5.6 percent). The Federal cost would be offset by the increased tax revenue due to the fact that all such interest income would then be taxable.

Relationship to Other Government Agencies

Unlike most other State government agencies, housing finance and development agencies are expected to be self-supporting. On permanent loans the agency commonly charges 0.5 percent higher than the cost of funding its operating budget and loss reserves. They repay their bond holders from rental income and mortgage payments as well as with Federal subsidy funds. Except in rare circumstances, no State appropriations from general tax revenues are needed beyond the startup period of operations.

Although they are relatively autonomous by statute, the majority of the finance agencies have established cooperation with other State bureaus or departments. They generally coordinate their planning activities with State departments of community affairs or State planning offices.

In the course of their production programs, State finance agencies frequently consult and coordinate with State and local social service agencies, provide housing for families dislocated by highway construction, deal with State highway and mass transit departments when considering housing placement, and work with departments of health on housing codes and with departments of parks and recreation to coordinate recreation facilities. However, they have had limited working relationships with State environmental protection agencies, largely because the latter are so new. They also have established ties with local communities, which in some cases have asked for planning or financial assistance. They work closely with local governing bodies to obtain approval for proposed housing programs and necessary zoning variances and tax abatements.

Performance

State housing finance agencies have concentrated their housing activities on the development of multifamily rental developments to the virtual exclusion of homeownership projects (largely due in most States to the lack of a court test of mortgage loans to individual homeowners as a legitimate public purpose within the interpretation of each State constitution). Most of their structures—72 percent—are high-rise. Most of their work has been confined to construction of new units, rather than rehabilitation of existing units; nearly 100 percent of these units have been built in urban and suburban areas. Thus, State housing finance agencies have been charged with failing to address the housing needs of small towns and rural areas. The housing needs of medium- to large-sized families are not being met by housing finance agency assisted projects because these agencies are building the largest number of their units—39 percent—with two bedrooms. (Another 32 percent are one-bedroom units; 18 percent have three bedrooms.)

In general, the inclusion of superior amenities, better design, and new technology has caused mortgage amounts per unit on projects assisted by housing finance agencies to exceed those federally subsidized projects undertaken without State agency participation. This forces the occupants in State-financed housing projects to pay higher rents than their counterparts in federally processed projects. The average per unit Federal subsidy for finance agency projects varies from $734 in the Great Lakes region to $1,448 in the high cost areas of New York and New Jersey (Table 3). These figures do not include taxes forgone from investors in the agency's tax-exempt bonds.

Experienced housing finance agencies have been able to deliver their projects for occupancy more rapidly than HUD. Housing finance agency projects typically are open for

occupancy in from 12 to 16 months, with the average ready in about 14 months. HUD projects, on the average, take 34 months for completion. HUD's longer processing time is attributable to the greater number of HUD personnel involved in reviews and approvals, and the deeper HUD organizational hierarchy, which forces the transmission of documents and decisions back and forth between area, regional, and central offices.[1]

The majority of State finance agencies operate equal opportunity programs. Although statistics on the racial mix in their housing units are inconclusive, the available data indicate that the fraction of nonwhite occupants in State-financed units is about 21 percent. This figure approximates that of federally assisted Section 236 projects, which currently places the minority occupancy rate at about 24 percent. In addition to efforts to recruit nonwhite tenants, State housing agency projects have directed attention toward providing housing for other special groups, such as the elderly and the handicapped, who represent 12 percent of the housing population in State projects.

Most of the agencies claim that they strive for an economic mix in each project, with some tenants paying the current market rate for their units while others receive the benefits of Section 236 and rent supplement aid. In Michigan, for example, families with incomes from $4,000 to $14,000 have moved into the same project. Massachusetts projects house families with incomes from $2,000 to $20,000, with individual units renting at market rents, or Section 236 levels, or at public housing rentals under Section 23 leasing arrangements.

To date, none of the 294 projects under Section 236 financed by housing finance agencies has been foreclosed, and only six of them have had any serious rent-up problems.

[1] Booz, Allen and Hamilton, "Comparative Analysis of Federal and Nonfederal Government Housing Program Procedural and Managerial Implementation," a report prepared for the National Housing Policy Review, Department of Housing and Urban Development, 1973.

Table 3. Per Unit Subsidies of State Housing Finance Agency Developments by HUD Region

Region	Average Annual Subsidy per Unit
I—Mass., Conn., Maine	$ 852
II—N.Y., N.J.	1,448
III—W. Va.	937
V—Mich., Ill.	734

Source: Department of Housing and Urban Development, National Housing Policy Review, based on data supplied by State agencies.

Prospects and Problems

Despite the rapid growth and initial achievements of State housing finance agencies, their future expansion is not completely assured, and some serious problems eventually will have to be confronted. The major problems are the agencies' heavy emphasis on new housing construction (as opposed to utilization of existing housing stock), and their heavy dependence on indirect and direct Federal subsidization: principally through tax-exempt bond financing combined with the Section 236 housing subsidy program, two subsidies that are quite costly to the Federal Government.

Community Affairs Agencies

Another recent development reflecting increased State activity in the housing field has been the establishment of community affairs departments. Today there are 37 States with such offices functioning, all but two of them formed since 1960. (See Chart 3.)

Although there is no single description of the functions of State community affairs agencies because their activities vary from State to State, they are involved in statewide planning, regional planning, local planning, and urban renewal activities. Depending on their size, they may also be involved in such housing-related matters as poverty, environmental control, health, law enforcement, and highway safety.

For the most part, the experience of these agencies has been limited to providing information, technical assistance, research, and planning to local communities. They explain and clarify Federal activities and educate cities, towns, and counties on how to obtain Federal funds.

The size of the staffs available to carry out the assorted functions of the community affairs agencies appears to depend on the degree of urbanization in the State as a whole. For example, the New Jersey agency, which performs most of the functions listed above, has a staff of 400, higher than the employment levels of all other agencies. Vermont operates its Agency of Development and Community Affairs with a staff of five. (See Table 4.)

In short, it is difficult to lump all the community affairs agencies together because their functions are so diverse. For example, most of them provide financial advice and assist in municipal management. Others provide such basic State services as personnel training. Most—operating as adjuncts of the Governor's office—work to create legislation.

Nevertheless, their existence represents a reorganization of State programs, geared to the multiplying activities of State governments in the housing and community development field in response to both Federal programs and the needs of local governments (Table 5).

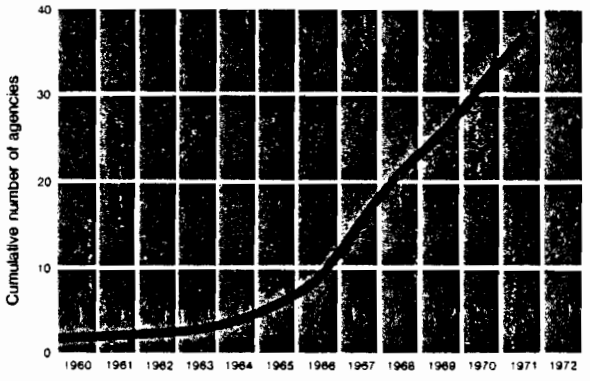
Land Use Controls

Until fairly recently, responsibility for controls over land use has rested primarily with local governments, in the form of the zoning power delegated to them by the States. But in the past 5 years especially, some States have been reasserting their authority over the land within their borders, insisting that it is the State's responsibility to preserve the environment. Additionally, the inherent inadequacy of local controls in meeting regional and statewide needs has encouraged increased State activity.

A few States have developed comprehensive plans to regulate land on a statewide basis. They are chiefly States with small land areas, such as Hawaii, which enacted a statewide land use law in 1961 dividing its entire land area into four classifications: agricultural, rural, urban, and conservation. In Hawaii, regulations governing urban districts are administered by county governments. Regulations for rural and agricultural areas are administered by the State and the counties, while the State, through its Department of Land and Natural Resources, develops and administers regulations governing conservation districts. Another State that has reasserted land use controls is Vermont, which in 1970 adopted a comprehensive land use plan. The plan is based upon such considerations as present use and ecological suitability for further development, as well as projected population growth and optimum settlement patterns.

Chart 3

Growth of State Community Affairs Agencies 1960-1972



Source: Department of Housing and Urban Development, National Housing Policy Review, based on data from Council of State Governments, The Book of the States, 1972-1973.

Environmental Activity

States, anxious to preserve areas of scenic beauty or ecological sensitivity, also are beginning to protect such areas through legislation. About a score of States, chiefly those with large coastal areas and wetlands, such as Maryland, Oregon, and Connecticut, and others with expanses of mountain wilderness upland areas and flood plains, such as New York, Vermont, and Minnesota, have moved to limit development in those critical resource areas.

Several States also have established programs to control large-scale developments, such as second home subdivisions and commercial and industrial developments. A prime example of such a program is the Maine Site Selection Law, enacted in 1970, which requires State approval of developments 20 acres or more in size and all commercial or industrial development of any size that may be a source

Table 4. Program Responsibilities of State Offices of Community Affairs

State	Date Agency Established	Service Agency	Reports Directly to Governor	Size of Staff	Statewide Planning (701)	Regional Planning (701)	Local Planning (701)	Urban Renewal	Poverty	Housing	Health	Area Redevelopment (Model Cities)	Environmental Control	Manpower	Law Enforcement	Highway Safety	Tech Assistance (Title IX)	Community Development Training (Title VIII)
Alabama	1969	Development Office	•	71	•	•	•		•	•		•					•	
Alaska	1959	Local Affairs Agency	•	15			•		•			•					•	•
Arizona	1968	Dept. of Economic Planning & Development	•	49	•	•	•			•		•						•
Arkansas	1971	Dept. of Planning	•	70	•	•	•			•	•		•			•		•
California	1965	Dept of Housing & Community Development	•	135	•			•		•								
	1964	Council on Intergovernmental Relations		10		•	•											
Colorado	1970	Dept. of Local Affairs	•	136	•	•	•			•	•	•			•		•	•
Connecticut	1967	Dept. of Community Affairs	•	230	•		•	•	•	•		•		•				•
Delaware	1970	Dept. of Community Affairs and Economic Development	•	69				•	•	•		•						
Florida	1970	Dept. of Community Affairs	•		•	•	•	•	•	•	•	•	•	•	•	•	•	
Georgia	1970	Bureau of State Planning and Community Affairs	•	100	•	•	•		•	•		•			•		•	
Illinois	1969	Dept. of Local Government Affairs	•	150		•	•	•		•								•
Iowa	1969	Div. of Municipal Affairs		13		•	•	•		•		•						
Kentucky	1968	Program Development Office	•	30	•	•	•		•	•	•	•				•	•	•
Maryland	1970	Dept. of Economic & Community Development	•	10				•		•		•						•
Massachusetts	1968	Dept. of Community Affairs	•	200		•	•	•	•	•		•	•	•				•
Minnesota	1967	Div. of Local and Urban Affairs		18	•	•	•				•			•	•		•	•
Mississippi	1964	Community and Area Development Div		25	•	•	•										•	
Missouri	1967	Dept. of Community Affairs	•	82	•	•	•	•	•	•	•	•	•	•	•	•	•	•
Montana	1970	Community Development Div		10	•		•			•		•					•	•
Nebraska	1967	Div. of Community Affairs		10				•		•		•						•
New Jersey	1966	Dept. of Community Affairs	•	400	•	•	•	•	•	•		•					•	•
New York	1959	Office for Local Government	•	200					•					•	•		•	•
	1965	Office of Planning Services	•	240	•	•	•					•						
North Carolina	1971	Div. of Local Affairs		20			•					•			•		•	•
North Dakota	1965	State Planning Div.		6	•		•			•		•						
Ohio	1967	Dept. of Urban Affairs	•	130				•	•	•		•		•	•		•	•
Oklahoma	1971	Office of Community Affairs & Planning	•	42	•	•	•	•		•	•	•	•		•		•	•
Oregon	1969	Local Government Relations Div		10	•	•	•										•	•
Pennsylvania	1966	Dept. of Community Affairs	•	260		•	•	•	•	•		•	•	•			•	•
Rhode Island	1968	Dept. of Community Affairs	•	80			•	•	•	•		•		•			•	•
Tennessee	1963	Office of Local Government		10														•
	1967	Office of Urban and Federal Affairs	•	80		•			•	•		•	•	•	•	•		
Texas	1971	Dept. of Community Affairs	•	25			•		•	•		•		•			•	•
Utah	1971	Dept. of Community Affairs	•	35		•	•		•	•		•		•	•	•		
Vermont	1968	Agency of Development & Community Affairs	•	5		•	•			•		•					•	•
Virginia	1966	Div. of State Planning & Community Affairs	•	125	•	•	•		•	•		•		•			•	•

(Continued on p. 149.)

(Continued from p. 148)

State	Date Agency Established	Service Agency	Reports Directly to Governor	Size of Staff	Statewide Planning (701)	Regional Planning (701)	Local Planning (701)	Urban Renewal	Poverty	Housing	Health	Area Redevelopment (Model Cities)	Environmental Control	Manpower	Law Enforcement	Highway Safety	Tech Assistance (Title IX)	Community Development Training (Title VIII)
Washington	1967	Planning & Community Affairs Agency	•	52	•	•	•			•	•	•		•	•		•	•
West Virginia	1969	Office of Federal-State Relations	•	73	•	•	•		•	•	•			•	•	•		•
Wisconsin	1967	Dept. of Local Affairs and Development	•	165		•	•		•	•		•					•	•

Source: Council of State Governments, *The Book of the States*, 1972–1973.

Table 5. Functions of State Offices of Community Affairs

State	Date Agency Established	Service Agency	Fiscal Advice	Municipal Management	Economic Development	Engineering and Public Works	Legal Advice on Intergovernmental Matters	Personnel Training	Inter-Local Cooperation	Assessments	Recommend Programs and Legislation	State Coordinating	Research and Information	Boundary Disputes	Financial Assistance	Local Finance Supervision
Alabama	1969	Development Office			•				•		•	•	•			
Alaska	1959	Local Affairs Agency	•	•	•	•	•	•	•	•	•	•	•	•		
Arizona	1968	Dept. of Economic Planning and Development	•	•	•				•		•	•	•			
Arkansas	1971	Dept. of Planning	•	•	•			•	•		•	•	•		•	
California	1965	Dept. of Housing and Community Development	•	•			•	•	•		•	•	•			
	1964	Council on Intergovernmental Relations					•		•		•	•	•		•	
Colorado	1970	Dept. of Local Affairs	•	•	•			•	•	•	•	•	•			•
Connecticut	1967	Dept. of Community Affairs	•	•		•		•	•		•	•	•		•	
Delaware	1970	Dept. of Community Affairs & Economic Development	•		•	•	•		•		•	•	•		•	
Florida	1970	Dept. of Community Affairs	•	•	•	•		•	•		•	•	•			
Georgia	1970	Bureau of a State Planning and Community Affairs	•	•	•	•	•	•	•		•	•	•	•	•	
Illinois	1969	Dept. of Local Government Affairs	•	•	•	•	•	•	•	•	•	•	•		•	•
Iowa	1969	Div. of Municipal Affairs	•	•		•	•	•	•	•	•	•	•	•	•	
Kentucky	1968	Program Development Office	•	•			•	•	•		•	•	•			
Maryland	1970	Dept. of Economic and Community Development	•	•	•	•	•	•	•		•	•	•		•	
Massachusetts	1968	Dept. of Community Affairs	•	•	•		•	•	•		•	•	•		•	•
Minnesota	1967	Div. of Local and Urban Affairs	•	•	•	•	•	•	•	•	•	•	•	•	•	
Mississippi	1964	Community and Area Development Div.		•	•	•			•		•		•			
Missouri	1967	Dept. of Community Affairs	•	•	•	•	•	•	•		•	•	•		•	
Montana	1970	Community Development Div.	•	•	•		•	•	•	•	•	•	•			
Nebraska	1967	Div. of Community Affairs	•	•	•	•	•	•	•		•	•	•		•	
New Jersey	1966	Dept. of Community Affairs	•	•	•	•	•	•	•		•	•	•	•	•	•
New York	1959	Office for Local Government	•	•	•	•	•	•	•	•	•	•	•	•	•	•
	1966	Office of Planning Services	•	•	•	•	•		•		•	•	•	•	•	•

(Continued on p. 150.)

(Continued from p. 149.)

State	Date Agency Established	Service Agency	Fiscal Advice	Municipal Management	Economic Development	Engineering and Public Works	Legal Advice on Inter-governmental Matters	Personnel Training	Inter-Local Cooperation	Assessments	Recommend Programs and Legislation	State Coordinating	Research and Information	Boundary Disputes	Financial Assistance	Local Finance Supervision
North Carolina	1971	Div. of Local Affairs	•	•	•			•	•		•	•	•			•
North Dakota	1965	State Planning Div.	•	•	•		•		•		•	•	•	•		
Ohio	1967	Dept. of Urban Affairs	•	•	•		•	•	•		•	•	•			•
Oklahoma	1971	Office of Community Affairs and Planning	•	•	•	•		•	•		•	•	•		•	
Oregon	1969	Local Government Relations Div.		•				•	•		•	•	•		•	
Pennsylvania	1966	Dept. of Community Affairs	•	•		•		•	•		•	•	•		•	
Rhode Island	1968	Dept. of Community Affairs	•	•	•	•	•	•	•	•	•	•	•		•	•
Tennessee	1963	Office of Local Government	•				•		•			•	•			•
	1967	Office of Urban and Federal Affairs	•		•		•		•		•	•	•		•	
Texas	1971	Dept. of Community Affairs	•		•			•	•		•	•	•			
Utah	1971	Dept. of Community Affairs	•	•	•		•	•	•		•	•	•			
Vermont	1968	Agency of Development and Community Affairs	•		•	•	•	•	•	•	•	•	•			
Virginia	1966	Div. of a State Planning and Community Affairs	•	•	•		•	•	•		•	•	•		•	
Washington	1967	Planning and Community Affairs Agency	•	•		•	•	•	•		•	•	•	•	•	
West Virginia	1969	Office of Federal-State Relations	•	•	•			•	•		•	•	•		•	
Wisconsin	1967	Dept. of Local Affairs and Development	•	•	•		•	•	•		•	•	•	•	•	

Source: Council of State Governments, *The Book of the States*, 1972–1973.

of pollution. A State commission evaluates potential pollution sources, and permission to proceed with the development can be denied outright on environmental grounds.

Almost half the States—particularly those where metropolitan development has accelerated or where major environmental areas are under development pressure—have adopted some form of environmental protection legislation. Most, although not all, of the laws have been enacted since passage of the Federal environmental legislation of the late 1960's and early 1970's (primarily the National Environmental Policy Act of 1969, the Clean Air Act Amendments of 1970, and the Federal Water Pollution Control Act of 1972). The legislation varies considerably among the States, ranging from broad requirements for environmental impact analysis, to legislation prescribing or regulating development in "critical resource areas," to diverse forms of environmental land use planning laws.

Since this kind of State activity is so recent, it is difficult to evaluate the impact of the new State environmental laws on housing. Nevertheless, it is reasonable to expect that such State initiatives ultimately will have profound effects on housing location and costs.

The States are moving toward implementation of the several Federal environmental regulatory acts, including imposition of the same type of environmental impact statements on developmental projects that are now required in certain policy areas under Federal law. Reinforcing the new State trend was a recent decision of the California Supreme Court holding that environmental impact statements required under State law must be prepared by a local government for private activities for which the local government is required to issue a permit, lease, or other entitlement.[2] Inevitably

[2] *Friends of Mammoth* v. *Board of Supervisors of Mono County*, 104 Cal. Rptr. 761, 4 ERC 1593 (1972).

Table 6. Housing and Related Activities of the 50 States

	Dept of Comm unity Affairs	Housing Finance & Development Agency	Bonds Outstanding	Consider Bonding	Hsg. Develop Agency	Acquire Land	Const./Rehab Hsg.	Statewide Bldg. Act	Manufactured Bldg. Act	Mobile Home Bldg. Act	Occupancy Act	Land Use Controls Gen.	Land Use Controls Spec.	Zoning	Environmental Controls	Impact Statement Reqd	Reg. Planning Agency	Multi-State Participation	Planning	Development	Environ. Control	Watershed	Tax Advances	Relief for Elderly	Regional Tax Increment Sharing	Tax Abatement Low Income Hsg. (Tax Actly)	Tax Abatement for Homeowner & Renter	Land Value Taxation Single & Graduated
Alabama	X			X				X	X	X		X			X			X					X	X				
Alaska	X	X	X		X					X	P	P			X			X					X	X				
Arizona	X								X	X	F	P						X				X	X	π				
Arkansas	X									X								X				X	X	X				
California	X	P			P			X	X	X	X	X	X		X	X		X	X	X	X	X	X	X	X			
Colorado	X	X		X	X				X	X		P	P		X			X				X	X	X				
Connecticut	X	X	X		X			X	X	X		X	X		X	X		X	X	X	X	X	X	X				
Delaware	X	X		X	X	P	P				P	X	X		X	X		X	X	X	X		X	X				
Florida	X				P				X	X	F	X	X		X			X				X	X	X				
Georgia	X	X			X	P	P		X	X		X	X		X			X				P	X	X		P		
Hawaii		X	X		X	X	X		X		X	X	X	X	X	X		X					X	X		P		
Idaho		X		X	X	X	P		X	X		P			X			X				X	X	X		P		
Illinois	X	X	X		X	X	P			X	P	X			X			X	X	X	X	X	X	X				
Indiana					P			X	X	X		X			X	X		X	X	X	X	X	X	X			X	
Iowa	X				P			X	X		X	P			X			X				X	X	X			X	
Kansas					P					X		P						X	X	X	X	X	X	X				
Kentucky	X	X		X	X	P						P			X			X	X	X	X	X	X	X				
Louisiana		X		X	X					X								X	X			X	X				X	
Maine		X	X		X	P	P		X	X		X	X		X			X		X		X	X	X		P		
Maryland	X	X		X	X	P	P	X	X	X	P				X	X		X				X	X	X		X	X	
Massachusetts	X		X		X			P	X	X	X	X	X	X	X	X		X	X	X		X	X	X				
Michigan		X	X		X	P	P	X	X	X	P	X	X		X	X		X				X	X	X		P	X	
Minnesota	X	X			X			X	X	X		X	X		X	X		X			X	X	X	X	X	P	X	
Mississippi	X									X								X				X	X				X	
Missouri	X	X	X		X	P					F	P			X			X	X	X	X	X	X	P				
Montana	X							X		X		P			X	X		X				X	X	X				
Nebraska	X				P					X		P						X				X	X	X				
Nevada									X	X	F	P						X	X	X	X	X	X	X				
New Hampshire					P													X	X	X	X	X	X	X				
New Jersey	X	X	X		X	P	P	X		X	X	P	P		X			X	X	X	X	X	X	X		P		
New Mexico									X	X					X	X		X				X	X	X			X	
New York	X	X	X		X	X	X	X	X	X	X	X	X		X		X	X	X	X	X	X	X	X		X	X	
N. Carolina	X	X			X			X	X	X		P			X	X		X					X	X				
N. Dakota	X				P					X	P	U			X			X				X	X	X				
Ohio	X	X		X	X	X		X	X		P	P			X		X	X	X	X	X	X	X	X				
Oklahoma	X				P				X		P	P			X			X				X	X				X	
Oregon	X	X		X	X					X	P	P			X			X				X	X	X			X	
Pennsylvania	X	X		X	X				X	X	P	P			X		X	X	X	X	X	X	X	X				
Rhode Island	X	X		X	X			X	X	X	X	P	P		X			X	X	X		X	X	X		X	X	
S. Carolina		X		X	X	P	P			X		P			X			X					X	X		X	X	
S. Dakota		X		X	X	P	P				F				X			X			X	X	X	X				
Tennessee	X	X		X	X					X							X	X	X	X	X	X	X	X				
Texas	X				P					X	F							X				X	X	X				
Utah	X				P					X								X				X	X	X				
Vermont	X	X			X						F	P	X		X			X	X	X		X	X	X			X	
Virginia	X	X		X	X	P		X	X	X		F	F		X	X		X				X	X	X				
Washington	X								X	X		X	X		X	X		X				X	X	X				
West Virginia	X	X	X	X	X	P	P		X									X	X	X	X	X	X					
Wisconsin	X	X		X	X	P				X	X	X	X		X	X		X				X	X	X			X	
Wyoming															X			X				X	X	X				
Totals	37	30	11	17	30	5	2	15	28	38	8	17	14	2	38	15	4		20	20	18	43		45	2	4	16	

(Data not readily available)

LEGEND:
X=Operating P=Pending F=Feasibility Study U=Unclear

Source: Department of Housing and Urban Development, National Housing Policy Review.

the effect will be to impose additional restrictions and expense upon housing developers. But until now the housing equation has given little or no weight to environmental considerations. To the social goal of providing adequate housing in a nondiscriminatory manner has now been added the new social goal of protecting and preserving the environment.

Actions on Local Codes

Due to the complexity and variety of conflicting housing and building codes, some State governments in recent years have begun to act to simplify the construction of housing by adopting model codes.

The National Conference of States on Building Codes and Standards was founded in 1967 for the purpose of advancing State adoption of model codes. Three model building acts have been developed by the Conference: (1) The "Statewide Building Act," which relates to all types of residential construction; (2) the "Manufactured Building Act," which focuses upon interstate reciprocity and certification; and (3) the "Mobile Home Act," which incorporates a model code and contains provisions directed toward interstate acceptance and construction control.

A number of States already have adopted mandatory State codes for some types of housing construction. A Connecticut law of 1969, for example, applies to all towns, cities, and boroughs. It provides that municipal building officials must be certified by the State building inspector before enforcing the code locally. Several States have adopted or are considering optional model building codes. Although mandatory adoption by localities would not automatically result from these codes, a standard would exist that localities could easily follow.

The most significant strides in uniform State codes have been in the area of industrialized housing. Since the late 1960's, 27 States have made such codes mandatory. In California, for example, a unit that receives certification at the factory is deemed to satisfy code requirements throughout the State.

Finally, since 1970, considerable progress has been made in reforming certain outmoded construction requirements. Spray-painting is gradually becoming accepted. Site-work costs on installation of manufactured modules are being reduced through agreements providing for composite crews and other cost-saving methods.

The variety and number of housing and related activities undertaken by the 50 States are summarized in Table 6.

Local Government Activities in Housing

Local Housing Authorities

Over the past 36 years, a close partnership has developed between the Federal Government and local housing authorities in providing low rent public housing. The primary function of the local housing authority is to develop, own or lease, and manage public housing. Starting with the Housing Act of 1937, the Federal Government has provided a public subsidy in the form of an annual contribution covering debt payments on the local financing of public housing.

Except for statewide housing authorities in nine States, public housing authorities are local agencies. As of December 31, 1972, there were 2,883 local housing authorities, nearly half of which were located in the southeastern and south central sections of the Nation. The 2,883 local housing authorities administer 10,248 projects containing 1,260,235 housing units under annual contribution contracts with the Federal Government. (See Chart 4.)

Most local housing authorities are small; 49 percent have fewer than 100 units and only about 13 percent have 500 or more units supported under the Federal program of annual contribution contracts. Both the local and Federal costs of administering these small authorities are high. Public housing programs tend to be concentrated in the larger cities and metropolitan areas. The 140 largest authorities manage more than 60 percent of all public housing units. About 300 of the local housing authorities are located in central cities, about 450 outside central cities in metropolitan areas that fall within the category of Standard Metropolitan Statistical Areas, and the remainder outside such metropolitan areas. Some 69 percent of all places with local housing authority programs have populations of less than 10,000. The geographical jurisdictions of the housing authorities gradually have been broadened as they sought to provide housing for low income families. Thirty-six States permit housing authorities to extend their operations beyond city boundaries, 34 States permit county housing authorities, and 15 States have authorized regional authorities.

Local housing authorities generally are created by State enabling legislation as entities separate from the local government, with authority to sell long-term, tax-exempt bonds to finance the construction or acquisition of public

authorities to 25 percent of the tenant's income. Recognizing that these rents were insufficient to meet operating expenses in many projects, the Congress authorized additional Federal subsi-

Table 14. Distribution of Section 235 Housing, by Income Class, as of December 31, 1972

(1)	(2)	(3)	(4)	(5)
Gross Income	Percent Distribution of Households Served by 235	235 Households as Percent of all Households	Direct Annual Subsidy Per Household Served	Direct Annual Subsidy Per Household in the Income Class*
$0– 999	Less than 0.05	Less than 0.05	—	—
1,000–1,999	Less than 0.05	Less than 0.05	—	—
2,000–2,999	0.3	Less than 0.05	$720	$0.19
3,000–3,999	2.1	0.2	768	1.52
4,000–4,999	10.2	1.0	780	7.70
5,000–5,999	23.7	2.3	768	18.03
6,000–6,999	26.4	2.7	768	20.83
7,000–7,999	19.3	1.9	792	14.80
8,000–9,999	15.9	0.8	828	6.71
10,000 or more	2.1	Less than 0.05	864	0.21

* Total subsidy paid to an income class spread among all households in that income class.

Source: Department of Housing and Urban Development, National Housing Policy Review estimates based on data from Department of Housing and Urban Development and Department of Commerce, Bureau of the Census. *Current Population Reports*, Series P-60, Nos. 84 and 87, and *1970 Census of Population*.

Table 15. Section 235 Regional Distribution, as of December 31, 1972

(1)	(2)	(3)	(4)	(5)
HUD Region	Percent of 235 Units Produced	Percent of U.S. Households	Percent of U.S. Households Having Between $3,000 and $7,000 Annual Income	Units to Target Group (Col. 2 ÷ Col. 4)
I	1.9%	5.7%	5.1%	0.4
II	3.8	13.7	12.4	0.3
III	3.0	11.3	11.3	0.3
IV	29.2	15.2	18.7	1.6
V	17.6	21.1	18.0	1.0
VI	19.4	9.7	11.4	1.7

which private enterprise is supplying an adequate volume of standard housing. The local housing authorities determine, subject to the approval of HUD, both the private market rent standard and the income limits for the project. Within these constraints, they set the public housing rents on the basis of the size of the unit, the tenant's income, and the operating expenses of the project. In the year ending September 30, 1972, the median income of families entering public housing was $2,816 and the median rent was $47 per month.

In recent years, the tenant composition of public housing has undergone a dramatic change, particularly in large and medium-sized cities. Compared to 1960, public housing tenants are much poorer today. During the period from 1960 to 1972, the median income of all U.S. families rose by 90 percent, while the median income of families moving into public housing rose only 21 percent. Of the families moving into public housing in 1960, 35 percent were receiving welfare assistance and/or benefits, compared to 71 percent in 1972. The elderly population also rose sharply, from 13 percent in 1960 to 41 percent in 1972. During the same period, the minority population in public housing has risen to 60 percent, and the combination of poverty linked with minority group status has served to stigmatize public housing in many areas as a kind of undesirable "housing of last resort." Moreover, the ever poorer status of public housing tenancy has been the single greatest contributing factor to the financial plight of local housing authorities and, in turn, to the pressure for larger Federal operating subsidies.

Five major factors have influenced the status of public housing tenancy. First, tenant incomes, while rising, lagged behind the rate of increase in operating costs brought about by inflation. Second, the problems associated with inner city decay also tended to increase operating costs. Third, housing projects were sometimes poorly designed, and in some cases poorly managed. Fourth, legislative changes and legal decisions prevented local housing authorities from exercising discretion with respect to tenant selection, bringing a significant increase in the proportion of "problem" families. Fifth, in some cases local communities failed to provide adequate community services to the tenants of public housing.

The above-mentioned legislative changes of 1969 have benefited some tenants directly by reducing their rents. However, the laws have increased the amount of Federal subsidies and weakened many of the incentives for sound management of public housing at the local level. In addition, they have made it easier for some States and localities to ignore their responsibilities for effectively serving the poor, with welfare assistance, in public housing within their governmental boundaries.

Local housing authorities gradually have moved away from their role as developer to that of developer-sponsor and purchaser, and also have assumed the roles of lessor and lessee. Until the mid-1960's, local housing agencies participated in all phases of the development, construction, and management of public housing. Because this procedure often resulted in delays and high costs, a number of alternative methods of development and construction have evolved. One alternative widely used since 1967 is the Turnkey Method, under which private developers enter into contracts to design and construct public housing and then turn over title to the authority once construction is completed. Local authorities also have increased their use of the Section 23 program, enacted in 1965, through which authorities lease housing units in existing or newly constructed, privately owned buildings (Table 7).

Selection of sites for low rent public housing is the responsibility of local housing authorities, subject to approval by HUD. In every case sites recommended by the authority must be approved by the local city council or other governing body. Because of increasing neighborhood opposition to public housing, the result of this selection process has often been to locate public housing in inner city slum areas characterized by heavy minority concentration and inadequate public services, jobs, and commercial opportunities. In an effort to reverse this trend, recent Federal court decisions have placed on the Federal Government the positive obligation to approve sites in a way that implements the goal of equal housing opportunity mandated by the Civil Rights Act of 1968;

those decisions are still too recent to have had any measurable impact, however.[3]

Local Redevelopment Agencies

The activities of local redevelopment agencies are not restricted to housing development alone. Since enactment of the 1949 Housing Act, which inaugurated the urban renewal program, local redevelopment agencies have been charged with renewing areas within cities and towns and with preventing further decay in deteriorating neighborhoods.

Local urban renewal agencies generally take on responsibility for planning, site acquisition and clearance, relocation of persons displaced, installation of streets and utilities, assisting the rehabilitation of structures, and disposition of land for redevelopment. Their plans often include such public facilities as parks, schools, police and fire stations, and municipal parking lots. Cleared areas are redeveloped by private developers for residential, commercial, or industrial uses, and by governmental authorities for public facilities and uses, including in many cases public housing.

As of June 30, 1972, there were 2,825 federally funded renewal projects in 1,151 localities. Between 1967 and 1972 the number of localities increased by about 29 percent and the number of projects by about 45 percent. (See Table 8.)

Urban renewal agencies in some States are part of city government, but in most they are separate public authorities. An urban renewal agency is responsible for the preparation and execution of a plan for the total improvement and reuse of a specific area that has been designated as a slum or "blighted" area. Their plans, which must be approved by the local general purpose government, may call for clearance and redevelopment, or for rehabilitation, or for both. Redevelopment generally is executed by private developers. With the assistance of Federal subsidies, urban renewal agencies are able to "write down" the resale price of

[3] *Kennedy Park Homes Association, Inc.* v. *City of Lackawanna, New York*, 436 Fed. 2d 108 (1970); *Gautreaux* v. *Chicago Housing Authority*, 342 Fed. Supp. 827 (1972); *Shannon* v. *United States Department of Housing and Urban Development*, 436 Fed. 2d 809 (1970); *Crow* v. *Brown*, 332 Fed. Supp. 382 (1971).

Table 8. Urban Renewal Program, Total Approvals Cumulative as of June 30, 1967 and 1972

Date	No. of Localities	No. of Projects	Grant Amount
1967	891	1,952	$6.025 Billion
1972	1,151	2,825	$10.790 Billion

Source: Department of Housing and Urban Development.

Table 7. Low Rent Public Housing

Number of Units Placed Under Annual Contributions Contract During Calendar Years 1964–1972 by Type of Production Method or Program

Type of Program	Total	Units Placed Under ACC								
		1964	1965	1966	1967	1968	1969	1970	1971	1972*
Conventional	202,592	32,117	21,312	26,034	36,127	10,967	21,198	32,461	10,349	12,027
Turnkey	205,822	2,189	3,587	4,818	17,337	23,734	35,226	51,876	36,355	30,700
Acquisition	38,134	1,981	1,292	1,908	1,420	9,817	6,338	3,979	2,559	8,840
Leased	153,038	412	136	10,915	14,940	31,600	41,529	16,219	8,535	28,752
Total	599,586	36,699	26,327	43,675	69,824	76,118	104,291	104,535	57,798	80,319

*Preliminary.

Note: A stated method of production or type of program is subject to change during any time prior to start of construction. For example, in many instances units which were approved under the conventional program were converted to the Turnkey Method of production.

Source: Department of Housing and Urban Development.

the land as a major inducement for such developers. The agencies have the power of eminent domain, which enables them to acquire and assemble land of appropriate size for development. Rehabilitaton, on the other hand, generally is effected by homeowners and other property owners, with Federal loans and grants, with help and technical assistance from the renewal agency.

Control over the reuse of the land is achieved in a number of ways. Urban renewal plan requirements, which are in addition to those of local zoning, are usually imposed through covenants and conditions contained in purchase contracts and deeds. In rehabilitation projects, after properties are brought up to plan standards, responsibility for maintenance of the renewed area is placed on the local code enforcement program. The agency reviews the design and construction or rehabilitation of structures. It prohibits redevelopers from transferring property at a profit before they complete construction.

Localities must supplement Federal grants by providing one-third (in some cases one-fourth) of project costs. The local share of costs may be met by contributing cash or by providing public improvements or facilities benefiting the area. In a few States, the increased tax revenues from renewal areas may be allocated specifically to repayment of debts incurred to finance renewal costs.

Redevelopment agencies have shown increasing interest in the inclusion of low and moderate income housing in urban renewal projects, partly because of congressional requirements laid down in 1966, 1968, and 1969. In the 1950's and early 1960's, the emphasis of Federal statutes was on the elimination of slums, rather than on the new uses of cleared land. The result was a substantial diminution of housing stock available for low income families. In-town slums were often replaced by the "highest and best use" of the land, which often meant commercial or industrial facilities, or housing that the former residents could not afford. Since the mid-1960's, however, there has been a substantial increase in the amount of low and moderate income housing planned for renewal areas.

During the four fiscal years ending June 30, 1972, a total of 88,607 units of new low and moderate income housing was started on renewal land, compared with 72,733 such units during the entire preceding 17 years (Table 9).

In recent years—again under congressional pressure as well as facilitating legislative amendments—urban renewal agencies have placed steadily increasing emphasis upon the preservation and rehabilitation of existing housing. The number of residential buildings in renewal areas scheduled for rehabilitation increased by almost 75 percent between December 31, 1970, and June 30, 1972 (Table 10).

Table 9. New Housing Units Started on Renewal Land

For Periods Ending in Fiscal Years 1968 and 1972

	Total	Low-Moderate Income	Low-Moderate Income as Percent of Total
Cumulative through June 30, 1972 (estimate)	283,349	161,340	56.9%
Cumulative through June 30, 1968	151,796	72,733	47.9%
Four years ended June 30, 1972 (estimate)	131,553	88,607	67.4%

Source: Department of Housing and Urban Development.

As of June 30, 1972, more than one million persons had been displaced from renewal projects and relocated elsewhere. Under the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, as well as previous urban renewal legislation, benefits must be paid to those displaced to aid them in moving and in acquiring or renting substitute housing. Many agencies, however, have expanded their relocation activities beyond the provision of shelter and have undertaken other services such as counseling, training, and referral to appropriate social service agencies. Renewal agencies are legally responsible for relocating displaced individuals and families to decent, safe, and sanitary housing, appropriate to their needs and at rents they can afford to pay.

Since 1971, the Administration has asked Congress to terminate the Urban Renewal Program as a separate categorical grant-in-aid program and, in lieu of it, to authorize a broad urban community development program placing local general purpose governments in charge of urban development activities. Entitled the "Better Communities Act," the proposed reform is a key piece in the Administration's plans for a "New Federalism" designed to strengthen the powers of State and local general purpose governments. Under this proposal HUD would allocate $2.3 billion in fiscal year 1975 to cities, urban counties, and States to spend on their own locally determined, high priority developmental needs.

Land Use Controls

The most common form of local land use control is zoning. Zoning is primarily a regulatory device limiting the possible uses of land without directing what the actual use will be. It has emerged as an exception to the traditional concept of private ownership, which permits use of one's land free from governmental control or interference. Until the introduction of zoning in the early 20th century, regulation of land use consisted largely of the doctrines of "nuisance" and "trespass," which inhibited one's use of his land only where it interfered demonstrably with the use of another's.

Modern zoning ordinances seek to segregate conflicting land uses by establishing districts or zones with residential, commercial, and industrial uses. Within these general categories, uses may be further defined. Multifamily residences typically will be located apart from single-family homes. Two- or four-family structures may be separated from highrise or larger developments. Industrial and commercial zones are redivided into "light" and "heavy" uses to separate retail sales from warehouses, and warehouses from factories.

Within each district, regulations also may be placed on building height, bulk, portion of land occupied, and population density. Regulations controlling the size of structures often prescribe maximum or minimum floor area. Controls on population density are often accomplished by specifying minimum lot sizes.

Subdivision regulations are another land use control mechanism. Whereas zoning has focused upon the regulation of individual lots, subdivision regulations are directed at regulating large undeveloped areas, often on the fringes of urbanization. Subdivision regulations

Table 10. Rehabilitation Status for Urban Renewal Projects in Execution and Neighborhood Development Programs

Cumulative 1967–1972

Status	June 30 1972	June 30 1971	December 31 1970	December 31 1969	December 31 1968	December 31 1967
Residential structures						
Workload	228,492	149,572	130,938	110,184	98,050	87,475
In process	13,145	11,095	9,690	10,877	10,735	11,637
Completed	83,798	70,708	65,094	54,275	45,737	38,825

Source: Department of Housing and Urban Development.

vary from State to State, but generally come into play where there is a division of a single parcel into five or more lots. They may require a developer to furnish certain public improvements or to coordinate his plans with the municipality's master plan.

Exclusionary Use of Zoning: Today local communities are concerned increasingly with the effects of piecemeal land development, poor planning, and unrestricted growth. As a result, many of them are postponing large-scale and multifamily developments until they evaluate the impact of such building activity on already strained municipal services. Some local communities also are hesitant about new building activity because of the additional expenditures that would be necessary for added municipal facilities, particularly schools. They maintain that the new growth would require additional tax levies, add to congestion, and cause adverse environmental effects.

The reluctance of municipalities to encourage development is manifest in their refusal to grant zoning changes or variances necessary to proceed with construction—especially of multifamily housing and in particular, subsidized housing. Among other actions being taken by the cities and towns, particularly in the suburbs, to discourage further growth are: setting large lot zoning requirements, prescribing minimum floor space, and imposing requirements of extensive offsite improvements in subdivisions. Such practices tend to reduce the amount of land available for building and to increase the cost of individual lots and public improvements—and, as a result, the cost of the dwellings themselves.

Perhaps of greater importance to lower income individuals who often reside in apartment buildings is the outright exclusion by many jurisdictions of multifamily developments. Some jurisdictions impose exorbitantly high permit fees or require substantial donation of land for public use as a precondition to granting building permits. These restrictions tend to increase the price of the housing provided.

Some localities are limiting growth by establishing an artificial geographic line, such as an "urban limit line," which prohibits development beyond that line. In some communities, land beyond the "line" is zoned as agricultural. As long as the zoning is not so restrictive as to constitute a "taking of property"—which would entitle the owner to compensation—development can be prevented without cost to the municipality. The effect on housing is to reduce the amount of land available for development and consequently to raise its price.

In recent court cases challenging such zoning practices, judges have been reluctant to impose their planning judgment as a substitute for that of local officials, except in cases of racially motivated policies. Various courts have upheld minimum lot size requirements, minimum floor size specifications, and certain restrictions on multifamily housing. But a few recent decisions, notably in Pennsylvania[4] and New Jersey,[5] have called for the municipalities to accept a "fair share" of regional growth by permitting the construction of more housing. In the National Land Investment case, the Supreme Court of Pennsylvania struck down a 4-acre minimum zoning requirement, reasoning that:

> Zoning is a tool in the hands of governmental bodies which must not and cannot be used by those officials as an instrument by which they may shirk their responsibilities. Zoning is a means by which a governmental body can plan for the future . . . Zoning provisions may not be used . . . to avoid the increased responsibilities and economic burdens which time and natural growth invariably bring.

Building and Sewer Moratoria: Building and sewer moratoria, in use in a limited but growing number of municipalities, are usually implemented by a refusal to grant building permits or construct public facilities necessary for the development of housing. These moratoria reflect the increasing awareness of cities and towns of the hazards and disadvantages of uncontrolled growth and its cost in the form of lost open space and congestion as well as higher tax rates caused by the need for additional public services.

But by failing to provide water and sewer connections, some local governments have

[4] *National Land Investment Co.* v. *Easttown Board of Adjustment*, 419 Pa. 504, 215A.2d 597 (1965) and *Appeal of Girsh*, 437 Pa. 237, 263A.2d 395 (1970).

[5] *Molino* v. *Mayor and Council of Gladsboro*, 116 N.J. Super. 195, 281A.2d 401 (1971) and *Oakwood at Madison, Inc.* v. *Township of Madison*, New Jersey 117 N.J. Super. 11 283A.2d 353 (1971).

brought residential construction to a virtual standstill in their jurisdictions, and shifted new housing locations to other areas. In areas where housing demand is strong, as it frequently is in areas where moratoria are imposed, the rapid consequence of such action is to drive up the price of both new and existing housing. New homes may be put beyond the reach of a substantial majority of families. The price impact of moratoria is certainly undesirable. However, many local officials and their constituents consider the construction of utility networks to be a useful and legitimate tool for guiding growth, particularly in view of the ineffectiveness of other public tools to influence private decisions.

An example is Fairfax County, Va., a largely suburban community near Washington, D.C., where population leapt 83 percent from 1960 to 1970 (248,897 to 455,032) and where the median price of owner-occupied homes jumped almost 90 percent from 1960 to 1970 ($18,700 to $35,400). To meet increasing costs, the county raised its property tax rate between 1962 and 1972 by 28 percent—from $3.35 to $4.30 per $100 of assessed valuation.[6] To combat further increases in tax rates and losses of open spaces, the county in 1972 imposed a sewer moratorium, which in effect has stopped large-scale development and triggered considerable litigation brought against the county government by large- and small-scale developers.[7]

Environmental Activities

Localities also are showing a rapidly accelerating concern for environmental preservation and are increasingly evaluating proposed housing developments from this standpoint. As in the case of State actions in the environmental area, many of the local efforts are in response to the Federal environmental regulatory acts concerning the quality of air and clean water, for example.

Since 1970, almost 400 communities have adopted or are considering the adoption of environmental goals or policies. In a recently completed survey of local governments that drew more than 1,100 responses, 43 percent were found to have an environmental policy in operation or under consideration.[8] Almost one-fourth of the responding large cities with populations in excess of 250,000 announced they had established environmental departments, departmental units, or agencies to provide advice, and carry out inspections, monitoring and planning functions. In 30 percent of those communities that have environmental policies in force, the builder or developer is required to file an environmental impact statement that shows what effect the proposed development will have on the environment before any proposed public or private development is authorized.

Many of the locally required impact statements are patterned after the requirement in the National Environmental Protection Act of 1969, although there are some significant local variations.

Building Codes

Building codes are imposed by a municipality to establish minimum safeguards in building construction and to protect occupants from such hazards as fire and collapse.

These codes deal with the shell and internal systems of the structure. Generally, their specifications are directed at structural and foundation loads and stresses, construction materials, fireproofing, building heights, ventilation, heating, plumbing and electrical systems, elevator and escalator construction, and other safety devices.

Their use is most common in larger towns and cities. A survey in 1968[9] revealed that of the almost 18,000 local governments sampled, only 46.6 percent had building codes. On the other hand, of approximately 4,000 cities and towns with a population of 5,000 or above, more than 80 percent had building codes.

The multiplicity of codes is frequently criticized for lack of uniformity, outdated provisions, and inconsistency. Such multiplicity has been

[6] From 1961 to 1971, however, the assessment-to-sales price ratio for single-family houses in Fairfax County fell from 33.3 percent to 31.5 percent. This reduced the effective tax rate increase to about 21.4 percent.

[7] See, for example, *Gulf-Reston* v. *Fairfax Co. Board of Supervisors*, Sixteenth U.S. Circuit Court (1973).

[8] Data collected in an analysis for the Environmental Protection Agency under a grant administered by the International City Managers Association (1973).

[9] Allen D. Manvel, *Local Land and Building Regulation*, prepared for the National Commission on Urban Problems, 1968.

condemned, particularly by builders, who frequently cite it as contributing substantially to higher construction costs by preventing economies of scale and discouraging innovations.

The variety of building components covered by the codes makes efforts at uniformity a major task. In some jurisdictions, building codes encompass electrical, plumbing, and mechanical codes, while in other municipalities such codes are separate. There is also considerable diversity in the administration of codes, because of different interpretations of similar codes in different jurisdictions.

There are indications that the problem of diverse and conflicting building codes is abating somewhat through joint State and local action. Four national model codes[10] and many State model codes have been formulated to cut through the maze. In a 1968 survey of municipalities, approximately two-thirds of those responding reported that they had based their codes originally on one of the model codes. Only about 15 percent, however, had regularly reviewed recommended changes so that their codes were reasonably up to date.

The guidelines for the new State models were laid down by the National Conference of States on Building Codes and Standards, discussed earlier.

Housing Codes

Unlike building codes, which are directed at the structural aspects of buildings, housing codes are concerned with conditions of occupancy. The primary areas covered by typical local housing codes are: (1) minimum facilities: toilet, bath, heat, water, light, and ventilation; (2) level of maintenance; and (3) standards of occupancy such as size and number of rooms as related to the number of people who may occupy them.

Housing codes are the outgrowth of traditional concern about the existence of unsanitary conditions in old housing and poor construction in new housing. Prior to the 1964 amendment to the National Housing Act of 1954, which required that housing codes be included in the Workable Program for urban renewal grants, few jurisdictions had adopted codes. A study by the Housing and Home Finance Agency (HUD's predecessor) revealed that in 1956, fewer than 100 of the larger cities had housing codes.[11] By 1968, a survey of 17,993 local governments of all sizes showed that 4,904 had housing codes.[12]

In 1968, the National Commission on Urban Problems found that even in jurisdictions where housing codes existed, the standards they established often were inadequate to provide even minimum conditions of health and safety. There was no uniform set of criteria for determining what constituted "standard" or "substandard" conditions. Moreover, although many jurisdictions professed to have adopted one of the four national model codes, local variations often were made that, in some cases, eliminated or reduced the minimum standards of the model code.

A second criticism of housing codes concerns the way in which they are enforced. Building officials become aware of code violations in two ways: complaints by residents and systematic inspection. The first method is haphazard and unreliable, and the second very costly. As a result, violations often go unnoticed and uncorrected.

Rent Controls

Alarmed at the rapid rate of rent increases in recent years, a growing number of city and county governing bodies are considering and passing rent control ordinances to limit or prohibit landlords from increasing tenants' rents.

Although rent controls apply a quick and popular brake on inflationary housing costs, they can bring unwanted consequences if retained over a long period of time. Apartment owners are faced with rising expenses, too—for property taxes, maintenance and repairs, trash removal, and other municipal services. Expenses that cannot be passed on to tenants must be absorbed by the owner and eventually will reduce his profit and return on investment. To compensate for this, owners often cut back

[10] American Public Health Association Code, International Conference of Building Officials Code, Building Officials Conference of American Code and Southern Standard Housing Code.

[11] Urban Renewal Administration, Housing and Home Finance Agency, "Provisions of Housing Codes in Various American Cities," *Urban Renewal Bulletin No. 3*, 1956.

[12] Allen D. Manvel, op. cit.

on maintenance services or postpone planned improvements. If rent controls continue, the property may become rundown, and the owner may be forced either to sell or to abandon it.

Experience in New York City, which has had rent control intermittently since 1916 and continuously since 1943, illustrates how this unfortunate chain reaction can occur. In that city, it appears that rent control has contributed to undermaintenance, deterioration, and abandonment of rental housing. Owners often milk whatever profit they can out of their buildings in order to make more advantageous investments.[13]

Financial institutions, too, have been reluctant to invest equity capital or make loans on properties subject to New York's rent controls. This reluctance has further punished the existing housing stock and retarded the construction of new apartments.

Finally, the administration of rent control becomes more burdensome and complex as time goes on. New York first tried to prohibit any exceptions to rent control, then instituted an increasingly complicated formula for justifying increases, and recently "decontrolled" certain categories of rental housing.[14]

In short, rent controls may keep rents down for consumers for a period of time, but only at the long-term risk of losses to owners, disinvestment and deterioration in existing rental housing, administrative problems, and eventually an inadequate supply of new rental housing.

Public Services and Tax Policy

The location and density of housing have a significant impact on the level of expenditures of local governments. Municipalities must provide public utilities and police and fire protection as well as other services and facilities. They have become increasingly opposed to authorizing large new developments because of the added strain that would be imposed on their resources.

The Nation's cities and towns rely heavily on the property tax to finance public services; as their costs soared over the last decade, they have become more reliant on State governments and the Federal Government to help them meet expenses.

In fiscal year 1971, almost 31 percent of local revenues was provided by the State (including Federal "pass-through" payments, which are matched by State funds), while Federal direct payments amounted to 3.4 percent of all revenue. (See Table 11.)

It is too soon to predict the extent to which Federal revenue sharing will alter the revenue structure of State and local governments. The Federal payments are expected to help relieve the squeeze between increasing demands for services and intensifying taxpayer protests. Through midsummer 1973, $8,131 billion in general revenue sharing funds had been distributed to more than 38,000 State and local government units.

The fiscal strain on most States has diminished recently, due in part to the infusion of Federal revenue sharing dollars. According to a survey in 1971, proposals to increase existing State taxes or create new taxes were expected to be considered by 35 of the 49 State legislatures meeting that year. A subsequent survey revealed that by the end of 1972, States had surpluses of $12.3 billion—due primarily to the economic upturn of 1972, lower school populations, and revenue sharing—and only a few States were considering tax increases for 1973.

Local Tax Policies

Because of their heavy reliance on property and sales taxes, local communities often encourage the development of high-tax-producing commercial and industrial facilities rather than low-yielding residential structures. It is commonly believed that the costs of providing public services to residential structures (particularly those designed for low and moderate income families) exceed the tax revenues they produce.

The property tax has been criticized as having the greatest adverse impact on housing. It is essentially a local action, although levied

[13] George Sternlieb, *The Urban Housing Dilemma; The Dynamics of New York City's Rent Controlled Housing*, New York Housing and Development Administration, Department of Rent and Housing Maintenance, Office of Rent Control, 1972.

[14] Ibid.

by a few States as well. One source of criticism is the wide variation of the property tax among jurisdictions, with some variation even among neighborhoods within a single jurisdiction. The property tax also has been criticized on the grounds that it is regressive: Because housing is such a significant item in the budgets of poor families, even a property tax at a uniform rate may absorb a much higher fraction of the income of the poor than of the rich. Sharply rising property taxes over the past few years have created a special problem for the elderly, many of whom live on fixed incomes.

Finally, the property tax has been criticized on the grounds that it is a tax on the consumption of a commodity that is especially valuable to the community: residential housing. As a consumption tax, it has an effective rate greatly in excess of the rates applicable to other consumer expenditures. By increasing the cost of housing, particularly to those least able to pay, the property tax is said to reduce the demand for housing, or, alternatively, to reduce the rate of return to housing investors. As a result, high property taxes are thought to deter increases in the stock of housing and in improvements in the quality of existing housing.

Many communities are using various methods to overcome some of the objections to the property tax system and to encourage particular types of development.

Tax Increment: Tax increment financing is used most extensively in California and Minnesota. In those States, any increases in property taxes attributable to redevelopment of a particular area are allocated specifically to finance various public costs—such as access roads, sewers, or public buildings—of the redevelopment project. The preredevelopment tax revenue base continues to go to the local government's general fund. In most cases municipal bonds are issued to finance the public redevelopment costs, with the projected tax "increment" pledged to repay the bondholders fully. Most of the land developed in this way has been devoted to commercial, industrial, or middle income housing uses. Recently, however, redevelopment agencies have begun to use the increment from high-tax-generating commercial and industrial development to finance improvements in low-tax-generating residential areas.

Table 11. State and Local Government Revenue, 1966–1971

(Amounts in Millions of Dollars)

	State Government					Local Government				
	1966–1967		1970–1971		Percent Change	1966–1967		1970–1971		Percent Change
	Amount	Percent	Amount	Percent	1967–71	Amount	Percent	Amount	Percent	1967–71
Total Revenue	61.082	100.0	97.233	100.0	59.2	65.377	100.0	100.993	100.0	54.5
Intergovernmental Revenue	14.298	23.4	23.908	24.5	66.6	20.386	31.2	34.473	34.1	69.0
From Federal Government	13.616	22.3	22.754	23.4	67.1	1.889	2.9	3.391	3.4	79.5
From State Governments						18.507	28.3	31.081	30.8	67.9
From Local Governments	673	1.1	1.054	1.1	56.6					
Revenue from own sources	46.793	76.6	73.424	75.5	56.9	44.981	68.8	66.521	65.9	47.9
Taxes	31.926	52.3	51.541	53.0	61.4	29.315	44.8	43.434	43.0	48.2
Property	862	1.4	1.126	1.2	30.6	25.418	38.9	36.726	36.4	44.5
Individual Income	4.909	8.0	10.153	10.4	106.8	926	1.4	1.747	1.7	88.7
Corporation Income	2.227	3.7	3.424	3.5	53.8					
Sales and Gross Receipts	18.575	30.4	29.570	30.4	59.2	1.979	3.0	3.662	3.0	85.0
Other Taxes	5.354	8.8	7.268	7.5	35.8	992	1.5	1.298	1.3	30.9
Other Revenue	14.867	24.3	21.883	22.5	47.2	15.667	2.0	23.088	22.9	47.4

Source: Department of Commerce, Bureau of the Census. *Governmental Finances*, 1966–1971.

Although the tax increment device has been very effective in rapidly growing communities, its use is more limited in small cities where growth is static.

Taxation of Land Value: It is often argued that by imposing a property tax solely upon land—or at a higher rate on land than on buildings—more intensive uses of land will be encouraged; where a sufficient level of demand exists, investors could increase their rate of return by developing sites more intensively.

Several communities already have tried various forms of land value taxation. Fairhope, Ala., has established a Single Tax Corporation, which buys land and leases it to individuals and businesses for 99 years. The corporation has simulated the effect of a site value tax by basing the rentals of its large holdings upon land alone without considering the value of any improvements.

A "graded" or "differential" tax—where both land and improvements are taxed, but the land is taxed at a higher rate—is currently being used in Pittsburgh, Pa., and the State of Hawaii. In two communities—Arlington County, Va., and Southfield, Mich.—an emphasis is placed upon land values by reassessing land annually and by basing the land assessment on potential market value rather than present use.

Tax Exemptions or Abatements: Typically, property owned by Federal, State, or municipal government entities (including public housing owned by local authorities, and land and improvements owned by local redevelopment agencies) has been fully or partially exempted from local property taxation, thus increasing the level of taxes needed from other local property owners.

Tax exemptions and abatements, however, also have been used to stimulate certain types of development. Some States attempt to encourage the construction of low and moderate income housing owned by private developers by abating the taxes that would otherwise be imposed upon those structures.

The effect of the abatement is to reduce the operating cost of the development and thereby reduce rents that must be paid by low income tenants. The lower rents enable developers to build and successfully to market housing units that would otherwise remain unbuilt.

"Circuit Breakers": In recognition of the special financial problems created for the elderly by rising local property tax rates, States are drafting, and in some cases have already adopted, property tax relief programs for the elderly. These programs, called "circuit breakers," vary from State to State.

Essentially they are analogous to the Administration's proposed refundable tax credit for the elderly. This proposed legislation would permit the elderly to claim a credit for the amount of property taxes they pay in excess of 5 percent of their income, limiting the credit to $500. The legislation applies to elderly renters as well as homeowners. The credit due to renters is subject to the same 5 percent floor and $500 maximum; for this purpose, 15 percent of their gross annual rent is assumed to be paid by landlords for property taxes.

Among the States that have already approved similar tax relief programs for the elderly are Vermont, Michigan, Wisconsin, and Tennessee. Each of these State programs reimburses a portion of the elderly person's property tax, or pays the local government directly on behalf of the elderly.

Many of these programs represent a significant change in public policy toward housing consumers in that they are available to renters—not just homeowners—and they are refundable to families who pay little or no taxes.

6 Housing Consumption

Introduction

Since the end of World War II, the growth in the real income of the Nation has permitted the average American household to upgrade significantly the quality of its housing. But despite this improvement, those with very low incomes still face severe housing problems closely related to the severity of their poverty.

The choice of housing is highly complex in that it involves many factors other than shelter alone. The decision to buy or rent a particular home is based in part on neighborhood characteristics, which may be given greater weight than the size and style of the structure itself. The quality of local schools, the adequacy of police and fire protection, the amount of pollution, the incidence of crime, and many other factors influence the consumer's selection of housing.

Frequently, a home buyer or renter is unable to find the exact neighborhood he prefers, so his final choice often represents a complicated trade-off between an area's good and bad characteristics. For example, a potential home buyer or renter might be willing to sacrifice proximity to his or her job in order to escape undesirable aspects of central city living, such as higher crime rates. The choice of a neighborhood is further constrained by budget considerations. Often the very poor are restricted to housing driven down in value partly because of the undesirable characteristics of its neighborhood.

As in the choice of neighborhood, the selection of the house or apartment itself is a highly complicated process in which the consumer's preferences for space, the number and arrangement of rooms, the presence or absence of amenities such as central heating, air conditioning, and a variety of other factors are often traded off against one another.

A study conducted for the National Housing Policy Review suggests that the more affluent home buyer often is concerned more with neighborhood characteristics than with the structure of the house because he can afford to alter the structure as he wishes. By contrast, the buyer with a modest income has enough of a problem accumulating a downpayment, and the characteristics of the structure often are more important to him than the characteristics of the neighborhood.[1]

In addition to structure and neighborhood, the choice of housing also is constrained by the variables that determine the supply of housing; the final choice is the result of the interaction between the forces determining supply and demand. These are dynamic forces that are not yet well understood. Therefore, this chapter does not attempt a complete description of all the processes that determine the quantity and quality of housing consumption. Rather, it offers a series of snapshots of the occupied housing of different groups at different times.

The Total Housing Stock

In 1970, there were more than 68 million housing units in the United States, 63 million of which were occupied by households.[2] Of these households, 37.1 percent were renters and 62.9 percent were owners.

The condition of the Nation's housing stock improved dramatically between 1950 and 1970. Chart 1 shows that during this period the proportion of the Nation's housing stock characterized as "dilapidated" decreased by more than 50 percent; the proportion not having complete plumbing facilities decreased by more than 80 percent; and the proportion that was overcrowded fell almost 50 percent.

Significant differences existed in the kind and quality of housing in the various regions of the United States. The Northeast region contained the highest concentration of structures of five or more units—22.4 percent—and the highest proportion of dwellings more than 30 years old—55.2 percent. The South had the largest proportion of single-family homes—77.7 percent—and the highest percentage of housing units without complete plumbing facilities—11.9 percent. The Western region contained the lowest proportion of housing units lacking some or all plumbing—3.3 percent—and had the newest housing stock, with only 26.8 percent of its units more than 30 years old (Table 1).

[1] Arthur D. Little, Inc., "Consumer Preferences in Housing," a study prepared for the National Housing Policy Review, 1973.

[2] A household is defined as the individual or group of individuals occupying a dwelling unit. Thus, the number of occupied units equals the number of households.

Over the years, the average size of the American household has declined; in other words, the number of households has grown much faster than the population. More specifically, between 1950 and 1970 the number of households grew 47 percent, from 43 million to 63 million, while the population grew only 34 percent, from 151 million to 203 million. (See Chart 2.)

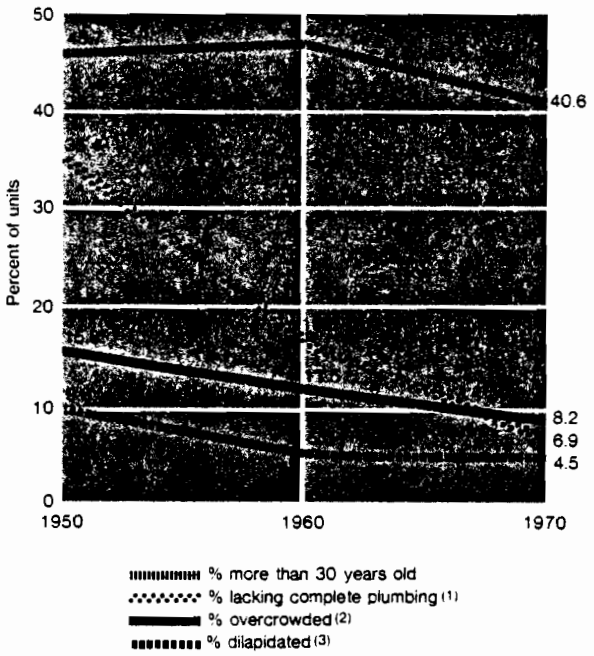
Part of the decline in household size is attributable to falling birth rates. Rising incomes, however, also played a role in reducing household size. As living standards improved, many elderly persons, who in earlier years would have lived with their adult children, could afford their own independent households. Similarly, children could afford to leave the family home at an earlier age. It also became less necessary for two or more families to share living quarters. While economic factors undoubtedly played a major role in these developments, changing social customs influenced the rate of change as well.

As the housing stock grew to match the increase in the number of households, there were notable changes in the composition of housing production (Chart 3). The most significant change has been the growing importance of mobile homes.[3] In 1950, only 63,100 mobile homes were shipped. By 1960, shipments had grown to 103,700 and by 1970, total annual shipments were 401,190. Although shipments may be lower in the last 5 months of 1973 than in the first 7 months, they should exceed 600,000 units for the entire year.

The relative importance of multifamily dwellings has also grown, although not at the same rate as that of mobile homes. In 1960, about 22 percent of all conventional construction starts consisted of multifamily dwellings, but by 1972, the proportion had grown to about 45 percent.

Chart 1

Characteristics of Housing Stock, Total U.S. 1950, 1960, 1970



(1) Lacking complete plumbing — housing units which lack one or more plumbing facilities or have a facility used also by occupants of another unit.

(2) Overcrowded — 1.01 or more persons per room.

(3) Dilapidated — housing which does not provide safe and adequate shelter, and endangers health, safety or well being of occupants. Defects are so critical or widespread that the structure should be extensively repaired, rebuilt, or torn down.

Source: Department of Commerce, Bureau of the Census, Census of Housing, 1950, 1960, 1970.

The Housing of the Typical American

Table 2 illustrates the important changes that have occurred in the characteristics of typical American households over the period 1950–1970. The median household income of owners grew 188.7 percent over the period, while the median income of renters grew 125 percent. Over the same two decades the cost of living as measured by the Consumer Price Index grew only 61.3 percent, and the consequent improvement in the standard of living allowed buyers and renters to increase the size and improve the quality of their living quarters. Specifically, the median number of rooms occupied rose from 4.6 to 5.1 while the median value of homes fell from 2.09 times income in 1950 to 1.79 times income in 1970; however, the rent-income ratio rose from 17.9 to 20.9

[3] The term "mobile" home is something of a misnomer: Most mobile homes remain on one site during their entire period of use.

The decline in the absolute size of the low income population over the long run reflects the fact that the real incomes of those at the low end of the income distribution have grown. The median income of the households in the lowest 20 percent of the income scale was 16.5 percent of the national median income in 1970, compared to 16.3 percent in 1960 and 14.3 percent in 1950.

The most dramatic increases have been in the incomes of the lowest fifth of the rural population, whose median income rose from 12.8 to 16 percent of the national median between 1960 and 1970, and for the elderly, whose median income also increased relative to the national median—up from 8 percent in 1960 to 10.9 percent in 1970, primarily because of increased Social Security benefits and private pension plan payments. (See Chart 4.)

The growth in the incomes of those at the low end of the income distribution has allowed significant improvement in the quality of their housing. For the third of the households with the lowest income, the percentage of households occupying housing without complete plumbing facilities dropped by nearly 80 percent between 1950 and 1970, and the percentage of overcrowded[5] units dropped by more than half during the same period (Chart 5). Part of this improvement is the result of the development of the mobile home industry, which has provided a low-cost housing alternative for those with modest incomes. Fifty percent of the households who occupied mobile homes in 1970 had incomes of less than $7,000.

Nevertheless, low income households still occupy poor quality housing far out of proportion to their numbers. Low income owners and renters live in units that are more expensive relative to their means than the nationwide median owner and renter. In 1970, while the typical renter spent between 15 and 25 percent of his annual gross income on housing, those at the bottom of the income distribution typically spent more than 35 percent of their annual gross income for housing. Those below the low income threshold are much more likely to live in ill-equipped and overcrowded housing. While only 32 percent of all renters had incomes below the 1970 low income threshold, they occupied 63 percent of the rental units that lacked complete plumbing facilities in 1970. Low income homeowners represented only 19 percent of the households who were homeowners, yet they lived in 57 percent of all the occupant-owned housing without complete plumbing.

The problem of low incomes afflicts a relatively high proportion of the rural population. In 1970, 20 percent of households living in nonmetropolitan areas were below the low income line, whereas only 13 percent were below the threshold in metropolitan areas. As a result, rural areas (open country and urbanized places with fewer than 2,500 residents) contain a disproportionate share of the country's poor housing. While such areas contained only 27 percent of the population in 1970, they contained 62 percent of the occupied units lacking complete plumbing, 31 percent of the crowded units (more than one person per room), and 38 percent of severely crowded units (more than 1.5 persons per room). The incidence of housing deficiencies is also more common for blacks and other minorities in rural than in urban areas. For instance, of the black-occupied rural housing units in 1970, 30 percent were overcrowded and 61 percent lacked complete plumbing, compared to 18 percent and 8 percent, respectively, for black-occupied urban units.

The problem of low income also affects the quality of the housing of the elderly. While Chart 4 shows that the incomes of the elderly poor rose relative to the rest of the population between 1960 and 1970, the increase was from a very low level. Of the 12.4 million households with heads aged 65 and over in 1970, 5.8 million, or 47 percent, had incomes of less than $3,000.

In 1970, 14.6 percent of all elderly households with less than $3,000 income had incomplete plumbing, compared to 9.1 percent for all elderly households and 5.9 percent for the population as a whole.

Overcrowding is one housing problem not faced by elderly households; only 1 percent were overcrowded in 1970, compared to 8 percent of all households in the United States.

[5] An "overcrowded" household is one with more than one person per room. While an overcrowded unit is not necessarily structurally deficient or lacking equipment, it is an indicator of poor living conditions.

Table 2. Characteristics of the Typical American Household

Characteristic	1950	1960	1970
Median income of families and primary individuals			
Owner	$3,360	$5,900	$9,700
Renter	$2,800	$4,100	$6,300
Median home value [1]	$7,400	$11,900	$17,100
Median value/income ratio [1]	2.09	1.92	1.79
Median gross rent [2]	$42	$71	$108
Median gross rent as percentage of income [2]	17.9%	19.7%	21.0%
Median persons per household	3.1	3.0	2.7
Median number of rooms	4.6	4.9	5.1
Median persons per room	Less than 0.75	0.59	0.50

[1] One family homes on less than 10 acres with no business on property.
[2] Excludes one family homes on 10 acres or more.
Source: Department of Commerce. Bureau of the Census. *Census of Housing*, 1950. 1960. 1970.

Chart 3

Total New Housing Units Produced for Selected Years

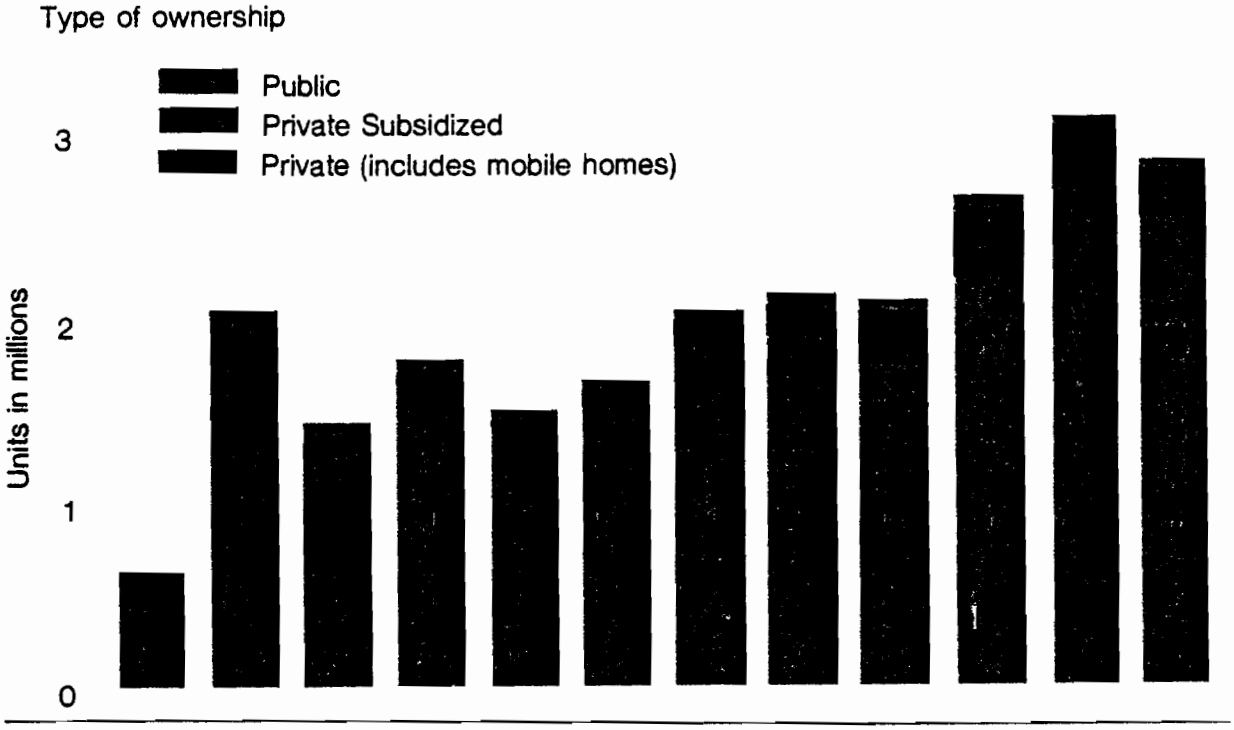
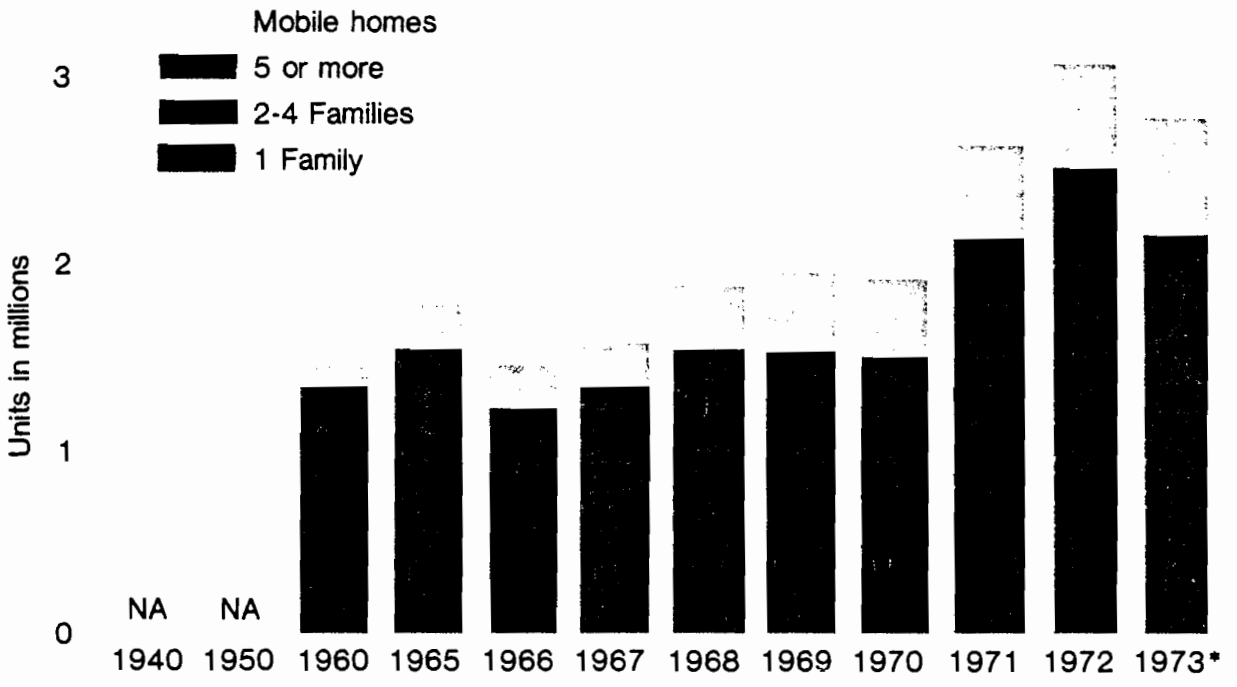


Table 3. Geographic Differences in Housing Markets, 1970

Characteristic	Central City	Metropolitan Suburbs	Nonmetro-politan
Median income of families and primary individuals			
Owner	$10,100	$11,600	$7,500
Renter	$6,100	$7,700	$5,300
Median home value [1]	$16,400	$20,800	$12,200
Median value/income ratio [1]	1.72	1.86	1.72
Median gross rent [2]	$107	$130	$84
Median gross rent as percentage of income [2]	21.8%	20.7%	19.5%
Median persons per household	2.4	3.0	2.7
Median number of rooms	4.7	5.3	5.1
Median persons per room	Less than 0.50	0.53	Less than 0.50

[1] One family homes on less than 10 acres with no business on property.
[2] Excludes one family homes on 10 acres or more.
Source: Department of Commerce, Bureau of the Census, *1970 Census of Housing*.

Chart 3 Continued



NA Not Available
* Data for 1973 are estimated

Source: Department of Commerce, Bureau of the Census, Construction Reports, Series C 20; Department of Housing and Urban Development.

A difficult problem faced by the elderly is the need to spend a large share of their income on housing. A substantial number devote more than 35 percent of their income for shelter; in some instances they spend more than 100 percent, necessitating the use of accumulated savings. This makes them highly susceptible to unexpected changes in their circumstances—serious illness, tax increases, and inflation.

Table 4 shows that households headed by nonwhite females became a much higher proportion of the low income population between 1960 and 1970. This was the only group to grow in absolute numbers over the period. The data on such households containing two or more persons show that they tend to be very poor, with a median income of only $3,576. About two-thirds live in central cities and more than 24 percent are in overcrowded quarters. In other words, the incidence of overcrowding is about three times that at the national level. About 15 percent lack complete plumbing; this is more than twice the national level of 5.9 percent.

It is often asserted that the housing conditions of the poor will be improved gradually by the process of "filtering"; this means that as the general income of the population rises and housing conditions improve, households with rising incomes will vacate slightly lower quality dwellings, leaving them available for the poor, who will move up from still-lower quality housing. A variant of this argument suggests that as the Government subsidizes new housing for moderate income groups and they move into the new units, an increased supply of existing suitable housing will be made available to the poor.

This process does work in the short run. In the very long run, however, natural economic forces tend to reduce the filtering benefits accruing to individuals whose income remains unchanged. The basic problem is that the amount that poor people can afford for their housing is limited by their meager budget. At the same time, investments in maintaining the stock of housing must earn an economic return. Therefore, while filtering temporarily allows poor persons to inhabit a better house, they or their landlord will not be able to maintain it unless the occupant's income (or rent) is increased.

If housing expenditures do not keep pace with maintenance and other costs, the quality of the house is gradually allowed to deteriorate. Of course, this may take a very long time, and before it happens the poor family may be able

Table 4. The Composition of the Low Income Population

(In Millions)

Category [4]	Low Income Threshold for Nonfarm Family of Two Adults and Two Children			
	1960 = $3,022		1970 = $3,968	
Total number in group	39.9	(100%)	25.5	(100%)
Aged	5.7	14%	4.7	18%
Disabled nonaged [1]	0.3[2]	1%[2]	1.2	5%
Nonaged, nondisabled	33.8[3]	85%	19.6	77%
White male head	18.0[3]	45%	8.4	33%
Nonwhite male head	7.5[3]	19%	3.1	12%
White female head	5.2[3]	13%	4.3	17%
Nonwhite female head	3.1[3]	8%	3.8	15%
Nonwhite (all categories)	11.5	29%	8.0	31%

[1] Persons who did not work in 1960 (or 1970) and reported the primary reason as illness or disabled (ages 14–64, only).
[2] Family heads only, age 25–64.
[3] Includes disabled other than family heads, age 25–64.
[4] Categories patterned after Michigan Research Center studies.

Source: Department of Commerce, Bureau of the Census, *Current Population Reports*, Series P–60, Nos. 68 and 81.

to move yet again to a higher quality dwelling just vacated by someone whose income has risen. In other words, the market is constantly in motion, and it may never reach a longrun equilibrium in which housing conditions are essentially determined by the amount people are willing and able to pay and by the rate of return on investments in housing. However, the longrun forces are always pushing the market in this direction and this reduces the effectiveness of the filtering process. Clearly, a more certain improvement in the housing conditions of the poor can be achieved only if their effort to find housing is subsidized, or their income is increased by other means.

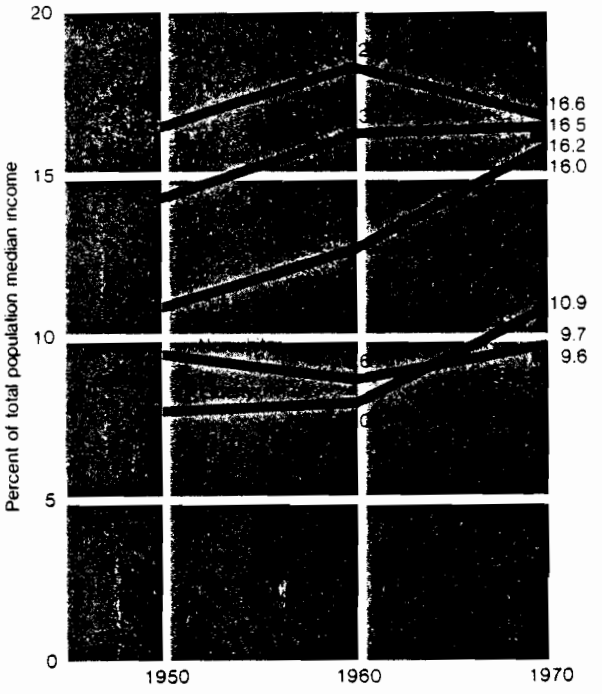
Empirical studies of filtration are in a primitive state, so it is impossible to assess accurately the importance of the phenomena described above.[6] Undoubtedly, conditions affecting filtration vary greatly from city to city and from neighborhood to neighborhood within cities.

The discussion thus far has focused on the physical characteristics of the housing of the low income population and has not considered

[6] For a detailed description of the theory of filtering and a review of related empirical studies, see "An Analysis of the Filtering Process with Special Reference to Housing Subsidies," a study prepared by W. B. Brueggeman for the National Housing Policy Review, June 8, 1973.

Chart 4

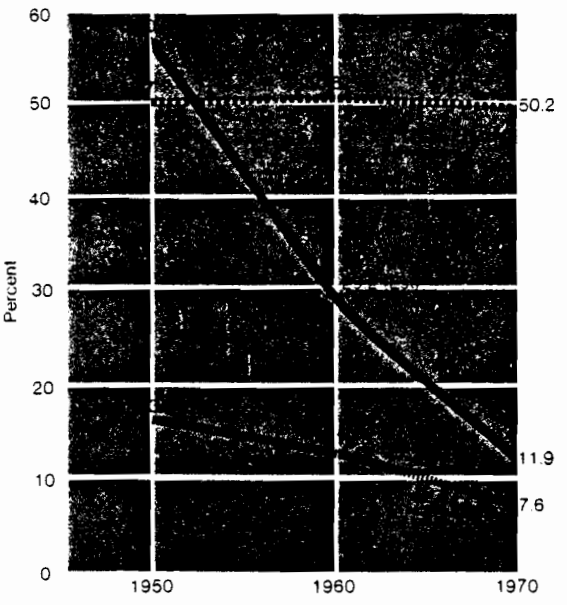
Comparison of Median Income of the Lowest 20% of Specified Groups and the Total Population 1950, 1960, 1970



Source: Department of Commerce, Bureau of the Census, Census of Population, 1950, 1960, 1970.

Chart 5

Characteristics of Housing of Lowest Third of Income Distribution (1) 1950, 1960, 1970



(1) Incomes of families and primary individuals:
1950-under $2,000 (34.4% of households)
1960-under $4,000 (37.5% of households)
1970-under $6,000 (35.4% of households)

(2) Non-farm only

Source: Department of Commerce, Bureau of the Census, Census of Housing, 1950, 1960, 1970.

the crucially important issue of the environment in which that housing is located. Housing problems are especially acute when they are concentrated in low income neighborhoods. The next section discusses the housing conditions in such neighborhoods and then considers some of the most important features of the low income environment.

Low Income Neighborhoods

Fifty low income neighborhoods were selected for analysis in this study. They are listed in Table 5. All 50 were classified as "major concentrations of poverty" after the 1960 Census and all still had high concentrations of low income households in 1970.[7] The neighborhoods were selected as representative of those that have had concentrations of the Nation's worst housing over a long period of time.

[7] More than 20 percent of the neighborhood's population lived in households with incomes under the low income threshold.

Table 5. Fifty Selected Neighborhoods

The 50 neighborhoods selected for study were located in the following cities. In some cases, more than one neighborhood was chosen in a particular city. The neighborhoods are listed by median family income in 1960, from the neighborhood with the highest to the one with the lowest median family income.

1. Chicago, Ill.
2. Chicago, Ill.
3. Milwaukee, Wis.
4. Cleveland, Ohio
5. Baltimore, Md.
6. Newark, N.J.
7. Los Angeles, Calif.
8. Boston, Mass.
9. Cleveland, Ohio
10. Cincinnati, Ohio
11. Washington, D.C.
12. Chicago, Ill.
13. Cincinnati, Ohio
14. Houston, Tex.
15. Chicago, Ill.
16. Minneapolis, Minn.
17. Queens, N.Y.
18. St. Louis, Mo.
19. Los Angeles, Calif.
20. Kings County, N.Y.
21. San Francisco, Calif.
22. Philadelphia, Pa.
23. Gary, Ind.
24. Indianapolis, Ind.
25. Pittsburgh, Pa.
26. Chicago, Ill.
27. Detroit, Mich.
28. Denver, Colo.
29. Bronx, N.Y.
30. Baltimore, Md.
31. Birmingham, Ala.
32. San Diego, Calif.
33. New Orleans, La.
34. Washington, D.C.
35. Philadelphia, Pa.
36. Miami, Fla.
37. St. Louis, Mo.
38. Oakland, Calif.
39. Manhattan, N.Y.
40. Dallas, Tex.
41. Los Angeles, Calif.
42. Boston, Mass.
43. Atlanta, Ga.
44. Dallas, Tex.
45. Atlanta, Ga.
46. St. Louis, Mo.
47. Houston, Tex.
48. San Antonio, Tex.
49. Memphis, Tenn.
50. Detroit, Mich.

Forty of the 50 neighborhoods are located in central cities with populations of more than one-half million, and the selection included neighborhoods from all regions of the country, with the largest number (18) in the north-central United States and 15 located in the South. The West contained the fewest in number—seven neighborhoods; the remaining 10 are located in the Northeast.

Between 1960 and 1970, there were dramatic changes in the population, the racial composition, and the condition of the housing stock in virtually all of the 50 neighborhoods. All but one declined in total population, the declines ranging from 3 to 63 percent. The only

exception was a neighborhood of Miami, Fla., which experienced a 28 percent increase in population as a result of a large immigration of Cuban refugees.

In all 50 neighborhoods, the white population declined. In 11 of the neighborhoods there was less than one white in 1970 for every four in 1960.

In 24 of the neighborhoods, the number of blacks increased, rising more than 50 percent in seven neighborhoods. The number of Spanish Americans increased in 33 of the neighborhoods—in some cases by more than 500 percent.

While the whites were generally moving out of the low income neighborhoods, and in half of the neighborhoods minorities were moving in, the median standard of living in most neighborhoods improved. The median gross income of families rose more rapidly than the cost of living in 43 neighborhoods, while the real income of unrelated individuals rose in 32. Moreover, incomes rose more than rents in 44 of the 50 neighborhoods, the exceptions all being in large cities—Chicago, Newark, New York City, and San Francisco.

The ratio of vacant to occupied units rose in 31 of the 50 neighborhoods, while the vacancy rate for the Nation as a whole fell between 1960 and 1970. With more vacancies, and hence with a greater choice of units, the inhabitants were able to upgrade the quality of their housing. The percentage of occupied units lacking complete plumbing fell in all but three neighborhoods and the proportion of overcrowded households decreased in all but eight.

Overall, the changes in the 50 low income neighborhoods indicate some surprising results. The neighborhoods were selected with an expectation of neighborhood decline, yet it was found that for virtually all neighborhoods studied, housing conditions and real incomes actually improved. All indices, however, still revealed relatively poor housing conditions. In 17 neighborhoods the percentage of households lacking complete plumbing in 1970 was twice as high as the national average. Overcrowding rates were greater than average in all but three, and in 10 the proportion of overcrowded units exceeded 20 percent, compared to a national average of 8.2 percent.

In summary, the neighborhood data suggest two conclusions. First, housing conditions tend to improve even in the worst neighborhoods if real incomes rise. Second, even in some neighborhoods where real incomes did not rise, there was an improvement in housing conditions, strongly suggesting that the process of filtration was working effectively. Only in a few cases is there evidence that new construction aided in improving the quality of the occupied housing stock.

Although the physical characteristics of the housing in the neighborhoods studied above were improving, it is not clear that the environment in low income neighborhoods in general showed similar improvements during the 1960's.

Low income neighborhoods typically receive relatively high levels of public service inputs, such as police patrolling, fire protection, and sanitation services,[8] because the problems attacked by these services are most serious in these areas. Despite the high levels of public service inputs, the problems remained severe and may have become worse during the 1960's.

There is much disagreement on some commonly used statistics, but it is generally believed that crime became a more serious problem in low income neighborhoods between 1960 and 1970.[9] The evidence of an increase in arson is less firm, but seems to point in that direction.[10] There also is general agreement that the quality of schools in low income neighborhoods remains far below that of the national average.

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[8] Charles S. Benson and Peter B. Lund, "Neighborhood Distribution of Local Public Services," Berkley: University of California, 1969, and John Weicher, "The Allocation of Police Protection by Income Class," *Urban Studies*, February 1973.

[9] National Commission on the Causes and Prevention of Violence, *To Establish Justice, to Insure Domestic Tranquility*, Washington, D.C.: Government Printing Office, 1969, pp. 42–43.

[10] Jonathan R. Laing, "Arson in the Ghetto," *Wall Street Journal*, April 9, 1970.

It should be noted that the problems of the environment of low income neighborhoods afflict all who live there regardless of their income class. While there is a great deal of segregation by income class within large American cities, it is far from total. Although in Birmingham 70 percent of all low income households were in low income neighborhoods, in Chicago in 1970, only 34 percent of the households below the poverty level lived in low income neighborhoods, and 70 percent of the households living in such neighborhoods were above the low income line.[11] Patterns similar to Chicago occur in many other American cities.

Despite these data, however, there is clearly a disproportionate concentration of poverty within the central cities. In these areas, therefore, improvements in the physical condition of their housing by subsidized new construction or by other means only solve part of the problem. Indeed, they may worsen the situation by reducing the migration of the poor out of an unsuitable environment. In other words, the housing problems of low income groups cannot be attacked adequately without a variety of complementary policies that improve the environment in which their housing is located.

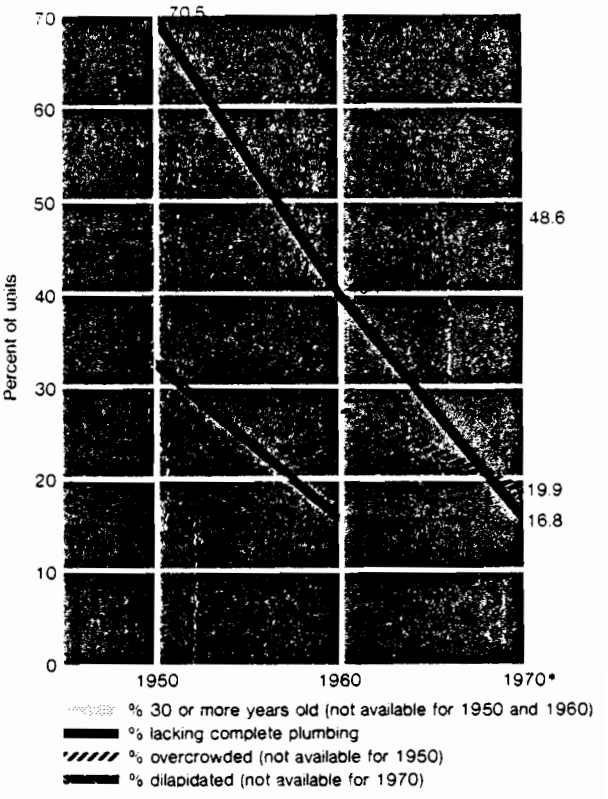
Housing for Minority Groups

One of the main reasons that minorities tend to be housed poorly is that they comprise a disproportionate share of the low income population. While the number of nonwhites[12] below the low income line fell from 11.5 million in 1960 to 8.0 million in 1970, 31 percent of the nonwhite population still remained in this category as compared to 13 percent of the entire population. Moreover, the median income of the poorest one-fifth of the nonwhites failed to make significant gains relative to the median income of the whole population. (See Chart 4.)

In addition to the problems posed by their low incomes, nonwhites still face housing discrimination, and strong patterns of racial segregation still prevail in most American cities. Growing incomes and antidiscrimination laws, however, have allowed significant housing gains over the last two decades. The proportion of nonwhite households lacking complete plumbing fell dramatically from 70.5 percent in

Chart 6

Characteristics of Housing Stock, Nonwhite Households 1950, 1960, 1970



*1970 data for black-occupied units only

Source: Department of Commerce, Bureau of the Census, Census of Housing, 1950, 1960, 1970.

[11] Office of Economic Opportunity, special tabulation of *1970 Census of Population*.

[12] The category "white" includes persons who indicated their race as white, as well as persons who did not classify themselves in one of the specific race categories on the Census questionnaire but entered Mexican, Puerto Rican, or a response suggesting Indo-European stock. The category "Negro", or black, includes persons who indicated their race as Negro or black, as well as persons who did not classify themselves in one of the specific race categories on the questionnaire but who had such entries as Jamaican, Trinidadian, West Indian, Haitian, and Ethiopian. The term "blacks and other races" or "nonwhite" includes persons of all races other than white.

1950 to 16.8 percent in 1970. The incidence of overcrowding fell from 28.3 percent in 1960 to 19.9 percent in 1970. But the improvement in the housing conditions of nonwhites has not been great enough to eliminate major housing problems for the Nation's minorities. (See Chart 6.)

Table 6 compares the housing and incomes of the median black household to that of the median Spanish American household and the median for the total United States population. For both renters and owners, the black median income is lowest; those of the Spanish Americans fall between those for blacks and the medians for the whole population. The same ranking applies to the median home value and median rent paid. The median Spanish American household is larger than that of the blacks and occupies fewer rooms.

Both groups undoubtedly still face housing discrimination, but only discrimination against blacks has been studied systematically. Because they face a restricted housing supply, blacks appear to pay more than whites of equal income for otherwise identical housing. The results of extensive empirical studies are not conclusive enough to specify the magnitude of these discriminatory premiums because it is difficult to isolate statistically the impact of discrimination from a myriad of other economic and location variables. A few of the studies that have been made of this difficult problem in several cities suggest that no significant discriminatory premium exists, but others estimate that a nonwhite buying a single-family home must pay 5 to 20 percent more than a white buying comparable living quarters.[13]

The housing problems of blacks and other minority groups go far beyond this discriminatory premium, however. Segregation in low income neighborhoods can lead to a highly unsatisfactory environment. Blacks confined to such an environment can improve their housing if they have sufficient income, but they still may have to endure high crime rates and send their children to inadequate schools. As a result, the improvement in housing conditions for nonwhites shown in Chart 6 may tell only a partial story: The quality of the nonwhite environment may not have improved nearly so dramatically as indicated.

In 1970, the approximately 764,000 American Indians constituted the poorest minority of all. The median family income of this group was only $5,832 in 1970, almost $3,800 below the national median family income. As their income would indicate, this minority is very poorly housed. Of the approximately 180,000 American Indian households, about 47,000, or 26 percent, occupied housing without complete plumbing facilities. A full 46 percent of all rural Indian households—49 percent of all Indian households—were living in dwellings lacking complete plumbing facilities in 1970. Thirty-one percent of all American Indian households lived in overcrowded housing in 1970, compared with only 8 percent of all American households. Clearly, American Indians occupy the worst housing of any American minority.

Migration

While increased incomes have facilitated a vast improvement in the quantity and quality of the Nation's housing stock, migration has been an important force determining its location. The most important movement has been from rural to metropolitan areas.[14] In 1900, only 40 percent of the Nation's inhabitants lived in an urban environment. By 1970, the proportion in metropolitan areas had risen to 69 percent, with a substantially higher percentage of the population living within commuting distance of metropolitan areas. In part, this trend reflects the steady decline in the relative proportion of the population engaged in farming. As the number of people engaged in farming declined from almost 32 million in 1920 to just under 10 million in 1970 their proportion of the total population declined from 30 percent to 5 percent.

[13] For a review of the literature see John Kain, "Background Paper on Housing Market Discrimination and its Implications for Housing Policy," a report prepared for the National Housing Policy Review, May 24, 1973.

[14] Metropolitan areas and Standard Metropolitan Statistical Areas are used interchangeably in this chapter to refer to all Standard Metropolitan Statistical Areas as defined by the Office of Management and Budget. The 1970 Census definition was "a county or group of contiguous counties which contain at least one city of 50,000 inhabitants or more, or 'twin cities' with a combined population of at least 50,000." There were 247 such areas in 1970.

More than 30 percent of the Nation's growth during the 1960's has occurred in metropolitan areas, which in 1970 had populations of 1 to 3 million people. In 1960, these cities and their surrounding suburbs had a total population of 35.4 million. Ten years later their population had grown to 42.9 million.

More than 25 percent of the increase in the population of metropolitan areas between 1960 and 1970 resulted from net immigration. The remaining three-fourths was the result of natural increase—more births than deaths. In 11 of the 19 Standard Metropolitan Statistical Areas with the greatest increase in population from 1960 to 1970, migration accounted for more than 50 percent of the population increase. Nine of these areas were located in the Southeastern and Southwestern portions of the country. (See Table 7.) During the 1960's, the most rapid growth occurred in Southern suburbs where the population rose 46.8 percent in 10 years. (See Table 8.)

In almost all regions the population growth was predominantly the result of natural increase. The one exception was the West, in which 43 percent of the total population growth was due to immigation (Table 9). In the North Central United States, there was a net loss due to net emigration of 752,000 persons.

As indicated by Table 7, the population of the central cities has not grown nearly as rapidly as their suburbs. In the Northeast, the total central city population declined 3.3 percent between 1960 and 1970. In the 10 major metropolitan areas with the greatest growth during the 1960's, all had larger suburban populations at the end of the decade than they had at the start, but only five contained central cities that had more inhabitants. Of these, four were in the South or West—New York City being the only exception. Of the 10 Standard Metropolitan Statistical Areas with the least growth, all but two had declining central city populations. (See Table 10.)

There have been other changes in growth and migratory patterns. During the 1960's, there was a continuing shift in the balance of the American population away from the Northeast and North Central regions. Although all regions experienced absolute increases in population, there was more growth in the South and the West.

Over the past 3 decades, blacks have been much more likely to migrate than have

Table 6. Characteristics of Black and Spanish American Households, 1970

Characteristic	Spanish American Households	Black Households	All Households
Median income of families and primary individuals			
Owner	$8,850	$6,500	$9,700
Renter	$5,740	$4,300	$6,300
Median home value [1]	$14,900	$10,700	$17,100
Median value/income ratio [1]	1.72	1.74	1.79
Median gross rent [2]	$99	$89	$108
Median gross rent as percentage of income [2]	20.6%	23.6%	21.0%
Median persons per household	3.6	3.0	2.7
Median number of rooms	4.5	4.6	5.1
Median persons per room	0.77	0.63	0.50

[1] One-family homes on less than 10 acres with no business on property.
[2] Excludes one family homes on 10 acres or more.
Source. Department of Commerce, Bureau of the Census, *1970 Census of Housing*.

whites. The main movement has been from the South to the Northeastern region of the country. Between 1950 and 1960, emigration from the South by blacks was equivalent to 14.4 percent of the South's 1950 black population. Between 1960 and 1970, the relative importance of emigration fell only slightly, to 12.2 percent.

Table 7. Total Population Change and Net Migration

Distribution of Net Increase in Metropolitan Population in Selected Major SMSA's—1960–1970

	Population Change 1960–1970 (Thousands)	Net Migration	
		Number (Thousands)	Percent
All metropolitan areas	19,824	5,307	26.8
Selected metropolitan areas	9,480	3,524	37.2
Los Angeles	993	253	25.5
New York	834	−87	−10.4
Washington, D.C.	797	417	52.3
Chicago	758	10	1.3
Anaheim—Santa Ana	716	551	77.0
Houston	567	310	54.7
Philadelphia	475	45	9.5
San Francisco	461	183	39.7
Detroit	438	−48	−11.0
Dallas	437	243	55.6
San Jose	422	283	67.1
Atlanta	373	200	53.6
Miami	333	254	76.3
San Bernardino	333	218	65.5
Minneapolis—St. Paul	332	99	29.8
San Diego	325	169	52.0
Seattle	315	184	58.4
Phoenix	304	188	61.8
Baltimore	267	52	19.5

Source: Department of Commerce. Bureau of the Census. *1972 Statistical Abstract*, table 20.

Over the same periods, black immigration to the Northeast was equivalent to 24.6 percent of the 1950 black population and 20.2 percent of the 1960 black population. Meanwhile, the white population was migrating southward and westward but at a very much slower relative rate. White immigration to the West between 1950 and 1960 was equivalent to 18.7 percent of the 1950 Western white population, while white immigration during the 1960's was equivalent to only 8.8 percent of 1960 population. Net outflows of whites from the Northeast and north-central regions was less than 3 percent of the base populations over the same 2 decades.

Much of the black migration was to the central cities. The black population in these areas grew 50.6 percent between 1950 and 1960 while the white population was growing only 5.7 percent. Between 1960 and 1970 the growth in the black central city population slowed somewhat to 31.6 percent, but the white central city population actually declined by 1.3 percent.

While the earlier section on low income neighborhoods suggested that blacks migrating to the central city moved into housing that was far below average in quality, it probably was still superior to their housing in the rural South. In other words, the vast migration that occurred is

Table 8. Percentage Change in Population Between 1960 and 1970

Residence	All Regions	Northeast	North-central	South	West
United States	13.4	9.1	11.0	13.5	24.2
Metropolitan	17.0	7.3	17.3	21.7	27.8
Inside Central Cities	1.5	−3.3	1.1	2.8	8.9
Outside Central Cities	33.5	17.4	35.7	46.8	44.0
Nonmetropolitan Areas	7.1	16.2	1.8	5.9	15.0

Source: Department of Commerce. Bureau of the Census. *Current Population Reports*. Series P-23. No. 37.

probably responsible for a part of the improvement in nonwhite housing noted earlier. Yet the rapid growth of the black central city population created many social problems because of that population's low incomes. Serving the new low income population was expensive for the central cities; higher tax burdens along with racial discrimination probably contributed to the emigration of whites to the suburbs. The whites took away a significant tax base as they moved, and this has undoubtedly restricted the quantity and quality of public services available to improve the living environments of the remaining central city population.

Considerations for the Future

By the year 1980, the population of the United States is expected to grow to between 228 and 237 million people.[15] These predictions correspond to rates of growth of 11.2 to 15.6 percent over the decade 1970–1980, as compared to a rate of growth of 18.5 during the 1950's and of 13.4 during the decade of the 1960's. The smaller rates of growth during the 1960's and in the first years of the 1970's reflect the declining birth rate.

During the 1970's, however, there will be a dramatic increase in the proportion of the population between the ages of 25 and 34. While the entire population will grow by about 23 to 32 million persons during the decade of the 1970's, the number of persons in this age group alone will increase about 11.6 million—

[15] The range results from the use of different fertility rates in arriving at these predictions. The lower number is based on a replacement birthrate, one which means the population would eventually stabilize. The higher is based on birthrates of 1964–1965. Department of Commerce, Bureau of the Census, *Current Population Reports*, Series P-25, No. 476.

Table 9. Components of Population Change: 1960 to 1970

Region and Race	Net Change Number (Thousands)	1960 to 1970 (Percent)	Natural Increase Number (Thousands)	1960 to 1970 (Percent)	Net Migration Number (Thousands)	1960 to 1970 (Percent)
United States	23,862	13.3	20,841	11.6	+3,020	1.7
Northeast	4,322	9.7	3,998	8.9	324	0.7
North Central	4,958	9.6	5,709	11.1	−752	−1.5
South	7,825	14.2	7,232	13.2	593	1.1
West	6,756	24.1	3,902	13.9	2,855	10.2
White	18,781	11.8	16,496	10.4	2,284	1.4
Northeast	2,744	6.6	3,264	7.9	−520	−1.3
North Central	3,649	7.6	4,910	10.2	−1,272	−2.6
South	6,851	15.8	5,045	11.6	1,806	4.2
West	5,547	21.5	3,278	12.7	2,269	8.8
Black	3,801	20.1	3,886	20.6	−85	−0.5
Northeast	1,314	43.4	702	23.2	612	20.2
North Central	1,126	32.7	744	21.6	382	11.1
South	753	6.7	2,132	18.8	−1,380	−12.2
West	609	56.1	308	28.4	301	27.7

Source: Department of Commerce, Bureau of the Census, *1971 Statistical Abstract*. Tables 10, 11, 13, 27, 42.

from 12.4 percent of the total population in 1970 to about 16 percent in 1980. This large increase will produce a rate of growth in the number of households far greater than the rate of growth of the population. The Bureau of the Census predicts that there will be between 76 and 77 million households by the end of this decade. This corresponds to an increase of 13 or 14 million and a rate of growth of 22 percent over the 10-year period. The 25–34 age group will account for about half of this increase, with the number of households headed by individuals between the ages of 25 and 34 growing by 6.1 to 6.6 million. Clearly, the country is entering an era of the young married household—a legacy of the World War II baby boom.[16] (See Chart 7.)

The basic household composition, how-

Table 10. Relative Growth Among Central Cities and Suburbs in Metropolitan Areas of 1,000,000 or More

(Thousands of Persons)

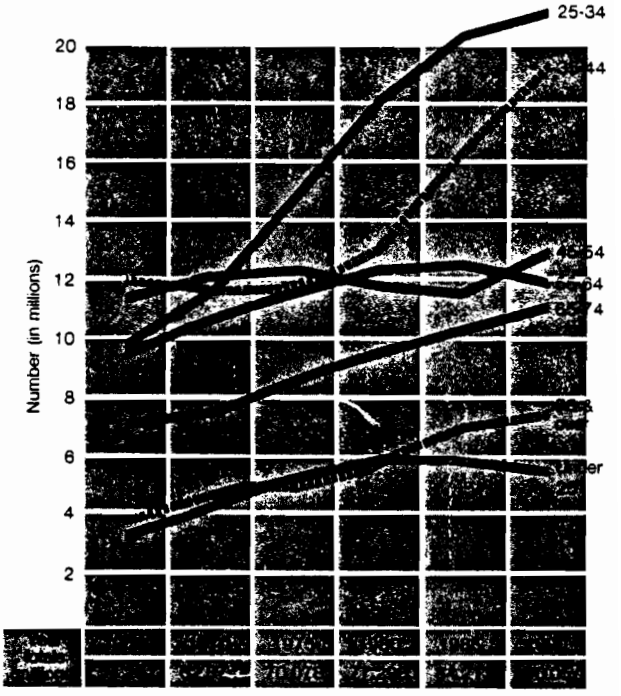
Metropolitan Areas	Net Change in Population, 1960–1970		
Areas with Greatest Growth	Total Metro-politan	Central City	Subur-ban
Los Angeles	993	352	642
New York	834	86	748
Washington, D.C.	797	−7	804
Chicago	758	−183	941
Anaheim—Santa Ana	716	157	559
Houston	567	295	272
Philadelphia	475	−54	529
San Francisco	461	−31	491
Detroit	438	−159	596
Dallas	437	165	272
Areas With Least Growth			
St. Louis	258	−128	386
Paterson-Clifton-Passaic	172	3	169
Newark	167	−23	190
Kansas City	161	32	130
Boston	158	−56	214
Cleveland	155	−125	280
Milwaukee	125	−24	149
Cincinnati	116	−50	166
Buffalo	42	−70	112
Pittsburgh	−4	−84	80

Source: Department of Commerce, Bureau of the Census. *1970 Census of Population & Housing*, PHC(2)–1.

[16] The predictions of the number of households and the composition by age of head are reported in two series of predictions by the Bureau of the Census. The difference between the two predictions is the result of different assumptions about the proportion of single person households and the number of persons ever married. The first, or higher series is based on the annual rates of change of singles and ever-marrieds during the period 1957–1969. The latter, and larger projection is based on a rate of change for singles and ever-marrieds one-half of that of the first series. The ultimate result should be somewhere in between.

Chart 7

Projected Number of Households by Age of Head



Source: Department of Commerce, Bureau of the Census, Current Population Reports, Series P-25, No. 476, Series 1 Projections.

ever, is not expected to change dramatically, but the trend to a higher proportion of single person households is expected to continue. The husband and wife household should continue to predominate, but will probably decline in relative importance. Correspondingly, nonfamily households, households with one spouse missing, and single person households will become relatively more important in terms of their proportion of total households.

Census projections suggest that the rapid rate of expansion in the number of households, which helped to spur the record rates of housing production in recent years, will subside by the 1980's. (See Table 11.) By 1990, the absolute increase in the number of households is expected to sink to pre-World War II levels.

The reduction in the rate of household formation will take some of the pressures off housing markets. But it must be emphasized that there are many other factors important to the demand for housing. Units will have to be produced to replace housing lost through deterioration or destroyed by natural disasters such as fires and floods. As incomes increase, individuals also will be able to afford to replace the low quality housing stock at a more rapid rate.

Table 11. Rate of Household Formation (1960–1990)

Period	Absolute Change (In millions)		Percent Change From Previous Period	
	Series 1	Series 2	Series 1	Series 2
1960–1965	(4.5)		(8.4)	
1965–1970	(5.6)		(9.8)	
1970–1975	7.2	6.5	11.5	10.4
1975–1980	7.2	6.7	10.3	9.6
1980–1985	6.9	6.4	8.9	8.4
1985–1990	5.8	5.4	6.9	6.6

Source: Department of Commerce, Bureau of the Census, *Current Population Reports*, Series P-25, No. 476.

In summary, production in the 1980's is likely to exceed that in the 1970's, but the explosive growth of the residential construction industry that has occurred in recent years will not have to be repeated.

7 Structure and Technology in the Housing Industry

Introduction

This chapter provides an overview of the structure of the U. S. housing industry, which for the purposes of this chapter is broadly defined as the builder of housing, the manufacturer of housing and housing components, and the manufacturer of mobile homes. It also highlights the technological and other developments that have brought about change in this industry in the last 5 years. It is not intended to give a comprehensive analysis of all the industries and government organizations that provide important goods and services to the housing industry. As a caveat, it should also be emphasized at the outset that information available on the housing industry is relatively scarce and sometimes of questionable accuracy. Accordingly, this report attempts to identify all sources as clearly as possible, with the understanding that conclusions and generalizations must be tempered, in some cases, with a certain amount of caution.

The Nature of the Industry

The portion of the housing industry dealing with the production of housing units has had two distinct industry sectors: traditional onsite homebuilding and mobile home manufacturing. The traditional homebuilding industry is extremely fragmented, comprising more than 110,000 builders—the majority of whom annually produce less than 25 units each. By contrast, the relatively young mobile home industry is made up of between 500 and 600 companies, including an unknown number of very small producers, and is fairly well concentrated within a small number of firms that account for a large proportion of total production. There are few barriers to entry in the traditional homebuilding field. In contrast, entry is more difficult in mobile home manufacturing, where long-term capital investment is required for all but the smallest operators.

It is fair to say that in recent years, these differences between conventional homebuilding and mobile home manufacturing have begun to erode somewhat. The increasing use of prefabrication and other forms of industrialization, for example, have begun to move major elements of homebuilding into the factory, where most mobile homes have always been produced. Moreover, a growing amount of concentration and diversification by both sectors of the industry has led to a situation where a fair number (some 20 to 50) of the largest corporations are involved in both traditional homebuilding and mobile home manufacturing. Although trends such as these appear to be blurring the distinctions between the two industry sectors to some extent, the differences are still greater than any similarities.

In 1972, the traditional homebuilding sector started 2,378,500 housing units, while completions—a better measure of production performance—reached 1,999,200 units, up 47 percent from the 1,360,500 units completed in 1968. Completions of privately owned single-family units totaled 1,143,300 in 1972, a rise of 33 percent from 1968's 858,600 units. Privately owned multifamily unit completions increased at a far greater rate; the completion of 828,200 units in structures with two or more units represented an 80 percent increase over the 461,200 multifamily units completed in 1968.[1] Meanwhile during 1972, the mobile home manufacturing sector produced and shipped 575,940 mobile home units to dealers and land developers, including more than 85,000 double-wide units (another 25,000 units were produced to house disaster victims and provide shelter to meet other special needs). The basic mobile home output was an increase of more than 80 percent over the 317,950 units shipped in 1968.[2]

While data are not available on the length of time that elapses between shipment of mobile homes by manufacturers, and sale and placement onsite by dealers, there is evidence that it now takes longer to complete a conventional housing unit than was formerly the case. In 1968, a single-family unit needed, on the average, 4.3 months after construction start to be completed. In 1971, the average time necessary was 4.8 months, and in 1972, the period

[1] Department of Commerce, Bureau of the Census, *Construction Reports*, C22-73-5.

[2] Mobile Home Manufacturers Association, *Mobile Home Shipments and Production*, 1972 Annual Report.

had increased to 5.2 months. Construction time for multifamily buildings exhibited similar increases; an apartment building with 10 to 24 units required an average construction time of 7.3 months in the period 1963 to 1967, 8.5 months in 1971, and 9.3 months in 1972.[3] Some of the recent lengthening of the construction process has been due to spot shortages of certain materials or craft skills. Materials and parts substitutions, and industrialization of the construction process offer some solutions to many of these problems, and should help to achieve a balance between industry capacity and the expanded demand for housing production.

Structure of the Traditional Homebuilding Sector

During 1972, the U. S. homebuilding industry produced almost $45 billion of new residential construction, making it one of the largest and most important segments of the domestic economy. Yet, unlike other industries of comparable size such as steel or automobiles, the homebuilding industry is characterized by many small firms with relatively short existences. Housing demand and production are highly cyclical due largely to fluctuations in the supply of mortgage credit, while equity capital requirements are minimal compared to those of other industries. As a result, firms move in and out of the industry with great frequency, and it is difficult to determine precisely the number of housing producers that are operating at any given time. It is estimated[4] that, as of 1967, roughly 110,000 homebuilding firms were in operation. In spite of the ease of entry, however, minority-owned construction firms continue to be quite rare.

The transitory nature of many of these homebuilding firms is evidenced by the fact that in 1967, about one-third did not have a payroll. The backbone of the industry consists of individual craftsmen, real estate operators, and other small entrepreneurs who may build housing during periods of plentiful mortgage credit and turn to other activities during periods of tight money. (See Chapter 3.) Other features that characterize the bulk of homebuilders operating in the U. S. are the following.

Emphasis on Single-Family Dwellings: Builders' responses to a 1969 National Association of Home Builders' survey indicated that fewer than 10 percent of those surveyed considered multifamily building their primary product. Homebuilders with unit production of less than 100 units were more likely to indicate custom homes or single-family homes to be sold on the speculative or open market as their primary products. On the other hand, larger producers (more than 100 units) were likely to be engaged in multifamily and/or speculative single-family building. (See Table 1.)

Flexible Business Strategies: Many homebuilders tend to "switch businesses" according to perceived market demands and/or the supply of money. They will also often engage simultaneously in the related businesses of speculative building, custom building, rehabilitation and remodeling, land development, and commercial and industrial construction. This has enabled many of them to survive financially when the residential housing market declines, thereby giving them the resilience to reenter that market when conditions improve.

Table 1. Percentage of Firms or Operators by Category

Primary Product Operation	Total 1969 Survey	Builders Surveyed		
		Small (1–25 units)	Medium (26–100 units)	Large (101+ units)
Speculative single family	20.4%	19.8%	33.0%	34.7%
Custom single family	19.0	28.8	13.8	4.2
Multifamily	9.3	4.8	13.5	31.7
Not classified above	51.3	46.6	39.7	29.4

Source: National Association of Home Builders, *Profile of the Builder and His Industry*, 1969.

[3] Department of Commerce, Bureau of the Census, *Construction Reports*, C30–70–1 Supplement; C20–72–7; C20–73–6.

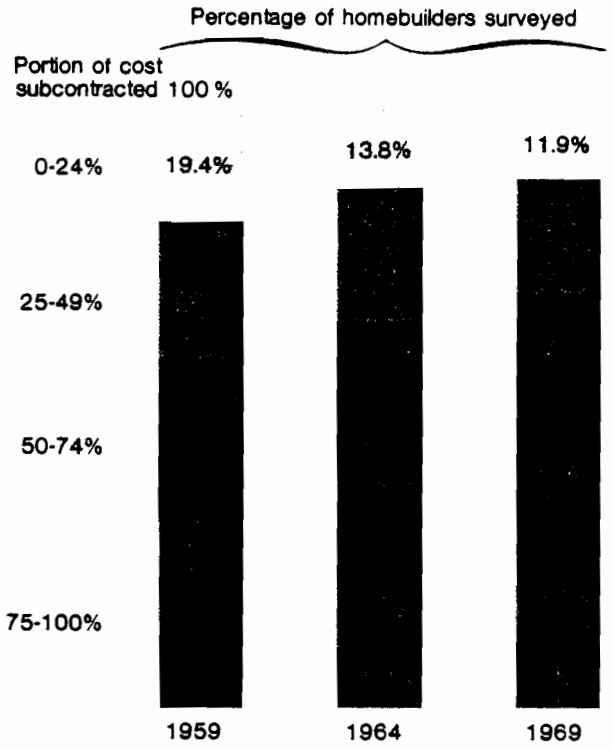
[4] Based on *The 1967 Census of Construction Industries*, Department of Commerce, Bureau of the Census.

High Incidence of Subcontracting: According to the 1969 National Association of Home Builders' survey, nearly 90 percent of the homebuilders surveyed subcontract at least 25 percent of their costs of construction. (See Chart 1.)

Increasing Proportion of Sole Proprietorships: According to the same survey, about 37 percent of U. S. homebuilders are organized as sole proprietorships and 45 percent as corporations, with the remainder being partnerships or a combination of forms. However, when the 1969 figures are compared with the National Association of Home Builders' 1964 survey, the proportion of builders organized as sole proprietorships had risen from 30 percent to almost 37 percent in 5 years. (See Chart 2.) Sole proprietorships are especially prevalent among single-family builders and producers of one to 25 units. These builders are the most likely to remain a short time in the industry and, therefore, the most likely to opt for a simple and inexpensive mode of entry. Conversely, among producers of more than 100 units annually, the corporate form of organization is most common, reflecting the need for greater financial resources and the limited liability features of incorporation. (See Chart 3.)

Chart 1

The Importance of Subcontracting by Builders



Note: Percentages may not add to 100.0 because of rounding.

Source: National Association of Homebuilders, Profile of the Builder and His Industry, 1969.

The Large Homebuilders

Although little further detailed information is available on the industry as a whole, considerably more can be said about the few large homebuilders at the top of the industry—i.e., those companies that either have annual sales of more than $10 million or annual volume of more than 200 units. Overall, it appears that these firms, which represent less than 1 percent of the firms in the homebuilding sector, tend to be comparatively stable, relatively well-capitalized corporations. They are characterized by:

1. An increasing share of the market—28 percent of 1972 housing production and 23.5 percent of dollar revenues in that year;
2. A high level of acquisition and merger activity; and
3. Uneven financial performance.

Despite their similarities, however, these large firms show distinct differences in terms of geographic span of operations, the incidence of public ownership, organizational structure, and other operating characteristics. The following sections discuss these key similarities and differences. It is important to emphasize, however, that these large homebuilders are the exception rather than the rule in this industry: Small homebuilders producing fewer than 200 units a year remain the dominant force representing over two-thirds of the market.

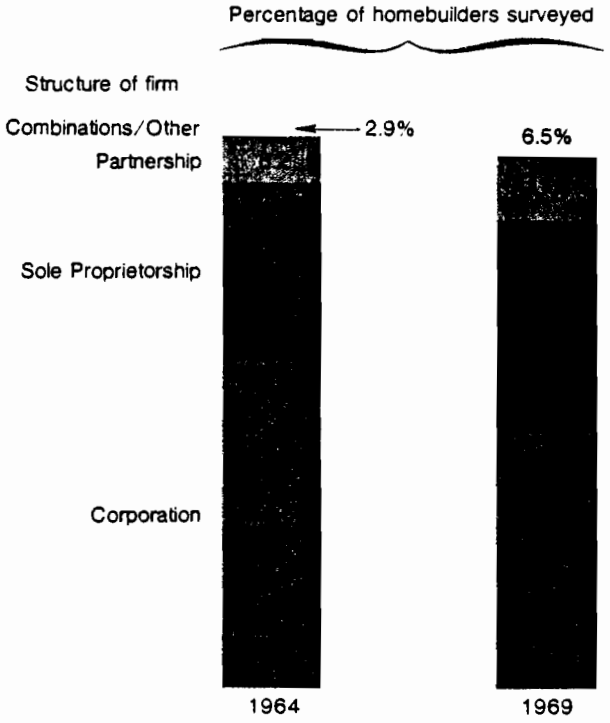
An Increasing Share of the Market: According to an annual survey prepared by *Professional Builder,* the number of homebuilders with more than $10 million in annual sales

grew from 119 in 1968 to 369 in 1972.[5] Observing the emergence of large homebuilding firms from another point of view, the *1973 Bluebook of Major Homebuilders* reports that the 511 builders with annual volume of more than 200 units have captured an increasing share of the market over the last few years. As shown in Chart 4, the unit volume of these builders represented 17.2 percent of total housing production in 1969. By the end of 1972, this share had increased to 28 percent. Moreover, about three-quarters of this 1972 share is attributable to the 225 firms with volume of more than 1,000 units annually. In terms of dollar volume, the value of housing constructed or manufactured by the largest homebuilders has increased steadily as shown in Table 2.

[5] The sales figures also include nonhousing-produced revenue. In addition, these are not constant dollars and therefore some portion of the firms entered the "giant" category solely by virtue of inflation.

Chart 2

Organization of the Homebuilding Industry



Note: Percentages may not add to 100.0 because of rounding.

Source: National Association of Homebuilders, Profile of the Builder and His Industry, 1969.

Table 2. Dollar Volume of Housing "Giants" [6]

(Housing Revenues)

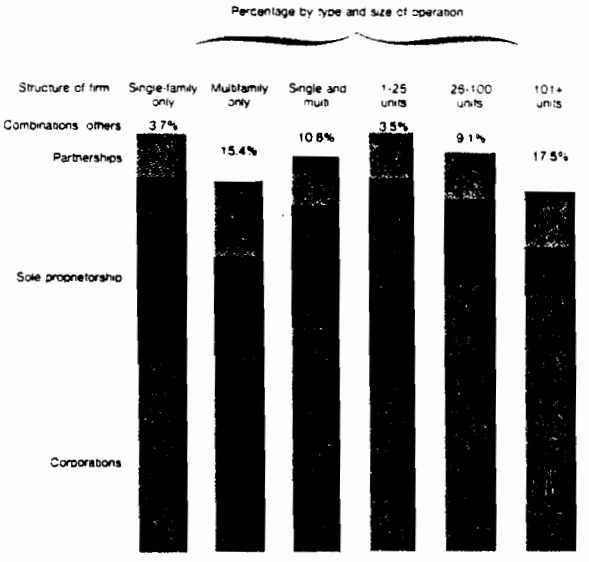
Year	Volume (Millions of Dollars)
1968	$2,670
1969	5,356
1970	6,833
1971	9,132

Source: *Professional Builder* magazine, July issues, 1969 to 1972.

[6] *Professional Builder* magazine defines "giants" as those homebuilders with sales greater than $10 million annually.

Chart 3

Structure of Firms by Type and Volume of Production



Note: Percentages may not add to 100.0 because of rounding.

Source: National Association of Homebuilders, Profile of the Builder and His Industry, 1969.

Although major homebuilders continue to increase total dollar volume and to capture a growing share of the total number of units produced, in 1972 their share of the industry's total dollar volume decreased (Chart 5).[7] Because small builders are more susceptible to cyclical factors, their volume declines during housing recessions more than that of the major homebuilders. The larger firms sometimes even maintain or increase their dollar volume in the face of recession, thus increasing their share of the market. In housing booms, the reverse occurs. Small builders grow faster than large builders, thus reducing the market share of the latter.

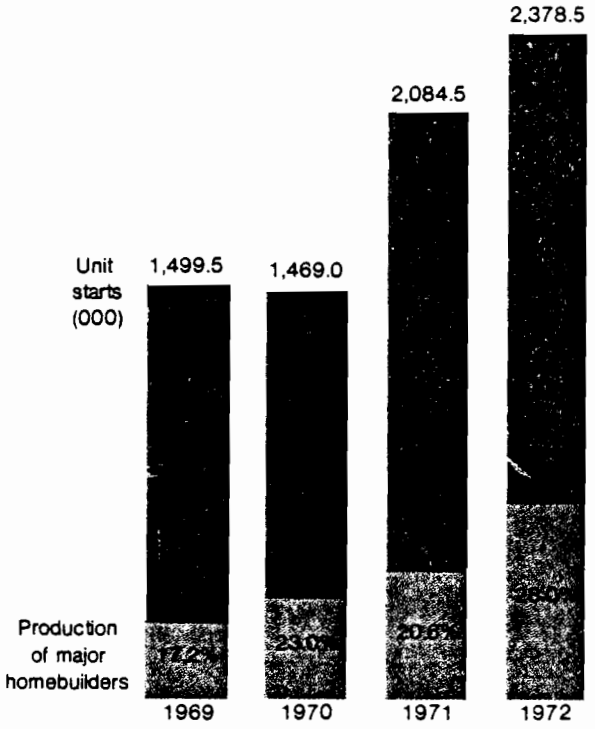
High Level of Mergers and Acquisitions: A high level of merger and acquisition activity has been associated with recent industry concentration, at least on the part of the publicly held homebuilders, whose activities are recorded. Industry observers feel, however, that this trend also is occurring among most large homebuilders—whether or not they are publicly held—and has been continuously occurring over time throughout the industry.

Between 1969 and 1972, 31 publicly held homebuilders with annual revenues exceeding $25 million engaged in a total of 84 mergers or acquisitions. This level of merger activity is extremely high compared to that of other industries. Among the top 200 manufacturing and mining firms, for example, the average number of mergers/acquisitions per company was 0.17 per year during the same period. By contrast, the average for the 31 publicly held homebuilders was 0.68 per year—about 4 times as many. Although this comparison is not a totally fair

[7] Chart 5 uses value put in place as a measure of total dollar volume. However, the sales of "giant" homebuilders as defined by *Professional Builder*, which is used to determine market share, include land sales. Therefore, the estimate of the share of "giant" homebuilders is somewhat overstated.

Chart 4

Market Share of Major Homebuilders

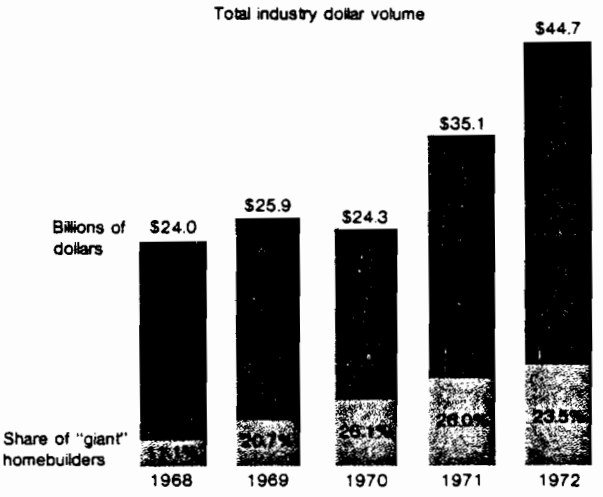


Note: Data exclude mobile home production.

Source: Department of Commerce, Construction Reports, C20-73-3; CMR Associates, Inc., Bluebooks of Major Homebuilders, 1970-1973.

Chart 5

Dollar Volume and Market Share of "Giant" Homebuilders



Source: Department of Commerce, Construction Reports, C30-73-6; Professional Builder Magazine, July issues 1969-1973.

one, due to the obvious differences between construction and manufacturing, it does provide some insight into current merger and acquisition activity in the industry.

Major homebuilders have been merging with and acquiring other firms for three principal purposes. First, they may wish to diversify into broader product lines. In response to the high unit cost of and diminishing growth in single-family detached housing, for example, a single-family homebuilder might acquire firms with capability to construct garden apartments, mobile homes, or townhouses. Of the identified mergers and acquisitions made by the 31 large publicly held homebuilders, 43 percent were actions that provided such product line diversification.

Geographic expansion is another important motivation behind merger and acquisition activity, representing about 32 percent of the mergers/acquisitions identified. Geographic expansion provides the benefit of shielding the builder from the possibility of serious dislocations in a single market area. Many large firms undertake geographic expansion through acquisition of existing builders in order to profit by the established builder's reputation and relationship with local governments and building officials. The importance of quickly gaining an understanding of local market preferences, suppliers, and sources of labor subcontractor capability is obvious. The diversity of local building codes is also a key force behind acquisition of this kind.

Finally, vertical integration has accounted for 25 percent of the mergers and acquisitions identified. Such integration generally has taken the form of combinations with building supply organizations, housing fabricators, land development enterprises, and financial institutions.

Despite this high level of merger/acquisition activity, economic concentration of homebuilding is still relatively low, with the largest homebuilding firm accounting for less than six-tenths of 1 percent of the Nation's total conventional housing production.

Uneven Financial Performance: Assessing the financial performance of the traditional homebuilding industry is extremely difficult. Any generalizations made about this area must be particularly guarded. Because of the fragmented nature of the industry, no meaningful financial statistics have been collected on a comparative basis for the bulk of U. S. homebuilders, which are proprietorships, partnerships, and closely held private corporations. Moreover, even among publicly held corporations and subsidiaries that must provide public financial statements, nonhomebuilding activities undertaken by these corporations are pooled with or incorporated into the financial results for homebuilding activities. The situation is further complicated by the fact that the accounting profession is currently redefining some important principles that apply to homebuilders. As a result, year-to-year comparisons may be somewhat inconsistent and misleading.

Despite these constraints, however, an analysis of the financial performance of 11 large, publicly held homebuilders with relatively uncomplicated income statements provides some insights into the financial structure and

Table 3. Average Financial Performance of Selected Major Homebuilders

Year	Return on Equity	Return on Assets	Gross Margin	Return on Sales	Equity as a Percentage of Assets	Sales/Assets
1972	23.8%	7.8%	20.3%	5.6%	41.3%	1.094
1971	31.8%	10.0%	19.7%	5.7%	37.5%	1.072
1970	33.8%	7.1%	19.3%	5.3%	31.8%	1.057
1969	17.5%	7.2%	19.0%	4.8%	35.7%	1.490

Source: *Professional Builder Magazine*, July issues, 1970–1973.

percent over the same period. Households also became less crowded, with the median number of persons per room falling from about 0.75 to 0.50.

The data for the "typical American" obscure some important differences, however, between the living conditions in central cities, suburbs, and rural areas. Table 3 shows that median incomes for owners and renters were highest in the suburbs. The median home value-to-income ratio was also highest in the suburbs, as was the median number of rooms. But the number of persons per room was somewhat greater in the suburbs than in central cities. This statistic, however, does not clearly indicate the degree of overcrowding in many central city households. The median for the central cities was lowered by the presence of large numbers of single-person households, which are rarer in the suburbs.

In general, the medians for central city and nonmetropolitan areas also do not reflect the poor housing conditions of the low income populations in these areas; these conditions are considered in detail in the next section.

The Housing of Low Income Americans

A low income makes it difficult for consumers to afford good housing, adequate food, clothing, and other essentials of life. The inferior housing so often occupied by low income families is only one manifestation of fundamental social and economic problems.

Over the years, the size and composition of the Nation's low income population have changed. The number of people whose incomes were below the Bureau of the Census' low income threshold[4] has declined significantly during the 1960's—from 39.9 million, or 22 percent of the total population in 1960, to 25.5 million, or 13 percent of the 1970 population. During the same period, the proportion of the aged within the low income population increased from 14 percent to 18 percent of the total. The only group to increase in absolute number was that of households headed by nonwhite females. This group grew in number by 700,000 between 1960 and 1970 and, as a percentage of the total low income population, nearly doubled from 8 to 15 percent. The percentage of all nonwhites of low income increased from 29 to 31 percent while their numbers dropped from 11.5 to 8.0 million. (See Table 4.)

[4] In 1960 the low income threshold for a nonfarm family of four equaled $3,022. In 1970, the threshold for the same family was $3,968. In 1972, this figure had increased to $4.275 and the number of persons below the low income threshold had decreased to 24.5 million, or 11.9 percent of the population.

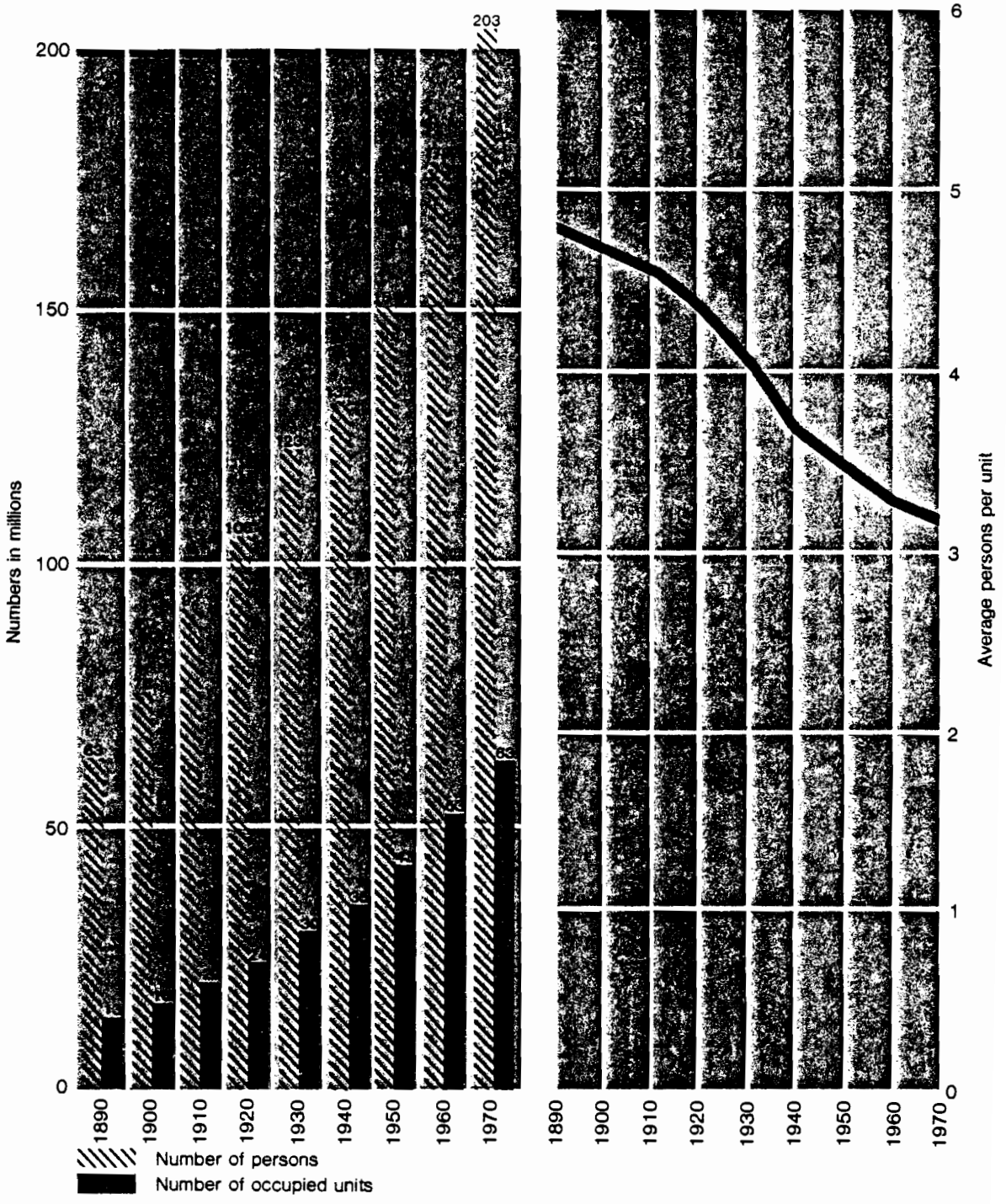
Table 1. Selected Characteristics of the Housing Stock by Region, 1970

	Total Year-round Units (number)	Units in One-unit Structures (percent)	Units in Structures of 5 or More Units (percent)	Units Over 30 Years Old (percent)	Units Lacking Some or All Plumbing Facilities (percent)	Median Rooms Per Unit (number)	Median Persons Per Unit (number)
Northeast	16,197,862	54.2	22.4	55.2	3.9	5.1	2.7
North Central	18,675,232	71.9	11.5	49.1	6.2	5.1	2.7
South	20,883,566	77.7	9.8	29.4	11.9	4.9	2.7
West	11,942,424	69.9	16.9	26.8	3.3	4.7	2.5
U.S.	67,699,084	69.1	14.5	40.6	6.9	5.0	2.7

Source: Department of Commerce. Bureau of the Census. *1970 Census of Housing.*

Chart 2

Population and Number of Occupied Units: 1890-1970



Source: Department of Commerce, Bureau of the Census, 1970 Census of Housing.

profitability of at least the largest participants in the industry. Average historical financial data for these firms in the years 1969 through 1972 are presented in Table 3.[8]

Financial Leverage: Financial leverage is defined as a firm's ability to augment its own equity with the financial resources of others—e.g., through issuing long-term debt and drawing on lines of credit.

There is a wide variance in the extent to which different firms use equity to finance asset holdings. Moreover, equity as a percentage of assets varies significantly from year to year in a single firm. For the average of all firms represented in the charts, the equity-asset ratio is higher in 1971 and 1972 than in 1969 and 1970, but the period studied is too short to establish a reliable trend.

Profit Margins: A major factor affecting return on investment is profit margin, or return on sales. Although many individual companies have experienced shifts in profit margins, average return on sales has not varied markedly for these selected companies during the past 4 years—i.e., from 4.8 percent in 1969 to 5.6 percent in 1972.

Velocity of Asset Utilization: Another component of the profit mechanism is the velocity of asset utilization, or the dollar volume of sales as a multiple of total assets employed. The basic rule applied is that the more effectively assets are utilized (or turned over) to make a profit, the lighter the burden of their fixed costs—i.e., interest and dividends. Asset velocity appears to have declined from the 1969 high, perhaps as a result of the increased size of these 11 large, publicly held builders.

Key Differences in Operating Characteristics: Although it can be assumed that the major homebuilders are different from the remaining thousands of small builders, important operating differences exist even among the approximately 500 firms that produced more than 200 units in 1972. To highlight these differences, a recent independent study conducted for HUD examined the 511 homebuilders identified by the "Bluebook of Major Homebuilders" in three groups: (A) the top 25 homebuilders in unit volume (Group 1); (B) a sample[9] of builders ranking from 26 to 200 inclusive in unit volume on the "Bluebook's" list (Group 2); and (C) an equal sample of builders whose unit volume places them between 200 and 500 on the list (Group 3). In analyzing the differences among these three segments, quite significant variations were found in terms of the following considerations.

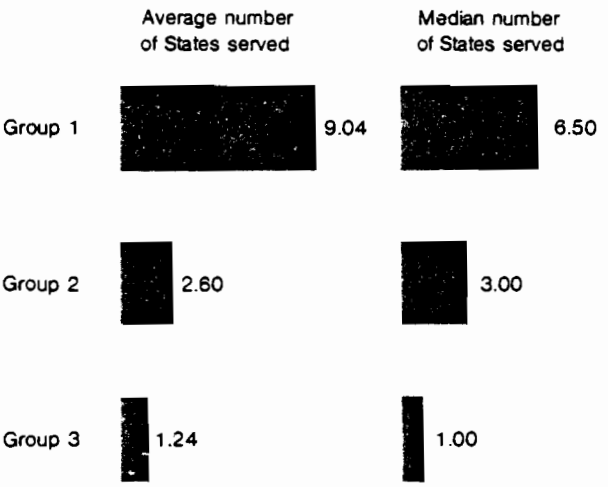
Geographical Span of Operations: As Chart 6 indicates, Group 1 builders operate in an average of nine States, while Group 2 firms typically operate in fewer than three States, and Group 3 firms primarily in one State only. However, it should be noted that all Census-defined regions of the country have experienced growth in the number of major homebuilders (Chart 7). Further, only the top 25

[8] Averages used are unweighted. Because of this and the variations in nonavailable data, the averages are only approximate indicators of the performance of this particular class of homebuilders.

[9] The sample size equaled 25.

Chart 6

The Relationship Between the Size of the Homebuilder and the Number of States Served



Source: CMR Associates, Inc., The Bluebook of Major Homebuilders, 1973.

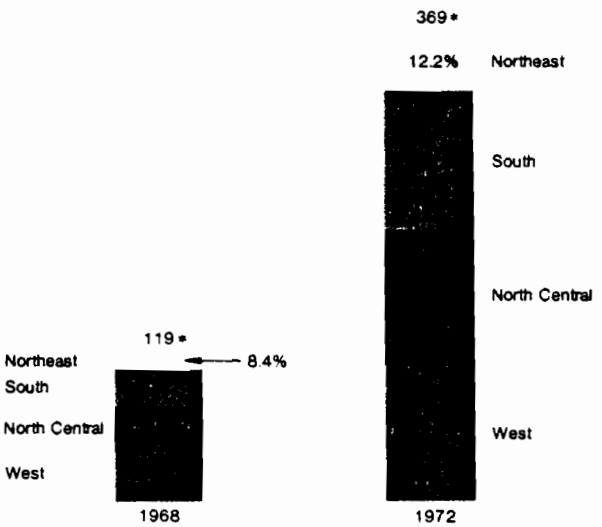
builders are multiregional. While six of these builders are known to operate on a nationwide basis, the average number of regions served is between two and three. Although operating data are not available on the smallest builders (i.e., those with annual volume of fewer than 200 units), one could conclude that the vast majority operate in only one marketing area. Thus, given that the smallest homebuilders represent more than 99 percent of all homebuilding firms, the industry is primarily a "local" business.

Ownership: As might be expected, the larger the homebuilding firm, the more likely it is to be publicly held (Chart 8). More than half of the top 25 are publicly held, while only 24 percent of the Group 2, and 20 percent of the Group 3, are publicly held. Although the transformation into public entities has provided these companies with a more stable source of capital, many have experienced severe personnel turnover problems. The bulk of homebuilding enterprises begin as "one-man" entrepreneurial operations and usually continue as such as they grow. Even the largest operations are today heavily dependent upon the personal style and leadership of "one-man" or are a confederation of "one-man" entities. When a chief executive becomes responsible to shareholders rather than himself, the situation changes considerably. For one thing, the entrepreneurial rewards formerly available as the result of profitable "deals" are replaced by more standard salary, bonus, and fringe benefit packages.

A further complication occurs when a public organization unfamiliar with the operating styles of homebuilding acquires a homebuilder. In such cases, the chief executive is compelled to conform to corporate procedures that may or may not be appropriate to housing production. As a result, executive turnover among publicly held homebuilders acquired by publicly held corporations has been high.[10] Of 14 recently acquired homebuilders, for example, only four of the acquired chief executives are still with their companies.

Chart 7

The Regional Concentration of Major Homebuilders



*Number of Headquarters.

Note: Percentages may not add to 100.0 because of rounding.

Source: Professional Builder Magazine, July 1973, p. 107.

Internal Organization: Among the large homebuilders, four distinct types of internal organization are typically employed:

1. Decentralized Management. Group 1 firms and some Group 2 firms typically adopt a regionalized organizational structure and delegate a large share of responsibility to the field. The field organization is supported by an operating staff at the regional level for finance, marketing, engineering, and construction. Headquarters executives review major decisions in terms of performance against plan, and are supported by a specialized budgeting and planning staff.

2. Coalition. Some Group 1 firms and the larger Group 2 enterprises employ a "coalition" form of organizational structure. This semicentralized form of organization essentially repli-

[10] A survey of the Nation's largest homebuilders recently conducted by the management consulting firm, McKinsey & Company, Inc., reported that the upper third of those homebuilders experiencing turnover realized an average annual loss of 35 percent of their middle managers. Another recent McKinsey study of the activities of insurance companies in real estate development operations reported "high turnover" among top, middle, and project managers.

cates small- to medium-sized building companies in each of the regions in which the firms operate, with a small central staff devoted primarily to financial management.

3. Centralized Management. Typical of the small Group 2 and larger Group 3 firms is a highly centralized structure that attempts to use management processes to reinforce the effectiveness of the organization's key decision-maker—usually the founding entrepreneur. This form of management places a small, expert project management team in the field at each project and centralizes all other staff, so that top management has access to them and can review all major operating decisions.

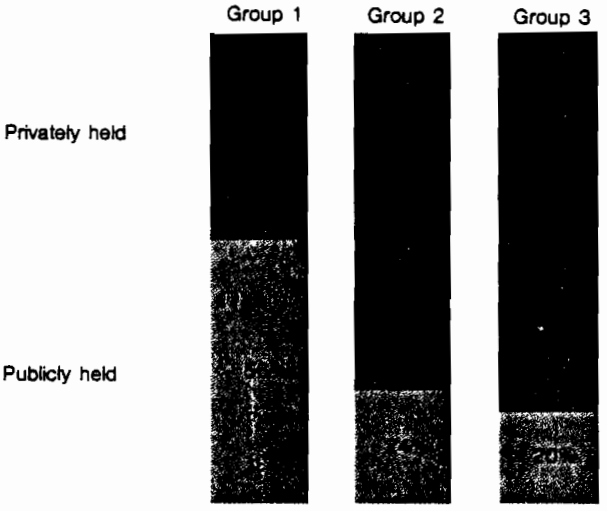
4. "One-Man" Management. The bulk of Group 3 and smaller entities employ a highly centralized form of management in which their chief executives (and close associates or members of their families) make all the operating decisions. In such cases, the small central staff spends much of its time onsite, and part-time specialists are employed on a project basis for accounting, financial management, design and engineering, and legal matters.

Type of Dwellings Built: In terms of product lines, there appear to be no dramatic differences among the three groups of large homebuilders. (See Chart 9.) Unlike the majority of homebuilders, the largest firms in the industry produce relatively more multifamily units than single-family, with the major share of the volume being derived from lowrise apartments. However, while the product mix of Group 2 builders has not changed significantly from 1969 to 1972, the top 25 builders have been diversifying out of single-family detached production into townhouses and highrises. Similarly, Group 3 firms also have been diversifying into townhouses.

The Use of Industrially Produced Parts: As might be expected, Group 1 homebuilders

Chart 8

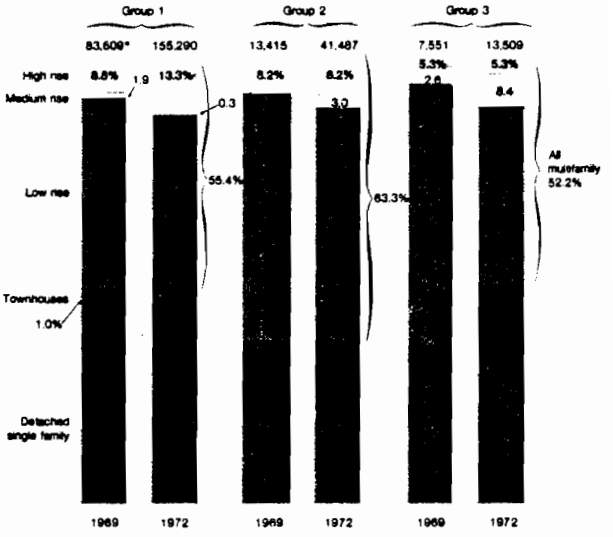
Incidence of Public Ownership by Size of Builder



Source: McKinsey and Company, Inc., "Analyzing Trends in the Housing Industry," a study prepared for the National Housing Policy Review, using data from CMR Associates, Inc., The Bluebook of Major Homebuilders, 1973; and Standard and Poor's.

Chart 9

Product Mix by Size of Builder



*Volume in units.

Note: Percentages may not add to 100.0 because of rounding.

Source: CMR Associates, Inc., Bluebooks of Major Homebuilders, 1970 and 1973.

use major premanufactured parts more extensively than Group 2 or 3 firms. (See Chart 10.) Of the top 25 builders, 60 percent report using industrially produced parts and components in 52 percent of their production. In many cases, these parts and components are manufactured in company-operated factories and then assembled onsite. Many executives of Group 1 firms anticipate a growing reliance on such methods of operation.

Structure of the Mobile Home Manufacturing Sector

Compared with the traditional homebuilding sector, the mobile home manufacturing segment of the housing industry comprises a relatively small number of firms,[11] with most activity concentrated among a relatively few firms. In addition, mobile home manufacturers are generally well-capitalized organizations, utilizing production-line fabrication techniques and distributing through dealerships. Although on a slightly different scale, the mobile home manufacturing sector has shown the same type of trends, however, that can be seen within the high-production segment of the homebuilding industry—i.e., increasing concentration, heavy merger/acquisition activity, and uneven financial performance.

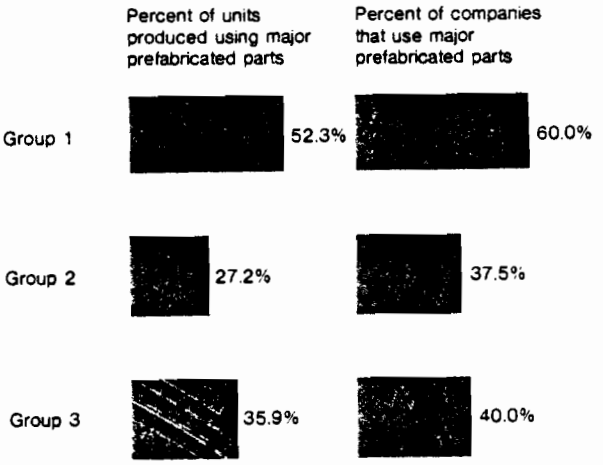
Concentration of the Industry: The Mobile Home Manufacturers Association recently estimated that about 335 mobile home manufacturers operate in the U.S., a number less than one-half of 1 percent of the number of firms engaged in traditional, onsite homebuilding. Among this relatively small number of companies, industry activity has become increasingly concentrated among the largest firms. The market share of the top 25 producers in terms of unit volume has grown from 53 percent to 63 percent during the period from 1969 to 1972. (See Chart 11.)

[11] This does not include an unknown number of very small operators who produce a few units per year. In total, it is estimated that there are between 500 and 600 producers of all sizes.

The reasons behind such concentration can be traced to the nature of the industry. To a far greater extent than is possible for onsite homebuilders, the operations of mobile home manufacturers lend themselves to economies of scale and other operating benefits achieved through increases in size. In an industry where

Chart 10

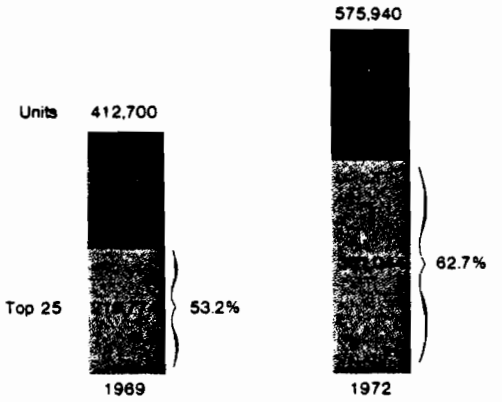
Use of Fabricated Parts by Size of Builder



Source: CMR Associates, Inc., The Bluebook of Major Homebuilders, 1973.

Chart 11

Market Share of the Top 25 Mobile Home Manufacturers



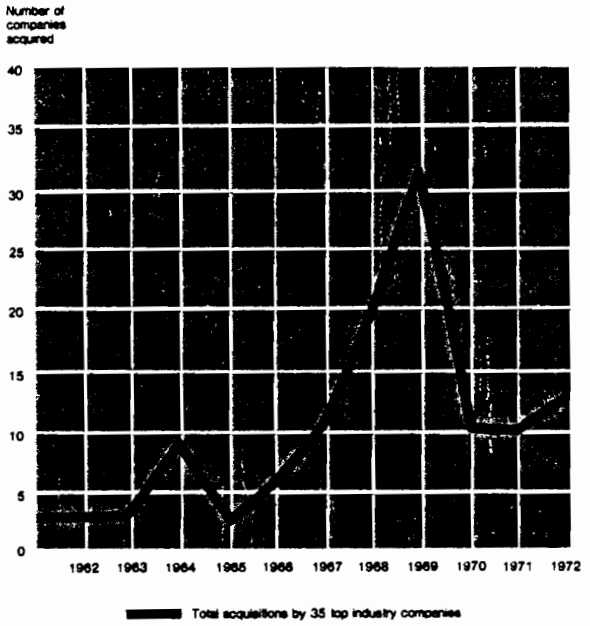
Source: Mobile Home Manufacturers Association.

the cost of purchased materials typically accounts for more than 50 percent of the total cost per unit, purchasing control and quantity price agreements are particularly significant. One of the top mobile home manufacturers believes that its purchasing power and skill have been the key factors in maintaining high profitability in the face of escalating costs.

Although it cannot be determined whether such concentration will continue, most of the largest mobile home manufacturers have built extensive new facilities over the last few years and have initiated ambitious expansion plans for the future. In 1972, for example, one of the top five producers added 10 new plants and anticipates adding another 10 each year for the next 4 years. Similarly, seven out of 32 companies with sales in excess of $25 million added two or three plants each last year. While it is difficult to identify the type and amount of expansion that is occurring among the smaller, privately held companies, one can speculate that their rate of expansion is not as high due to comparatively limited capital resources.

Chart 12

Acquisition Activity in the Mobile Home Industry



Source: McKinsey and Company, Inc., "Analyzing Trends in the Housing Industry," a study prepared for the National Housing Policy Review, using data from Standard and Poor's.

High Level of Merger and Acquisition Activity: The benefits of economies of scale, purchasing power, and broad geographic penetration have been instrumental in spurring the high level of merger and acquisition activity that has occurred in this industry segment, particularly during the late 1960's and to a lesser extent in the 1970's (Chart 12). From 1969 to 1971, merger and acquisition activity in the mobile home manufacturing sector exceeded levels in the overall manufacturing and mining industries—an annual rate of 0.47 mergers/acquisitions per company[12] compared to 0.17 for the 200 largest manufacturing and mining concerns. This level of activity is less than that in the traditional homebuilding industry, probably because the industry is smaller and already much more concentrated, thereby limiting the number of possible mobile home manufacturers that are candidates for merger and acquisition.

An analysis of mergers and acquisitions recorded by Standard and Poor's between 1962 and 1972 shows that nearly 120 such actions involved mobile home concerns (Chart 13). Of these, the largest number—over 40 percent—were horizontal combinations of mobile home manufacturers that led to production or purchasing economies of scale, and, perhaps more importantly, geographic penetration. In order for a mobile home manufacturer to penetrate a new market, it must either build or acquire a plant in that locale. This is because the high cost of transporting mobile homes limits the profitable distribution in most cases to within 300 to 500 miles of the manufacturing facility.[13]

Although the great bulk of mergers and acquisitions during the last decade has been within the industry itself, 23 percent of the actions identified have been recent acquisitions by large, diversified corporations seeking a

[12] McKinsey & Company, Inc., "Analyzing Trends in the Housing Industry," a 1973 study prepared for the National Housing Policy Review, using data for 35 of the largest publicly held mobile home companies for which public information is available.

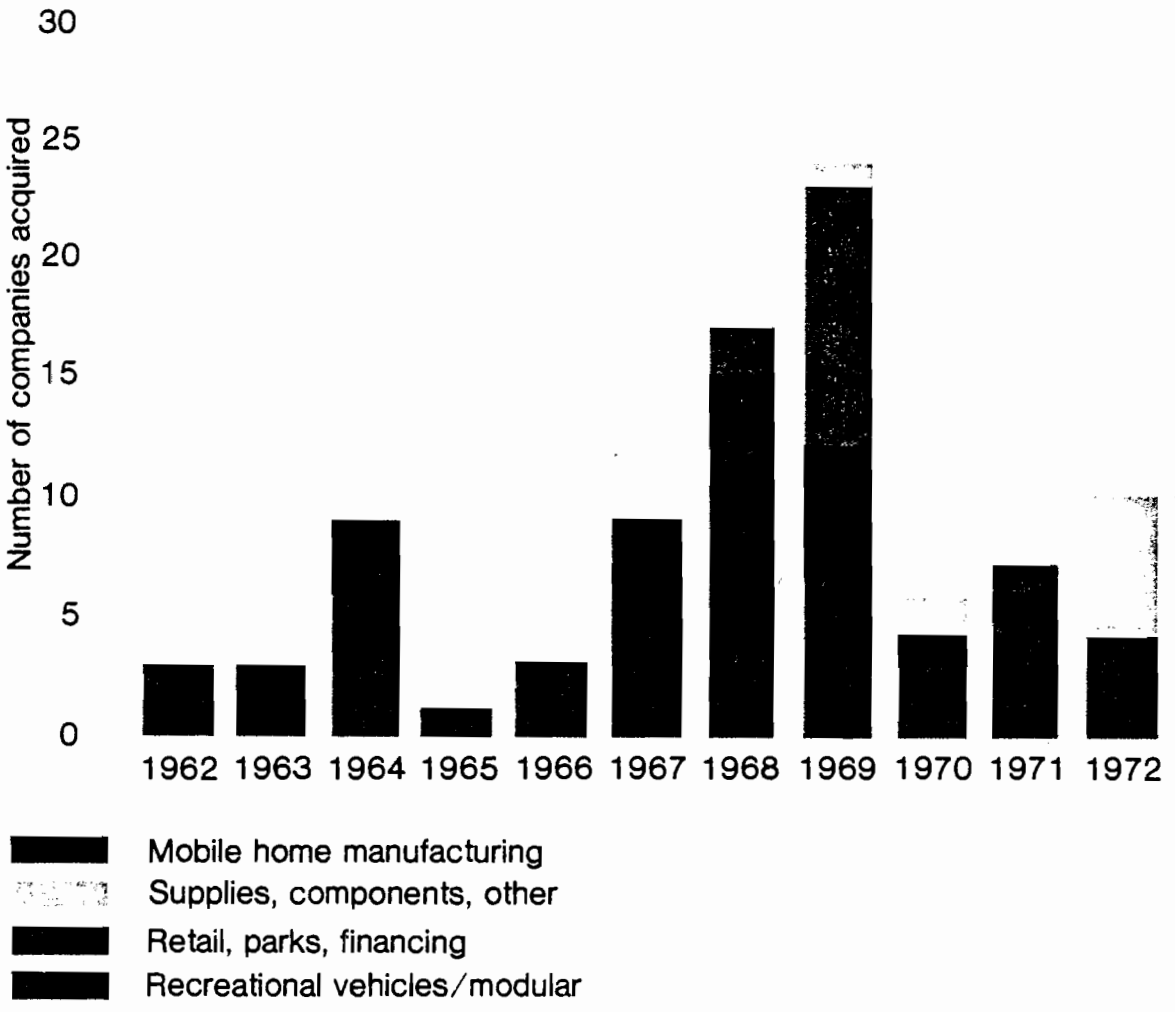
[13] *Ibid.* The transportation costs of mobile homes ranged from 60 cents to 90 cents per mile in 1973.

share of the industry's growth in sales and earnings. In such cases, large publicly held corporations have acquired some of the highest volume producers in the industry. Three of the top 10 mobile home manufacturers, which together accounted for more than $300 million in sales in 1972, have become subsidiaries of large, diversified corporations in the last few years.

Major Operating Characteristics: While the production of mobile homes is somewhat concentrated, the distribution and retailing system is not. Most mobile home manufacturers distribute their homes through an estimated 10,500 nonexclusive mobile home dealers—plus at least that many retailers who are primarily engaged in other activities while selling mobile homes as a sideline. In addition,

Chart 13

Principal Production Activity of Firms Acquired by Mobile Home Manufacturers



Source: McKinsey and Company, Inc., "Analyzing Trends in the Housing Industry," a study prepared for the National Housing Policy Review, using data from Standard and Poor's and 21 mobile home manufacturers.

some mobile home manufacturers have diversified into retailing themselves. The independent retail outlets that specialize in mobile homes are generally small, with typical annual sales of less than $500,000, and they almost always carry competing brands of products. Other key operating characteristics of mobile home manufacturers are as follows:

Geographic Concentration: Because the high cost of transporting mobile homes limits markets geographically, State and regionally based businesses are the norm in the mobile home industry. As a result, many small manufacturers have been able to survive in their locales despite the presence of large manufacturers in the industry. Only the top five producers, for example, operate on a nationwide basis, having from 24 to 56 plants each. The remaining top 25 manufacturers tend to distribute in one or two census regions, operating from four to nine plants. The geographic limitations on production and distribution have also led to concentration of producers in those areas where consumer demand is highest. As Chart 14 shows, between 1968 and 1972 mobile home output became even more concentrated in the South, where the retirement and nonurban blue collar markets are particularly strong. In turn, production in the North Central States, the other traditional market area, has declined somewhat.

Ownership: In conjunction with merger and acquisition activity on the part of larger firms, the degree of public ownership has increased substantially over the past several years. Of large mobile home manufacturers,[14] more than 90 percent now are publicly held (or parts of publicly held enterprises) compared with 64.5 percent in 1969. (See Chart 15.)

Financial Performance: As in the case of homebuilders, financial data are available only for the large, publicly held mobile home manufacturers. An analysis of 10 of the largest firms whose principal business is mobile home manufacturing shows an uneven performance during the past 4 years as evidenced by fluctuations in profit margins, leverage, and asset velocity.[15] (See Table 4.)

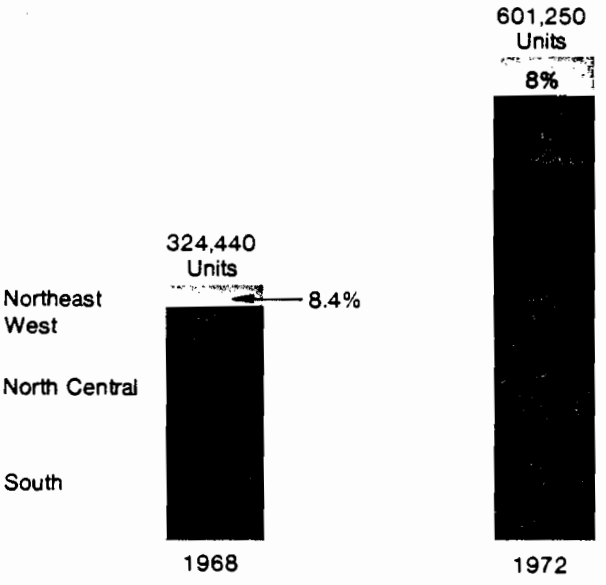
Profit margins (return on sales), an important variable in this production line industry, have varied from 3.95 percent in 1969 to a low of 3.3 percent in 1972, with intervening fluctuations in 1971 and in 1970. In general, return on equity (profitability) has been highest in those years with highest return on sales. For example, in 1969 and 1971, when profit margins were highest (3.95 percent and 3.8 percent respectively), return on equity was most attractive (33.9 percent and 35.8 percent). Conversely, 1972, the year of poorest aggregate performance (20.3 percent return on equity) also was a year of low profit margins (3.3 percent). In this high volume industry, it should be noted that profit margins are not nearly so

[14] *Ibid.* The 32 mobile home manufacturers with 1972 sales exceeding $20 million, of which at least 50 percent was derived from the manufacture of mobile homes.

[15] Averages used are unweighted; because of this and variations in nonavailable data, the averages are only approximate indicators of the performance of this particular class of mobile home manufacturers.

Chart 14

Regional Concentration of Mobile Home Plant Output



Note: Percentages may not add to 100.0 because of rounding.

Source: Mobile Home Manufacturers Association.

high as in traditional homebuilding, where return on sales typically runs 5 to 6 percent for the largest homebuilders.

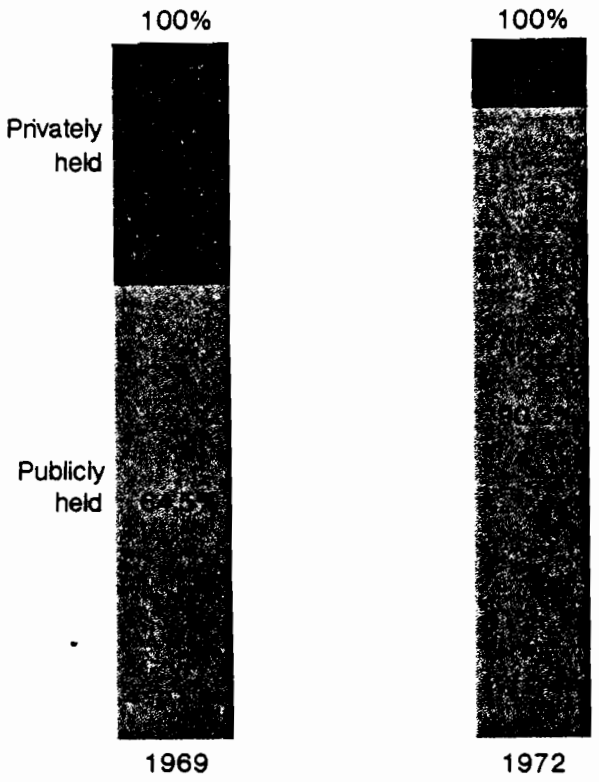
Financial leverage also has shown an uneven pattern. Equity as a percent of assets was at about 54 percent for 1969 and 1972, but significantly higher for 1970 and 1971. As might be expected from the differences in their operations, mobile home manufacturers have a higher degree of equity financing than major homebuilders, whose equity as a percent of assets averages from 30 to 47 percent.

One distinct trend among large, publicly held mobile home manufacturers has been a decreasing level of asset velocity. Aggregate sales to asset ratios have decreased from 4.6 in 1969 to 2.8 in 1972. Although asset turnover is decreasing dramatically (probably as a result of increased size), it is important to note that it still exceeds traditional homebuilder velocity by a factor of two.

In sum, traditional onsite homebuilding and mobile home manufacturing are now sharply distinct sectors of the housing industry. As noted, the traditional sector is extremely fragmented, deriving its production primarily from thousands of small custom and speculative builders, many of whom enter and leave the market as dictated by market conditions. In contrast, the mobile home sector is essentially a manufacturing, assembly line business involving a relatively small number of manufacturers. As mentioned at the outset, however, the lines between these two sectors are beginning to blur to some extent. As described in the next section, some of this slight convergence can be traced to the increased industrialization of the industry, and advances in technology that have enabled homebuilders to realize the economies of factory-produced housing hitherto available only to mobile home manufacturers.

Chart 15

The Amount of Public Ownership of Mobile Home Manufacturers



Source: McKinsey and Company, Inc., "Analyzing Trends in the Housing Industry," a study prepared for the National Housing Policy Review, using data from 32 publicly held mobile home manufacturers.

The State of Housing Technology

In the housing industry, the concept of technological advances as radical shifts in methodology does not readily apply. Changes in this industry have been gradual—evolutionary rather than revolutionary.

Rapid change in housing technology is inhibited in part by the inability to test or "prove" new ideas easily. There is great reluctance on the part of builders and housing manufacturers to experiment with new products and techniques, since innovations are perceived to be risky under many market conditions. Another reason for the relatively slow growth in housing technology is the existence of a vast number of divergent and restrictive State and local building codes. (See Chapter 5.) These codes usually specify hundreds of different construction requirements. Another ef-

fect of building codes has been to fragment and thus limit the size of particular housing markets, making mass production more difficult. The cyclical nature of the housing industry also inhibits the rate of technical progress because it limits the willingness of producers to adopt the capital-intensive production techniques that are often necessary to make new products economical.[16]

Despite these and other constraints, there have been some significant changes—particularly when viewed over a longer period of time—in the way in which a house is built. Sectional and modular housing, for example, were relatively unheard of prior to the 1960's. Although mobile homes have been in existence for over 40 years, the speed at which they can be produced has increased very rapidly in recent years, due to the introduction of and refinements in assembly line techniques. In addition to these advances, the housing industry also has experimented with new applications of materials—e.g., plastics, fiberglass, and epoxy.

Production Technology

Industrialization in housing involves the application by housing producers of such industrial methods as advances in production techniques, equipment, and organization and management. The introduction of industrially produced components into the onsite production of housing is one important element in the industrialization process. The use of these products has been evolutionary, beginning with small elements and progressing to larger, more complex components. Examples of these manufactured items include electrical parts, windows, kitchen cabinets, prehung doors, roof trusses, utility cores, and exterior wall units.

The most visible changes in construction techniques and methodologies are to be seen in the growing rate of factory production of complete housing "packages" or packages of major components of housing. *Automation in Housing* magazine, in its 1973 Factbook, predicted that 70 percent of all housing starts in 1973 would involve the use of at least some major industrialized components (exterior wall units, interior panels, roof trusses, floor systems, utility cores, gable ends, soffit systems, prehung doors, etc.) This level of usage represents an increase from 48 percent in 1969.

Some industry observers believe that the actual level of use of industrialized components in housing is substantially higher than that. Considering that such factory-made parts as kitchen cabinets and prehung doors are used so commonly, it has been estimated that more than 90 percent of all starts include some "manufactured" component. Whatever the precise figure, it is clear that this level of industrial-

[16] For an analysis of these problems, see "An Historical Evaluation of Industrialized Housing and Building Systems in the United States," prepared for the *Report of the President's Committee on Urban Housing*, Vol. II, Washington, D.C.: Government Printing Office, 1968, pp. 181–189.

Table 4. Average Financial Performance of Selected Major Mobile Home Manufacturers

Year	Return on Equity	Return on Assets	Gross Margin	Return on Sales	Equity as a Percentage of Assets	Sales/Assets
1972	20.3%	12.0%	13.7%	3.3%	54.4%	2.779
1971	35.8%	21.5%	15.2%	3.8%	57.2%	3.080
1970	26.4%	15.7%	15.1%	3.58%	59.6%	3.220
1969	33.9%	16.9%	NA	3.95%	54.2%	4.612

NA = Not available.

Source: McKinsey and Company, Inc., "Analyzing Trends in the Housing Industry," a study prepared for the National Housing Policy Review, using data from *Professional Builder Magazine*, July 1970–1973.

ization in housing has been increasing—most recently in application of the following components:

Trusses and Panels for Floors, Ceilings, and Walls: These items are used more often than other major industrially produced elements. A recent study by *Automation in Housing* magazine, conducted in the 10 largest cities in the U.S., showed that more than 80 percent of the builders in these markets were using this type of prefabricated item.

Mechanical Cores: Mechanical cores are perhaps the most revolutionary innovation in recent years in the homebuilding industry. These units usually contain an entire kitchen and one or more bathrooms. They come complete with all fixtures, plumbing, installation, and electrical wiring. Although such cores are not really new—they have been used by one major home manufacturer for the last 10 years—they are now gaining wider acceptance.

Individual Plumbing and Electrical Cores: In the same family as kitchen/bathroom cores are the individual plumbing cores, or "plumbing trees" and electrical cores. These components provide all the plumbing or wiring necessary for the structure in one package. While accurate figures are not known, the volume of these units is also expected to increase.

Most of the housing starts incorporating manufactured components are still made largely by conventional onsite builders, some of whom have integrated vertically to provide this capability. One of the top 10 homebuilders reports that it intends to manufacture components itself for about 40 percent of its units. The number of starts made by conventional onsite builders using manufactured components has increased, according to *Automation in Housing,* from about 230,000 units in 1969 to almost 500,000 units in 1972.

Housing Packages: Although conventional builders are still the primary users of factory-made components, an emerging force in this field is the housing manufacturer who fabricates complete or nearly complete housing "packages," ships them to the site, and assembles the house there. The four most prominent kind of housing "packages" are:

Panelized Housing: A completely prefabricated housing unit that has been "knocked down" and shipped to the site, where it is assembled. These units closely resemble conventionally built homes, but with the advantage of substantial onsite labor and time savings. Moreover, onsite pilferage of lumber and other construction materials is also reduced. The exterior shell of a panelized house can often be assembled onsite and locked up in one day.

Modular Housing: This form of housing production is constructed in three dimensions in a factory and shipped to a site for erection. The three-dimensional "building blocks" vary from a block for each room to a complete house as one piece.

Section Housing: A form of modular housing where a complete one-story house is fabricated in two sections.

Precut Housing: Another method, requiring comparatively more onsite labor, is the precut package, for which all individual members are cut to size offsite and assembled onsite.

Despite some well-publicized failures and plant closings, the manufactured-housing industry generally has been increasing its production capacity by 20 to 25 percent a year during the past 10 years. Since 1960 manufactured shipped housing units increased at an 11 percent compound annual rate—from 126,800 units to about 440,000 units in 1972. (See Chart 16.)

In addition to these "visible" changes in housing production, there are many changes in the manner in which a house is constructed that are totally unnoticeable to anyone not closely associated with homebuilding. Often the changes are small and have little positive or negative impact on the soundness of the structure, but do allow some savings in time and/or money. An example of this kind of change is the attaching of steel beams to wood sills with steel bands instead of using conventional bolts or fasteners. Another new technique is the attaching of adhesives to studs to reduce the

number of nailings necessary. As indicated earlier, however, the use of such methods has been limited somewhat by building codes and, in some cases, a lack of awareness of the new techniques.

Production Aids

As the homebuilding industry advances in terms of construction techniques, new aids and tools have been developed to assist the builder. The most significant are those used in actual construction and those devised for increasing the management effectiveness of the homebuilding or manufacturing operation. The most commonly used construction aids that have been developed in the past few years are:

Automatic Gun-Nailers: The pneumatic gun-nailer, capable of nailing one nail at a time, has been used for onsite building for quite some time. However, the increase in factory manufacturing of houses and house components has led to the development of new guns that are capable of multiple, simultaneous nailing.

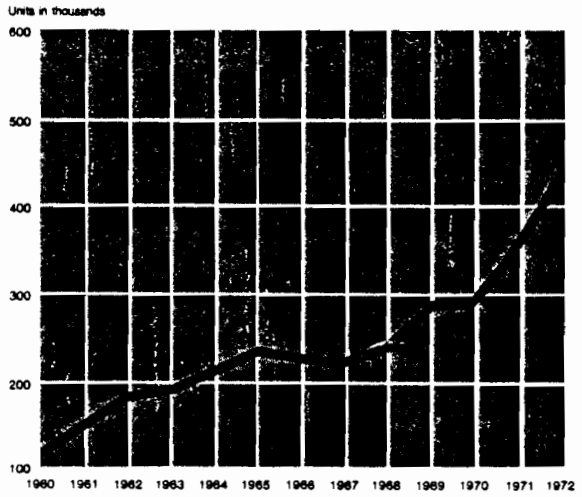
Panel Cranes: As a result of the increased use of panels for floors, walls, and ceilings, cranes attached to the transport truck have become widely available to lift and place these panels in their proper position at the building site.

Truss Assembly Forms, Framing Tables, Sheathing Machines: As may be self-evident, these items assist in the assembly of major components of the house.

Adhesives and Adhesive Guns: Resin epoxies developed in space technology have been increasingly applied to the housing construction industry. A logical corollary of these new adhesives is the adhesive gun, which dispenses ribbons of adhesive from metal containers. One constraint in the application of such adhesives, however, is lack of controlled climatic conditions that are necessary for the adhesive to set correctly.

Chart 16

Manufactured Housing Units Shipped



Note: Counts only complete home packaged and modular type units that conform to local building codes and are eligible for long term financing.

Source: McKinsey and Company, Inc., "Analyzing Trends in the Housing Industry," a study prepared for the National Housing Policy Review, using data from the National Association of Building Manufacturers.

Management Tools

Computers are still rare in homebuilding, but they have been appearing in recent years—at least among the large home manufacturers. There are, thus far, two primary applications for computers in housing:

Engineering Construction Designs: Some large component manufacturers use computers to identify the kind of lumber, roof pitch, spans, and snowloading capacity required for trusses in various types of houses. The key benefits of such a method are not only savings in time, but a reduction of material wasted through mistakes or miscalculations.

Scheduling the Flow of Materials and Parts: Another use of the computer is scheduling the cutting of parts, and other tasks, so that all the components of a particular unit are ready to be shipped out at the same time. As the sophistication of the homebuilding industry grows, the application of computers in production scheduling and purchasing is likely to increase in the larger homebuilding companies.

Materials Technology

The basic materials used for the construction of residential units are wood, concrete, brick, stone, plastic, steel, aluminum, and glass. The basic materials have not changed so much over time as have their frequency and application in the construction of a house:

Wood: Although there have been major changes in the application of wood in homebuilding, its frequency of use in its familiar forms is decreasing because of the high cost of lumber. Hardwood floors, for example, are becoming custom options rather than standard features. Doors and window frames are often metal or plastic. Wood as an exterior siding is often used not as the basic material but to adorn the structure, although wood and wood products have been the major type of exterior wall material for about 30 percent of new one-family homes started each year since 1969.

Concrete: Prestressed and precast concrete is being used more extensively for walls, floors, and ceilings, in part as a result of increased lumber prices. In some cases, carpeting is being applied directly over the concrete floor slab.

Plastic: There has been a significant increase in the use of plastic in all components of home construction. One Operation BREAKTHROUGH house, for example, was built with plastic exterior walls. At least one major builder has indicated that 40 percent of the dwellings that the company will build next year will have fiberglass exteriors. Complete plastic bathroom assemblies also have been developed, and plastic is being used as the basic material for cabinets, insulation, roofing shingles, and as "manufactured-marble" vanity tops. Although not extensive at this time, the use of vinyl as an exterior siding is increasing. Perhaps the greatest increase in the use of plastic has been in the use of plastic pipes in plumbing systems.

Steel: Traditionally used very extensively in heavy construction, the incidence of steel in residential construction had been fairly limited until recently. However, it is now being used in homes for roof trusses, floor joists, studs, and hollow metal doors—again, partly as a response to high lumber costs.

Aluminum: A recent innovation has been the development of the lightweight aluminum frame. One aluminum company predicts that these frames will be used in at least 10 percent of the new houses built by 1980. Aluminum also is being used in doors and, more extensively, as a siding material.

Glass: Glass is still being employed in the traditional manner in the construction of the home, but some new glasses have been developed that provide greater insulation to the home than the traditional flat glass. Both insulating glass and mirror-like reflecting glass are being used to cut down on the heat and air conditioning needed in houses.

Outlook for the Future

As discussed above, technological advances in homebuilding have been occurring somewhat slowly, primarily in the direction of providing a fully manufactured housing "package." The outlook for the future is brightened by the general industry consensus that new products, techniques, and materials applications not only produce savings in time and cost, but may even be of superior quality and within closer tolerances. Moreover, often due to the efforts of architects and the design professions, the typical homebuyer often cannot tell the difference between a "factory-made" house and one that has been built from the foundation up in the traditional manner. Good design can accelerate the use and consumer acceptance of worthy innovations.

Perhaps most important to the future of housing technology is the availability of product testing. Several private concerns, such as the National Association of Home Builders and the American Plywood Association, operate research centers funded for this purpose. Some of the major homebuilders also have their own engineering capability and, in some cases, research divisions. At least one major builder has testing facilities that are not only used for its own products, but for those of other builders as well. But the number of such facilities still is very limited compared to other industries.

An experimental project recently undertaken by a major homebuilder in conjunction with at least 10 other corporations is another sign of progress for the industry. As the National Association of Home Builders has been doing over the years, this group of builders constructed and sold a "laboratory" house in Columbia, Md., equipping it with a number of new products or innovations that the owners of this house allow to be inspected periodically. Some of the more interesting features are a prebuilt modular bath/shower component made of seamless fiberglass; solid vinyl siding; "shangle" roofing, which is made of 8-foot panels of asbestos that resemble wood shingles; and exterior paneling made of extruded polystyrene board used as a substitute for sheathing and insulation.

Overall, the trend has been toward greater use of technology and other improvements in industrialized techniques in housing production and manufacturing; this trend undoubtedly will continue, with rapid advances in the development and use of industrialized parts. How rapidly the industry advances in this direction in the future will depend, among other things, on the extent to which new modes of construction are properly tested and, equally as important, on the speed at which innovations can be brought into use through approval by governmental authorities.

The Responsiveness of the Industry to Changes in Demand

The presence of a large number of small builders who move in and out of the construction industry helps to make the supply of housing very responsive to cyclical changes in demand. The evidence suggests that as demand varies in response to changes in credit conditions, very little change in price is necessary to bring forth changes in production. In fact, in the short run there seems to be no significant relationship between the price of housing and the number of units started.[17]

Similarly, the longrun supply appears to be very responsive to longrun increases in demand. One study suggests that a 1 percent increase in price in the long run will induce far more than a 10 percent increase in the quantity of housing supplied.[18] There is a time lag in the response, however; only about two-thirds of a longrun increase in the desired stock of housing is satisfied within 3 years.[19]

While the supply of housing generally is very responsive to changes in demand, there is some evidence that the subsector of the industry that supplies rental housing responds relatively more slowly to changes in demand. Here, a longrun 1 percent change in rents seems to induce somewhat less than a 1 percent change in supply.[20] It is difficult to explain this result in light of the evidence of the responsiveness of the housing supply in general. Perhaps the results are related to the fact that the small builder, who moves easily in and out of the industry, typically concentrates his efforts on the single-family home constructed for potential owners. On the other hand, it must be noted that our statistical techniques still are very primitive and that definitive conclusions are not yet possible. Future research may reveal less of a difference between the relative responsiveness of the rental and homeowner markets.

[17] William W. Alberts, "Business Cycles, Residential Construction Cycles, and the Mortgage Market," *Journal of Political Economy*, Vol. LXX, No. 3, June 1962.

[18] Richard F. Muth, "The Demand for Non-farm Housing," published in Harvey S. Perloff and Lowdon Wingo, Jr., *Issues in Urban Economics*, Baltimore: Johns Hopkins University Press, 1968, pp. 286–291.

[19] Richard F. Muth, "The Demand for Non-farm Housing," published in Arnold C. Harburger, Editor, *The Demand for Durable Goods*, Chicago: University of Chicago Press, 1958.

[20] Frank de Leeuw and Nkanta F. Ekanem, "The Supply of Rental Housing," *American Economic Review*, Vol. LXI, No. 5, December 1971.


21

8 The Cost of Housing

Introduction

The formation of new households during recent years has greatly increased the demand for housing, which, in turn, has resulted in record levels of housing production. The increase in production required larger quantities of productive resources for residential construction, and some increase in the relative price of housing was necessary to attract these resources.

This chapter analyzes recent relative price increases and places them in historical perspective. While the analysis is complex, the conclusions are straightforward. During the past 2 decades, most measures of income have far outrun housing costs even though the gap has narrowed somewhat during the past 5 years. In this period the percentage increase in homeownership costs has roughly matched the increase in income. On the other hand, rental costs have continued to increase much less rapidly than income.

Despite the relatively rapid rise in homeownership costs, Americans have continued to purchase approximately the same quality of housing as they did before relative housing costs accelerated rapidly. While this has required greater housing expenditures, the fact that money income has risen faster than other prices has meant that households could increase housing expenditures enough to maintain housing quality while continuing to buy more nonhousing goods and services as well.

The Rising Price of Housing

Defining Housing Price

Before analyzing changes in the costs of housing, it is necessary to explain in precise terms what is meant by "housing," "housing services," and "housing costs."

The nature of housing changes over the years; the typical house of 1973 is quite different from the house of 1900. Size, number of rooms, number of bathrooms, the presence or absence of central air conditioning and other amenities—all can vary through time to affect the price of housing. When the average price of a house sold goes up, therefore, it is difficult to determine whether the increase represents a true inflation in housing costs or whether the price increase indicates that the consumer is getting a larger and higher quality home for his money.

Moreover, buying houses is only a small part of the effort involved in providing housing for American households. First, 37.1 percent of all households were renters in 1970. Second, the purchase or construction of a home is only the first step in providing housing. The house has to be maintained and operated, and this involves purchasing a whole array of complementary services such as utilities, repairs and maintenance, insurance, and those public services that are "purchased" through real estate and other taxes. Renters also purchase these services, paying for them as part of their rent.

To a person about to buy a house, the price of the house itself and the credit conditions that determine the downpayment and the interest rate are of prime importance. These, however, are of overriding concern to the small fraction of homeowners buying homes each year—less that 9 percent in 1970, for example. The vast majority of American households are not house buyers in any one year and, for them, it is the cost of renting or living in their own house that is of prime importance.

Various Government agencies compute indexes of the price of buying or renting living space and the prices of all of the complementary services purchased by the "typical" household. The agencies make an effort to compare the price of identical houses and aggregations of auxiliary services at different points of time, but housing is such a complex good that this is not always possible. For this reason, the indexes of price are often far from precise. Subsequent sections of this chapter will describe the most important weaknesses in the data and, wherever possible, the impact of the resulting statistical inaccuracies will be assessed. In addition, wherever possible a number of different indexes are used in order to provide substantiation of major trends.

Housing Cost and Income

As noted in the introduction, relatively rapid increases in housing costs are a recent phenomenon. Housing costs have gone up a great deal over the past 20 years, but so have the prices of most other goods and services, and so has the income of the typical household. Table 1 compares changes in two basic measures of income to changes in the overall Consumer Price Index, and to changes in the housing price measures, which are part of that index.

The two income measures are per capita disposable income (income after taxes) and hourly earnings in manufacturing. Disposable income is the better single measure of purchasing power, but the hourly earnings figure is also of interest because part, though by no means all, of the overall increase in income is due to the growth in the number of families with two working members.

Table 1. Changes in Income and Housing Costs, 1953–1972

Measure of Income or Cost	Percentage Increase Over the Period		
	1953–1972	1963–1972	1967–1972
Per capita disposable income	141	78	39
Hourly earnings in manufacturing	119	55	35
Consumer price index (CPI)	56	37	25
Housing component of CPI*	60	39	29
Shelter component of CPI	76	48	34
Rent component of CPI	48	25	19
Cost of homeownership component of CPI	87	57	40

*Rent and homeownership, together with a minor hotel-motel expenditure component, comprise the shelter component of the CPI. The shelter component, in turn, is one of the components making up the housing component; the others are fuel and utilities, and household furnishings and operations.

Source: Department of Commerce, *Business Conditions Digest*, September 1972 and July 1973; Department of Labor, Bureau of Labor Statistics, *Employment and Earnings*, July 1972, Table C-1; *Handbook of Labor Statistics*, 1972, Table 127; *Monthly Labor Review*, May 1973, Table 25.

The Consumer Price Index, compiled by the Bureau of Labor Statistics, is the most commonly used measure of changes in the cost of living. Since 1953, it has included a "housing" price index as one major component. The housing price index is a weighted average of the cost of renting and of owning a house, including maintenance and repair expenditures, property taxes and insurance, as well as the purchase price or rent for the housing unit itself; the index also contains the cost of buying fuels, utilities, and home furnishings. The housing component of the Consumer Price Index is thus the broadest available measure of the cost of occupying housing. During the 20 years that it has been compiled, it has increased much less rapidly than either of the measures of income discussed above. Hourly earnings increased twice as fast as housing costs, and per capita income increased still more rapidly.

The change in the housing cost index is actually the result of price changes occurring among a variety of housing services. This raises the possibility that the changes shown in the housing index could be masking significant increases in some of its components, which are being offset by less than average increases in other components. Closer inspection indicates that this is indeed the case, and that the behavior of the housing price index does not tell the complete story.

To begin with, the housing index includes home furnishings as well as fuels and utilities. Both have risen relatively little over the past 20 years; furnishings went up 33 percent, and fuels and utilities 45 percent. When they are omitted from the index, it appears that the price of housing itself (defined as "Shelter" in the Consumer Price Index) has risen more sharply—by 76 percent in the last two decades. This is still much less than the increase in either measure of income, however.

Shelter consists of both rental and homeowner housing-cost components. When these are examined separately, the prices of housing services purchased by renters and homeowners appear to have changed in very different ways.

Whereas the cost of renting has risen by only 48 percent during the past 20 years, the cost of homeownership went up by 87 percent. Again, both have risen much less than either measure of income, but the cost of homeownership has risen much faster than other components of the housing cost index.

When shorter, more recent periods of time are investigated, the picture changes somewhat. For the 1963–1972 decade, per capita disposable income continued to rise more rapidly than all measures of housing cost, but homeownership costs and hourly earnings in manufacturing rose at about the same rate. The situation has changed still more noticeably in the 5-year period from 1967 to 1972. Per capita income rose by 39 percent, and hourly earnings in manufacturing by 35 percent, while the cost of owning a home rose by 40 percent. The main reason for the change in this most recent period is a marked increase in costs; income has been rising nearly as rapidly in the past 5 years as in the longer periods. Nonetheless, when renters as well as homeowners are considered, costs rose by only 34 percent, which was slightly less than the increase in either measure of income. This occurred because the rent index increased by only 19 percent. In other words, the average wage earner was able to live in the same (or better) house in 1972 as he did in 1967, without having to increase the portion of his total budget spent for housing.

Changes in the Relative Price of Housing

Because all measures of housing cost (as well as the overall Consumer Price Index) have increased much less rapidly than income, it is not surprising that the last two decades have seen the dramatic improvement in housing conditions described in Chapter 6. Table 1, however, also shows that the price of housing has increased more rapidly than the overall Consumer Price Index, so that the price of housing relative to prices of all the other goods and services typically bought by consumers has increased. This section evaluates the importance of the increase in the relative price of housing and its components.

Table 2 shows the year-to-year changes in the Consumer Price Index and the major categories of the housing index. Between 1953 and 1972, the housing index increased by 60 percent, or at a compound annual rate of about 2.4 percent. The average price of all consumer goods, however, increased nearly as much—56 percent—over the same period. The price of housing, then, relative to the price of all goods, has risen by only 2 percent (1.60 ÷ 1.56 = 1.02) in 20 years—one-tenth of 1 percent per year.[1]

The components of the housing index show somewhat greater changes. The shelter component, for example, rose by 11.5 percent in 20 years relative to the Consumer Price Index. Most striking, however, is the behavior of the rent and homeownership indexes. The cost of renting declined relative to the cost of all goods—by 5 percent in 20 years. The relative cost of homeownership, on the other hand, rose by 19.1 percent in the same period.

Although the cost of homeownership increased relatively throughout the period, the increase has accelerated recently; over two-thirds of the increase has occurred since 1967. Thus, whether considered relative to income or to the cost of all goods, the cost of homeownership has been rising sharply in recent years. (See Chart 1.)

Per capita disposable income, however, still increased considerably more rapidly than the overall Consumer Price Index over the 1967–1972 period (39 percent vs. 25 percent). Consequently, if it wished, the typical homeowning household could maintain its standard of housing consumption in the face of rapidly rising housing prices without having to sacrifice its consumption of other things. Renters will be in a still better position because rents increased only half as fast as income.

What scant data are available for the first half of 1973 suggest that the situation actually has improved since 1972, in that the relative price of housing has declined. Between June 1972 and June 1973, for example, the cost of homeownership increased by 3.9 percent, while the overall Consumer Price Index grew at 5.9 percent. The rate of growth of per capita

[1] This relatively slight shift is typical of the major components of the Consumer Price Index; the relative price of clothing, for example, decreased by 8 percent in the same period.

Table 2. The Price of Housing, 1953–1972

(Components of the Consumer Price Index)

Year	All Goods (CPI)	Housing		Shelter		Rental		Homeowner	
		ABS	REL.	ABS.	REL.	ABS.	REL.	ABS.	REL.
1953	80.1	80.8	1.01	76.5	0.96	80.3	1.00	75.0	0.94
1954	80.5	81.7	1.01	78.2	0.97	83.2	1.03	76.3	0.95
1955	80.2	82.3	1.03	79.1	0.97	84.3	1.05	77.0	0.96
1956	81.4	83.6	1.03	80.4	0.97	85.9	1.06	78.3	0.96
1957	84.3	86.2	1.02	83.4	0.97	87.5	1.04	81.7	0.97
1958	86.6	87.7	1.01	85.1	0.98	89.1	1.03	83.5	0.96
1959	87.3	88.6	1.01	86.0	0.99	90.4	1.04	84.4	0.97
1960	88.7	90.2	1.02	87.8	0.99	91.7	1.03	86.3	0.97
1961	89.6	90.9	1.01	88.5	0.99	92.9	1.04	86.9	0.97
1962	90.6	91.7	1.01	89.6	0.99	94.0	1.04	87.9	0.97
1963	91.7	92.7	1.01	90.7	0.99	95.0	1.04	89.0	0.97
1964	92.9	93.8	1.01	92.2	0.99	95.9	1.03	90.8	0.98
1965	94.5	94.9	1.00	93.8	0.99	96.9	1.03	92.7	0.98
1966	97.2	97.2	1.00	96.8	0.99	98.2	1.01	96.3	0.99
1967	100.0	100.0	1.00	100.0	1.00	100.0	1.00	100.0	1.00
1968	104.2	104.2	1.00	104.8	1.01	102.4	0.98	105.7	1.01
1969	109.8	110.8	1.01	113.3	1.03	105.7	0.96	116.0	1.06
1970	116.3	118.9	1.02	123.6	1.06	110.1	0.95	128.5	1.10
1971	121.3	124.3	1.02	128.8	1.06	115.2	0.95	133.7	1.10
1972	125.3	129.2	1.03	134.5	1.07	119.2	0.95	140.1	1.12
Change in price relative to CPI, 1953–1972		-2.0%		+11.5%		-5.0%		+19.1%	

ABS. = Absolute value of component of the consumer price index.
REL. = Component divided by Consumer Price Index.

SOURCE: Department of Labor, Bureau of Labor Statistics, *Handbook of Labor Statistics*, 1971, Table 127; *Monthly Labor Review*, May 1972, Tables 24 and 25, February 1973, Tables 24 and 25.

disposable income for the same period was 10 percent—much greater than for either the Consumer Price Index or its homeownership component. Data for the last half of 1973, however, may reveal some acceleration in the rate of increase of homeownership costs because of the very rapid increase in interest rates that occurred during the summer.

Components of Homeownership Costs

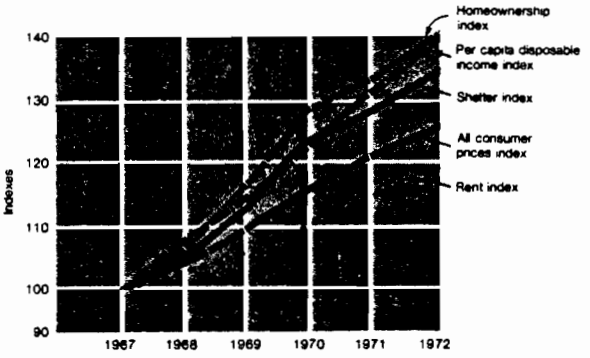
Because the most rapid rise in housing costs has occurred during the period 1967–1972, the analysis of the components of the cost increase will be focused on this period. Only the components of homeownership costs are studied, because data are not available to apply a comparable analysis to the rental index. Moreover, it is the homeownership index that has risen most rapidly. Because of the significantly lower rental cost increases, however, care must be taken to avoid assuming that homeownership cost trends necessarily reflect overall trends.

Chart 2 breaks down the homeownership index into its components and shows the weight of each in the overall index. Mortgage interest

payments and property taxes have risen most rapidly, and have increased faster than per capita disposable income; maintenance and repair expenses have risen just about as fast as income; while home purchase price has risen more slowly than income, and only slightly more rapidly than the overall Consumer Price Index. Home purchase price, however, has a heavy weight in the computation of the index and, as a result, it has been the most important factor increasing the cost of homeownership. Each component's weighted contribution to the overall homeownership cost increase of 40.1 percent over the 5–year period is provided in Table 3.[2]

Chart 1

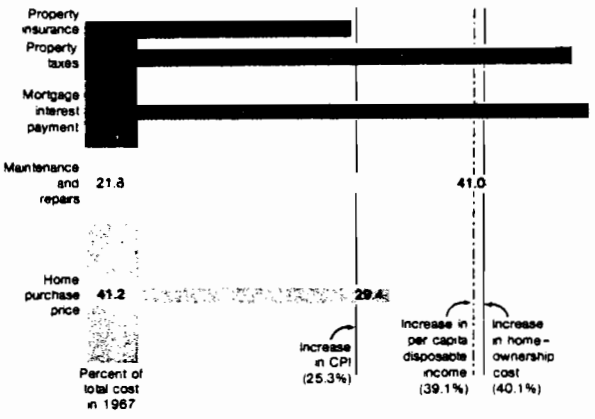
Costs of Homeownership and Renting Compared to Per Capita Disposable Income 1967-1972



Source: Department of Commerce, Bureau of Economic Analysis, Business Conditions Digest, September 1972 and August 1973; Department of Labor, Bureau of Labor Statistics, Monthly Labor Review, May 1973, Table 25.

Chart 2

Percent Increase in Homeownership Costs and Per Capita Income, 1967-1972



Source: Department of Labor, Bureau of Labor Statistics, Relative Importance of Components in the Consumer Price Index; Handbook of Labor Statistics, 1972; Monthly Labor Review, February 1973, Table 25.

[2] The home purchase price and mortgage interest payment components of the Consumer Price Index are not publicly available and, therefore, could not be published in this chapter. The figures used in the chapter are derived from the published "expenditure weights" for home purchase and mortgage interest payment; changes in these weights can be used to determine close approximations to the changes in the unpublished index numbers. The "expenditure weights," however, refer only to the month of December in each year; other series used are annual averages. Thus, the home purchase and mortgage interest payment data are not precisely comparable to the other data; calculations using all of the series include slight rounding errors and other minor discrepancies as a result. The source for the "expenditure weights" is *Relative Importance of Components in the Consumer Price Index*, published annually by the Bureau of Labor Statistics, Department of Labor.

Table 3. Components of Change in Homeownership Cost Index, 1967–1972

Component	Weighted Absolute Contribution	Percentage Contribution
Home purchase price	12.4	30.9
Mortgage interest payments	11.2	27.9
Maintenance and repairs	9.2	22.9
Property taxes	6.3	15.7
Property insurance	1.0	2.5
Total	40.1	100.0

Note: Detail may not add to totals because of rounding.

Source: Department of Labor, Bureau of Labor Statistics. *Relative Importance of Components in the Consumer Price Index: Handbook of Labor Statistics*. 1972; *Monthly Labor Review*. February 1973. Table 25.

While the increase in home purchase price has contributed most to the increase in the overall cost of homeownership, the relatively more rapid increases in mortgage interest payments, maintenance costs, and property taxes have caused their relative importance in the homeownership price index to rise as the relative weight of the home purchase price has fallen.

Before detailed discussion of the changes in the components of the cost of homeownership, two general points deserve attention. First, the importance of mortgage interest payments and property taxes for many homeowners is overstated in the Consumer Price Index. Both interest and taxes are deductible from Federal income tax liability for those homeowners who itemize deductions. Other costs of homeownership are not deductible. Thus—in terms of out-of-pocket costs—net of taxes, mortgage interest, and property taxes will have less weight for the typical homeowner than they do in the Consumer Price Index. The value of the deduction depends on the income of the homeowner: The higher his tax bracket, the smaller the share of his interest and the property tax payments he actually pays.

In particular, the value of the tax deduction over time increases as the individual homeowner's income increases and he moves into a higher marginal tax bracket. Thus, for any homeowner whose income has increased since 1967, and who itemizes deductions, a 10 percent increase in property taxes is in reality less of an increase in his cost of homeownership than is a 10 percent increase in, say, maintenance and repair expenditure.[3] In other words, the Consumer Price Index components measure only the cost increases incurred by those homeowners whose incomes have not increased since 1967, or who do not itemize deductions.

By contrast, the changes in the rent index do measure cost increases experienced by typical renters. Renters are not able to deduct from their taxable income the portions of their rent that go to pay the property taxes and mortgage interest payments of their landlords. Part of the difference in the movements of rent and homeownership indexes may be due to this difference in the tax impact of cost increases, to the extent that landlords are forced by competition to keep rent increases in line with their cost increases after tax advantages have been taken into account.

The second qualification refers to the home purchase price and mortgage interest payment series. These series reflect changes in the initial cost of acquiring a house rather than in the ongoing costs of operating and maintaining it. For most households, the purchase of a house is a relatively infrequent occurrence. The fact that prices of houses, and mortgage interest rates, have risen since 1967 does not affect the out-of-pocket housing costs of those families who bought and financed houses prior to 1967. In other words, the Consumer Price Index cost of homeownership index tends to overstate current housing costs.

Relatively few households actually are affected directly by changes in home prices and mortgage interest rates. For example, 64 percent of all households owning their own homes in 1970 had occupied those same houses for at least 5 years.

Moreover, rising home prices have little impact on homeowners who seek to sell one house and buy another; in general, the prices of both houses will rise, so the homeowner is "leveraged," benefiting from the 30 percent rise in the price of the home he now owns, and paying 30 percent more for the house he buys than he would have had to pay in 1967. The change in the home purchase component of the Consumer Price Index is not applicable to these homeowners; the cost increase applies only for the household that is buying a house for the first time—e.g., a renter or a newly formed household.[4]

The change in mortgage interest rates, however, does represent a cost to all home buyers, including those who previously owned their own homes. The interest rates at which

[3] A more detailed discussion of the deductibility of mortgage interest and property taxes is contained in Chapter 2.

[4] A family seeking to move to a better house will have to pay more for it, of course, but this does not affect the argument if both houses increase in value at the same rate; the family's original house would represent the same fraction of the value of the new house in both 1967 and 1972. For families whose homes have experienced changes in value that are significantly different from the average, the impact may be substantially different when they move.

these households financed mortgages on their present houses typically are much lower than those reflected in the current homeownership index. Thus, a rise in home prices does not affect all home buyers; a rise in mortgage interest rates does.

It also can be argued that maintenance and repair expenses are infrequent items for households, although perhaps more common than home purchase or financing. This is probably true of the major repairs, but all homeowners are likely to have some minor maintenance expenses as well in any one year.

In summary, the cost of homeownership index includes two costs all owners must pay each year (property taxes and insurance); one they probably face each year (maintenance and repairs); one they face only when buying a house (mortgage interest payments); and one they face only when buying a house for the first time (the home purchase price). The overall increase in the cost of homeownership thus does not apply to all, or even most, homeowners; but two of the three rapidly rising components—property taxes and maintenance expenses—probably do affect all homeowners.

Home Purchase Price: Although other components are increasing much more rapidly, home purchase price remains the largest single component of overall homeownership costs and therefore it merits special attention. Table 4 isolates some of the elements comprising new home purchase price; these, in turn, affect the price of an existing home.

Land Costs: The most striking element in higher home purchase prices is the increase in the cost of land. The relative cost per square foot of new housing sites has risen by 58 percent since 1967. So, not surprisingly, land now accounts for a larger fraction of the total value of new houses than at any time since World War II. The fraction undoubtedly would have been still larger had it not been for a sharp decline in lot size of some 12 percent since 1967.

New housing sites tend to be located in outlying areas, away from the existing housing concentrations in central cities and nearby suburbs. Many factors account for the increasing demand for new housing in general and for suburban housing in particular—all of which contribute to the substantially increased cost of acquiring new housing sites. It has been persuasively argued that one reason for the relatively large increase in the demand for housing is the children of the post-World War II "baby boom" reaching homeownership age; another is the change in lifestyles. Two factors commonly supposed to have greatly enhanced the appeal of suburban living are improved transportation systems (particularly, the growing network of highways and expressways) and a gradual drift of employment and other community infrastructure towards the suburbs—both of which tend to reduce the commuting time and costs for many suburban residents.

It is difficult to predict how long such large increases in the cost of land used for new housing will continue, especially in view of the fact that the trend could be slowed or reversed by changes in any number of factors, e.g., a reduction in the rate of new household formation. It is unlikely, however, that the general trend toward higher prices for residential land will be reversed, because land tends to become

Table 4. Relative Prices of Housing Capital Inputs, 1963–1972

Year	Site Value [1]	Labor Costs [2]	Construction [3] Material Costs
1963	NA	0.90	0.95
1964	NA	0.92	1.01
1965	1.00	0.94	1.01
1966	0.97	0.97	1.02
1967	1.00	1.00	1.00
1968	1.06	1.02	1.01
1969	1.08	1.07	1.02
1970	1.29	1.09	0.97
1971	1.41	1.13	0.99
1972	1.58	1.15	1.01

NA = Not available.

[1] Source: Median price of site per square foot of new FHA homes, from table 197, of *1971 HUD Statistical Yearbook*, and *FHA Trends*, 3rd quarter 1972, and made relative to the CPI.

[2] Source: Department of Labor, Bureau of Labor Statistics. *Employment and Earnings*, July 1973. The average weekly earnings of construction workers from table C-1 made relative to CPI.

[3] Source: Department of Commerce. *Construction Review*, May 1973 and June 1967, table E-2. The index of all construction materials was made relative to the CPI.

available very slowly for housing uses in response to expanding metropolitan areas. Moreover, "no growth" policies and other environmental controls probably will limit further the amount of land available for new construction in the future.

Construction Costs: Housing construction costs, the other basic determinant of a home's purchase price, also have risen more rapidly than has the general price level, although much less sharply than has the cost of land. Table 4 shows that the wages of construction labor have increased by 15 percent since 1967, relative to the Consumer Price Index.[5] To some extent this cost increase has been offset by productivity increases.

In contrast to rapidly rising land prices, which seem to be a rather recent phenomenon, rising construction costs seem part of a longrun trend dating back to World War II. If, as has been suggested, the rapid rise in the cost of new home sites is largely attributable to a sudden increase in housing demand, why have construction costs risen less dramatically? The most obvious explanation is that labor and construction materials are mobile resources, while land is not; consequently, the former are more readily diverted away from other uses in response to an increased demand for housing.

While overall construction materials costs have gone up relatively little, a few specific materials have undergone large price increases. Lumber prices, for example, have increased by 59 percent since 1967 (27 percent relative to the Consumer Price Index); plywood and millwork prices also have increased more rapidly than has the Consumer Price Index. The average prices of nearly all other building materials, however, have increased very little, so that the overall increase in construction materials costs is less than the Consumer Price Index increase.

The discussion of construction costs thus far has focused on changes in prices of the principal resources that go into housing—materials and labor. Clearly, however, it is the change in the cost of the finished structure, and not the change in the cost of ingredients, that matters most to the buyer.

As already noted, between 1967 and 1972, the Consumer Price Index home purchase component rose 29.4 percent, or 3.3 percent relative to the total Consumer Price Index. Comparable increases are recorded by an index of housing construction costs computed by the Bureau of Economic Analysis (formerly the Office of Business Economics of the Department of Commerce), which shows a 4 percent relative increase, and one by the Bureau of the Census showing a 4.5 percent relative increase. These relatively modest increases in home purchase price and construction costs suggest that none of these indexes may adequately reflect all the relevant costs involved in producing a house, especially with relative costs of land and construction labor increasing by 58 and 15 percent, respectively. There are, in fact, a number of possible explanations.

First, the relatively slow growth in the cost of materials has compensated somewhat for the increased price of labor.

Second, just as home builders can alter the mix of materials to economize on more expensive inputs, they also have considerable opportunity to adjust the construction process in response to increased labor costs. For example, prefabricated components increasingly have been substituted for onsite production activity. This has permitted labor productivity gains to be realized, especially through the greater use of mass production techniques that are more readily implemented in a manufacturing plant than at the building site. In the absence of a suitable measure of overall construction labor productivity, therefore, any assessment of the true labor construction costs at this point would be highly conjectural. Instead, it

[5] These labor costs are based on the average weekly earnings of contract construction workers, both union and nonunion, and they reflect premium pay for overtime and late-shift work as well as basic pay. Because average hourly earnings also reflect such premium pay, their use would not alter the results reported here.
It should also be noted that contract construction workers include workers other than those in residential construction. (When average weekly earnings of construction workers engaged in building construction are used, the results are not significantly different.) These data also probably overstate the amount of union labor employed in residential construction, however, because many residential construction workers are not covered by contract construction data.

can be said with confidence only that the labor cost measures used in this section are biased upward. By abstracting from productivity changes, they tend to overstate the importance of labor cost increases in the overall cost increase for housing.[6]

Third, none of the indexes computes land properly. Neither the Consumer Price Index nor the Census home purchase index keeps the size of lot constant; consequently, as lot sizes are decreased in response to increased land prices, the total land cost component of the "standard house" rises much more slowly than does the price of land per square foot. The Bureau of Economic Analysis index does not include land at all. In other words, all of the indexes understate the true rise in the cost of an identical house on an identically sized lot.[7]

On the other hand, specific measures of land costs tend to exaggerate the rate at which the cost of housing sites is rising. The particular measure used here—median price per square foot of new home sites insured under FHA Section 203—contains two biases, both of which overstate the increase in land costs in the Consumer Price Index home purchase price component. For one thing, some two-thirds of all new, single-family homes are not FHA-insured, so their costs may be poorly represented by the index based on FHA data, especially because for homes insured under Section 203 the average ratio of land cost to sales price per unit is higher than it is for homes financed differently. In 1971, for example, Section 203 homes had an average site-to-value ratio of 21.2 percent, compared with an average ratio of 18.3 percent for all homes. Consequently, increased land costs are likely to have been less important to the typical home purchaser than the Consumer Price Index home purchase series indicates.

A considerable portion of higher land costs also stems from increased fees and charges for various amenities available at the housing site. However, it is difficult to distinguish between those increases that represent payments for real quality improvements from those manifesting pure price increases. For example, a site for a new house may command an increased price because a new street or sewer line is constructed adjacent to it, or the higher price may be due, say, to a moratorium on sewer hookups, which effectively limits the supply of building sites and thereby intensifies inflationary pressures. In the former case, the increase in price is due to an improvement of the site; in the latter, there is a pure price increase.[8]

Mortgage Interest Payment: The increase in the mortgage interest payment component is the second most important factor in explaining the 40.1 percent increase in homeownership costs occurring between 1967 and 1972. As shown in Chart 2, mortgage interest payments in 1967 were only about half as large as the costs subsumed under "home purchase price;" during the following 5-year period, however, the mortgage interest payment component increased at a much faster rate (52.6 percent v. 29.4 percent). As a result, increased mortgage interest payments between 1967 and 1972 contributed nearly as much to the increase of homeownership costs as did the increased home purchase price, i.e., 27.9 v. 30.9 percent.

It is extremely important to note that the increased mortgage interest payments reflect both an increased mortgage interest rate and an increased principal against which the interest rate is assessed. With an unchanged loan-to-value ratio,[9] more than half of the increased

[6] The widely known Boeckh Index of residential construction costs, which includes both labor and material costs, has increased by 16 percent more than has the Consumer Price Index since 1967. This index may tend to overstate the true increase, however, because only union wages are used in determining labor costs, and a large fraction of home construction is produced by nonunion workers. (U.S. Department of Labor, Bureau of Labor Statistics Report 417, *Selected Earnings and Demographic Characteristics of Union Members*, 1970. found that median annual earnings of full-time, male construction union members exceeded earnings of nonunion members by almost $4,000.) The Boeckh Index also differs from the other indexes because of differences in the statistical procedures used to calculate them. In particular, the Boeckh Index does not adjust for productivity increases or for substitution of one material for another.

[7] All of this is not to say that these are not valid, useful indexes. The point is that they are not entirely appropriate to the specific requirements of this study. The three indexes are further described in Appendix A.

[8] A more complete analysis of the land price data is provided in Appendix D.

[9] A constant loan-to-value ratio is maintained in the mortgage interest payment index by adjusting, monthly, the base period amount of the loan by the Consumer Price Index change in home purchase price.

mortgage interest payments occurring during the 1967–1972 period is due to the increased home purchase price.

An index of mortgage interest rates, published by the Bureau of Labor Statistics, has risen by 17.5 percent in the past 5 years. (The mortgage interest payment component of the homeownership cost index is approximately the product of the home purchase price series and the mortgage interest rate series; for 1972, the mortgage interest payment component was 1.526, which is approximately 1.294 times 1.175, or the values of the home purchase price times the mortgage interest rate series, respectively.[10]) Allowing for the influence of increased home purchase prices and proportionately larger mortgages, increased mortgage interest rates account for about one-eighth of the 1967–1972 increase in overall homeownership costs—homeownership costs would have risen by 35.2 percent rather than 40.1 percent had it not been for higher interest rates.

The mortgage interest rate index is expected to have exceeded 130 by the end of 1973. This alone will push up the overall homeownership cost index by about 3.2 percent. An example of how this rate increase can be further leveraged by an increase in the principal is provided by arbitrarily assuming that the home purchase price index rose at the same rate in 1973 as it did in 1972. The increased mortgage principal will magnify the impact of increased interest rates, causing total homeownership cost to increase by some 4.5 percent in 1973.

While measuring a general rise in mortgage interest rates, the cost index masks some very important fluctuations in the interest component of housing costs which occurred during the 5-year span. Interest rates rose significantly from 1967 to 1970 and then fell abruptly until the beginning of 1972. (See Table 5.) A sharp increase has been experienced since the spring of 1973, and this will add significantly to the cost of homeownership. Interest rates, however, enter the Consumer Price Index with a time lag, and their impact on the Consumer Price Index does not appear immediately.

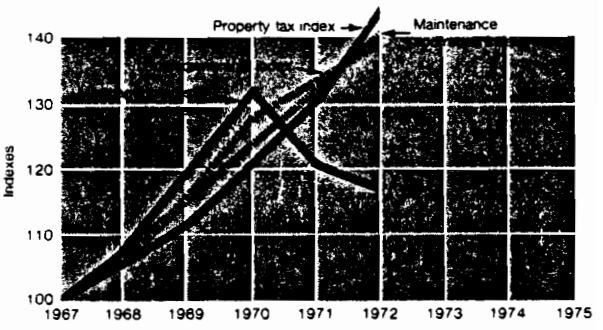
[10] The approximation occurs because of the nature of the calculating procedure used to derive the mortgage interest payment component.

Maintenance and Repair Costs: The third most important factor contributing to the homeownership price increase in the period 1967–1972 has been the cost of maintenance and repairs, which rose 40.7 percent, or 12 percent relative to the total Consumer Price Index. When these costs are broken down, it appears that the cost increase is due mostly to increased labor costs. Maintenance services such as "repainting living and dining rooms" rose by 48 percent from 1967 to 1972—18 percent relative to the Consumer Price Index. By contrast, maintenance commodities, such as paint, rose by only 24 percent—a decline of 1 percent relative to the Consumer Price Index. This is very similar to the pattern for overall construction costs, in which labor rose rapidly and materials were stable.

Property Taxes: While property taxes rose even faster than maintenance and repair costs, they have a lower weight in the Consumer Price Index and, on balance, contributed less to the overall price increase. Moreover, only part of the tax increase represents a true price increase. Some part of the rise in taxes has been used to finance an increase in the supply of local public services—more schools, police protection, etc. To the extent that more services

Chart 3

Changes in Components of Homeownership Cost 1967-1972



Source: Department of Labor, Bureau of Labor Statistics, Handbook of Labor Statistics, 1972, Table 127; Monthly Labor Review, February 1973, Tables 24 and 25.

have been provided, the index overstates the relative increase in housing costs. (See Chart 3.)

It is possible that property taxes will increase much less in the near future than they have in the recent past. Part of the recent tax rate increases is due to the need to provide education for the children of the postwar "baby boom" as they grew up; these children have now finished school, and the need for increased educational expenses has abated somewhat. Also, revenue sharing has provided State and local governments with an alternative to increasing property taxes; this also may reduce future tax rate changes.

Other Costs: Other housing cost factors are property insurance and utilities.[11] As can be seen in Table 5, the relative cost of property insurance has increased at about the same rate as the overall price index in recent years, while the relative price of utilities has declined by approximately 10 percent over the past decade. Until 1972, neither of these factors contributed much to the overall increase in the relative

[11] The "cost of homeownership" index includes neither utilities nor fuels. They are, however, part of the operating costs included in the broader "housing" index and, as with many "homeowner" costs discussed here, they probably affect renters as much as they do owners. If the cost of utilities and fuels were included in the cost of homeownership, the overall cost increase would be only 34.8 percent rather than 40.1 percent. This occurs because the cost of utilities and fuels has risen by only 21.6 percent since 1967.

Table 5. Relative Prices of Mortgage and Operating Expenses, 1963–1972

Year	Relative Property Tax Rate	Mortgage Interest Rate	Relative Mortgage Interest Payments	Relative Repair & Maintenance	Relative Utility Price	Relative Property Insurance
1963	NA	0.90	0.93	0.96	1.07	0.87
1964	0.95	0.89	0.93	0.96	1.06	0.91
1965	0.97	0.90	0.93	0.97	1.04	0.95
1966	0.97	0.95	1.02	0.98	1.02	0.97
1967	1.00	1.00	1.00	1.00	1.00	1.00
1968	1.01	1.07	1.11	1.02	0.97	1.01
1969	1.02	1.20	1.25	1.05	0.94	1.00
1970	1.04	1.32	1.37	1.07	0.93	0.98
1971	1.08	1.20	1.23	1.10	0.95	0.99
1972	1.16	1.18	1.22	1.12	0.96	0.98

NA = Not available.

Source: Department of Labor, Bureau of Labor Statistics, *Relative Importance of the Consumer Price Index: Handbook of Labor Statistics, 1972: Monthly Labor Review*, February 1973.

costs of homeownership. The current "energy crisis," however, probably indicates that utility costs will rise much more rapidly in the future.

The Impact of Rising Homeownership Costs on Households

General Household Response

The discussion in this section centers on the cost of owning a home; renters and rental costs are the special focus of a later section of this chapter. To reiterate, during the 1967–1972 period homeownership costs rose especially rapidly—about 40 percent. During the same period, however, the overall Consumer Price Index rose by only 25 percent while per capita disposable income increased by 39 percent. The implication of these data is that the typical American household has had several options available to it in adjusting to the increased cost of owning a home.

Theoretically, the improvement in living standards has permitted the average household to increase its housing consumption in the face of price increases. Alternatively, the household may have decided that more housing was not worth the price, choosing instead to devote its increased real income to other things while buying a smaller or lower quality house. Indeed, a household may decide to change radically the style of its housing by shifting to a less expensive home. In any case, such shifts represent the outcome of voluntary consumer decisions, except in the case of those families whose real income has lagged behind that of the rest of the population. The typical family has the resources to improve the quality of its housing by spending a larger portion of its increased income on housing if it wishes to do so.

How the average household actually responds to higher housing costs is not completely known. There is some limited evidence, however, that households recently have been buying smaller homes. The median square footage of floor area of a new, privately owned, single-family home purchased in 1972 was some 7 percent less than it was in 1967.[12]

Although this tendency toward smaller homes seems substantial, there are several reasons for believing that it considerably overstates any reduction in housing consumption attributable to increased housing prices, and that it will have been reversed in 1973. For one thing, the years of greatest decline in home size, 1970 and 1971, are also the years of most rapid growth in the Section 235 program for home acquisition by low and moderate income families, and in FmHA-subsidized programs; some of the decline in median home size, therefore, undoubtedly is due to the building of many more, smaller, Section 235 and FmHA homes. Again, any burden represented by the actual reduction in housing size depends largely upon the amount households are being forced to pay for this housing. Evidence, developed later in this chapter, indicates that most groups of households who are buying smaller homes are also paying less of their real incomes for them, leaving more of their incomes for other uses, including mortgage interest costs.[13] Finally, a smaller size does not necessarily imply that the home is of lower quality. Buyers may be more than compensated by adding various amenities; there is some evidence that this is, in fact, what has happened.

In contrast to declining home size, statistics on annual home sales indicate that the number of new homes available nationally expanded greatly during the period from 1967 to 1972; annual sales of new, single-family homes increased by more than 47 percent, from 487,000 in 1967 to 718,000 in 1972.[14] These statistics suggest that the heightened demand and its attendant price increases have induced a significant increase in housing supply.

Moreover, the annual volume of sales of

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[12] Department of Commerce, Bureau of the Census, Construction Reports, *Sales of New One-Family Homes, Annual Statistics*, 1967, C–25–73, Table 31; advance data from 1972 annual statistics.

[13] Between 1969 and 1970, the average sales price of new, one-family homes declined by 4.7 percent, despite a 3.3 percent rise in the one-family house price index. *U.S. Department of Commerce News*, July 5, 1973. CB473–166. p.2

[14] Department of Commerce, Bureau of the Census, *New One-Family Homes Sold and For Sale*, Construction Report C25–73–2, February, 1973.

existing, single-family homes showed a similar increase, with the number of sales in 1972 exceeding the 1967 figure by 61 percent.[15] Although sales of existing homes do not contribute directly to the total supply of housing, an increase of this magnitude reveals an increasingly active resale market for houses; in other words, rising prices have in no way decreased the level of activity in the marketplace.

Judging from the substantially increased sales of new and existing homes since 1967, rising costs of owning a home do not appear seriously to have dampened general demand for housing. But housing is not uniform. Quality, for example, is variable, making it possible for households, if they wish, to offset rising costs by purchasing housing that has fewer amenities.

[15] National Association of Real Estate Boards, Department of Research, *1972 Annual Report*.

Housing Cost v. Housing Value

Although no single measure is likely to

Table 6. FHA New Housing Costs and Values

Part I: 1963 Base

Year	Cost of Standard Home (New Home Purchase Index)	Median Value New FHA 203 Home	Difference (Value-Cost)	Percent Change in Housing Quality (Difference/Cost)
1963	$15,789	$15,789		
1964	16,200	16,063	−$137	−0.8
1965	16,555	16,561	6	0.04
1966	17,207	17,163	−44	−0.3
1967	18,085	17,992	−93	−0.5
1968	18,682	18,797	115	0.6
1969	19,839	20,213	374	1.9
1970	21,929	22,957	1028	4.7
1971	22,806	23,866	1060	4.6
1972	23,907	24,665	758	3.2

Part II: 1967 Base

Year	Cost of Standard Home (New Home Purchase Index)	Median Value New FHA 203 Home	Difference (Value-Cost)	Percent Change in Housing Quality (Difference/Cost)
1967	$17,992	$17,992		
1968	18,585	18,797	$212	1.1
1969	19,737	20,213	476	2.4
1970	21,817	22,957	1140	5.2
1971	22,690	23,866	1176	5.2
1972	23,785	24,665	880	3.7

Source: Department of Housing and Urban Development.

provide an entirely accurate record of changes in housing quality, one relatively straightforward approach is to compare the year-to-year change in the cost of a standard house (as measured by an appropriate cost index) with the year-to-year changes in the price of housing that people actually buy. If the price of houses actually purchased rises more than the cost of a standard house, it is assumed that quality improved, since people are buying a house that is more expensive than the standard quality house.

Table 6 makes such a comparison. The second column in Part 1 shows what the typical new 1963 single-family house insured by the FHA Section 203 program would have cost in each succeeding year. This is calculated by multiplying the 1963 price of the house by the increase in costs, measured by an FHA home purchase index. Because costs rose by 2.6 percent from 1963 to 1964, the typical 1963 house rose in cost by 2.6 percent, from $15,789 to $16,200. Similarly, the 2.2 percent cost increase from 1964 to 1965 would have further raised the cost of the "standard" 1963 house, from $16,200 to $16,555. The remaining entries are calculated in the same way.

Column 3 gives the median value of all new houses insured by FHA under Section 203 in each year. This is the most comprehensive information available about the value of the new houses that people actually bought. The 1963 value is also used as the benchmark value in Column 2 for 1963, to provide a ready basis of comparison of costs and values.

Columns 4 and 5 show how much more rapidly housing values increase; Column 4 is the dollar value of the difference, and Column 5 is the percentage by which housing has improved. In 1972, for example, a new "typical 1963 house" would have cost $23,907, but the median value of the house actually bought was $24,665. This represents an improvement of $758 or 3.2 percent. The typical new house actually purchased in 1972 was worth 3.2 percent more than the typical new house purchased in 1963, even after cost increases are taken into account.

Part II of Table 6 takes 1967 as the base year and compares the value of new homes purchased in subsequent years to the cost of the "typical 1967 house." Between 1967 and 1972, the expenditures on new houses rose 3.7 percent more than the cost of the standard home, providing some indication that a higher quality home was being purchased. In fact, the relative improvement since 1967 exceeds that since 1963 because "quality" appears to have declined slightly in 1966 and 1967. The evidence is weak, because FHA's share of the market has been shrinking in recent years, and some statistical biases may have been introduced because of changes in the nature of the FHA market. On the other hand, if there had been major declines in the quality of houses purchased, one would expect to find some indication of the phenomenon, even in this somewhat deficient data.[16]

Applying the same technique to purchase of existing homes, the picture is slightly different. (See Table 7.) "Quality" was 2.6 percent lower in 1972 than it was in 1967 and roughly the same as in 1963.

The Differential Impact of Cost Changes

Up to this point, the analysis has been based on highly aggregate data dealing with the "typical" household or the "typical" homeowner. As in the case of the housing index and its components, however, averaging often conceals a great deal, thereby presenting a somewhat blurred picture. Succeeding sections of this chapter provide information on the housing cost changes experienced by different subgroups of the population, to the extent that the available data permit. This section briefly considers the probable impact that the different rates of increase of homeownership cost components have had on different population

[16] These statements strictly apply only to FHA houses used in the data. The same patterns, however, occur for costs and expenditures on all new houses, according to data collected by the Department of Commerce, Bureau of the Census and published in the *Construction Reports* series. The Census data in the most recent years are somewhat affected by the large increase in volume of Section 235 houses, which contributes to a slight downturn in housing values, but these data still show a 4 percent improvement in quality over the 1963–1972 period, which is close to that shown by the FHA data. Bureau of the Census, *New One-Family Homes Sold and For Sale*. Construction Report C25–73–2, February 1973.

subgroups. Renters will be discussed in a subsequent section.

Maintenance and repair costs, for example, increased particularly rapidly between 1967 and 1972. One would expect maintenance needs to rise with the age of the dwelling; correspondingly, one would expect maintenance costs to constitute a larger percentage of housing costs for an older dwelling than for a newer one. Further, to the extent that older housing tends to be concentrated in the central city, the rising relative costs of maintenance services would seem to strike hardest at central city dwellers. Studies generally find residents of the central city to include large percentages of blacks, the aged, and families headed by females—groups which, in turn, generally have a lower income than that of the general population. In short, the major impact of rising housing maintenance costs may be upon the poor.

The direct impact of land cost increases, by contrast, is likely to fall on relatively high income groups. Because most new construction tends to be in suburban areas, the increased

Table 7. FHA Existing Housing Costs and Values

Part I: 1963 Base

Year	Cost of Standard Home (Existing Home Purchase Index)	Median Value Existing FHA 203 Home	Difference (Value-Cost)	Percent Change in Housing Quality (Difference/ Cost)
1963	$14,342	$14,342		
1964	14,453	14,614	$161	1.1
1965	14,882	15,128	246	1.7
1966	15,295	15,148	−147	−1.0
1967	15,438	15,828	390	2.5
1968	15,660	16,081	421	2.7
1969	16,661	16,617	−44	−0.3
1970	17,487	17,773	286	1.6
1971	18,281	18,856	575	3.1
1972	19,726	19,691	−35	−0.2

Part II: 1967 Base

Year	Cost of Standard Home (Existing Home Purchase Index)	Median Value Existing FHA 203 Home	Difference (Value-Cost)	Percent Change in Housing Quality (Difference/ Cost)
1967	$15,828	$15,828		
1968	16,056	16,081	$25	0.2
1969	17,082	16,617	−465	−2.7
1970	17,929	17,773	−156	−0.9
1971	18,743	18,856	113	0.6
1972	20,225	19,691	−534	−2.6

Source: Department of Housing and Urban Development.

price of new home sites probably is being paid by relatively well-to-do suburban households, rather than by low income groups.

It is one thing, however, to identify who is paying the increased costs for a component of housing, although this is difficult enough; it is quite another thing to determine precisely how these increased housing costs affect any particular population subgroup. Increased land prices, for example, may make it more difficult for, say, low income groups to become suburbanites. In this case, the low income household would be affected adversely, albeit indirectly, by being less able to afford new suburban homes.

These implications of the increasing costs of land, and of maintenance, are consistent with the relatively slight reduction in the quality of the existing housing purchased by the typical household. (See Table 7.) The reduction may reflect purchases of older, central city housing by relatively low income families. This housing becomes increasingly less desirable as maintenance costs rise, because it is most likely to require maintenance; at the same time, existing houses are bought because land price increases have made it still more difficult for low and middle income households to buy new, suburban housing.

Housing Cost by Income Class

To get a better understanding of how American households may have been affected by recent housing cost increases, it is useful to look at the housing expenditure patterns of various income groups. (See Table 8.)

Examination of three income brackets—low, medium, and high—permits a comparison of the average new housing consumed by a typical family in 1967 with that consumed by a

Table 8. New Housing Consumption by Income Group*

	Low			Medium			High		
	4–500 Monthly Income 1967	5–600 Monthly Income 1972	Percent Change	7–800 Monthly Income 1967	9–1000 Monthly Income 1972	Percent Change	10–1100 Monthly Income 1967	12–1400 Monthly income 1972	Percent Change
Average Family Income	6,591	8,091	22.8	9,640	12,171	26.3	13,204	16,243	23.0
Median Total Acquisition	14,169	18,520	30.7	17,937	23,838	32.9	21,328	26,693	25.2
Median Number of Rooms	5.1	5.1	—	5.72	5.78	1.0	6.27	6.16	-1.8
Median Number of Bedrooms	2.95	2.90	-1.7	3.06	3.11	1.6	3.22	3.19	-0.9
Percent with more than 1 Bath	34.8	46.4	33.3	75.4	79.3	5.2	88.5	88.0	-0.6
Median Floor Area	975	1,020	4.6	1,183	1,206	1.9	1,368	1,342	-1.9
Median Monthly Expense	126.19	184.88	46.5	168.83	243.14	44.0	199.70	276.15	38.3
Median Expense/Income Ratio	27.8	33.2	19.4	22.6	25.7	13.7	19.2	21.4	11.5
Median Age of Mortgagor	27.6	27.8	0.8	30.8	29.0	-6.2	34.7	30.6	-13.4
Median Total Fixed Obligations	169.90	240.35	41.5	260.73	355.28	36.3	325.45	438.09	34.6
Average Principal and Interest	79.13	113.31	43.2	101.71	130.82	28.6	120.45	164.54	36.6
Average Mortgage Insurance Premium	5.88	7.03	19.6	7.41	8.14	9.9	8.69	10.22	17.6
Average Hazard Insurance	3.62	5.82	60.8	4.36	5.53	26.8	5.00	7.05	41.0
Average Real Estate Tax	10.79	21.44	98.7	20.79	27.86	34.0	28.95	46.42	60.3
Average Repair and Maintenance	7.23	12.43	71.9	9.90	12.32	24.4	12.23	16.19	32.4
Average Heating and Utilities	19.52	25.41	30.2	24.93	26.83	7.6	28.56	32.96	15.4
Average Other Recurring Costs	51.30	60.12	17.2	94.45	88.88	-5.9	130.00	170.73	31.3

*Note: Monthly income classes are total effective monthly income not current income. Total effective income is the FHA-estimated amount of the mortgagor's earning capacity (before deductions for Federal income taxes) that is likely to prevail during approximately the first third of the mortgage term.

Source: Department of Housing and Urban Development, *1967 HUD Statistical Yearbook*, and unpublished data.

comparable family (one with the same real income) in 1972. Because the real income of typical buyers increased over the period, this approach overstates the impact of rising housing costs on most people. Also, the data are only for purchases of FHA-insured houses, which introduces a further bias.[17]

The most severe increase in homeownership costs also occurred during this period. Table 8 shows that families whose real income did not increase may have altered their consumption of new housing in response to increased housing costs. First, the median total acquisition cost of housing increased more for the low and medium groups than it did for the high income group. (The increases are 30.7 percent, 32.9 percent, and 25.2 percent, respectively.) The ratio of housing expenditures to income rose for all groups with constant real incomes, since monthly expense rose more rapidly than did money income. The increases in the ratio range from 10 percent to 20 percent. Second, the low and medium groups bought slightly larger houses in 1972, but the change is less than 5 percent for all measures of housing space. The high income family, by contrast, bought a slightly smaller house.

Table 9 presents the same information for buyers of existing houses. Again, the rate of increase of median monthly expenses outpaced increases in income, increasing the ratio of housing expense to income, but the increases are smaller than for buyers of new houses. Despite the increases, it appears that buyers in all three groups purchased about the same type of house in 1972 as they did in 1967, although acquisition expenditures made by the low group increased by somewhat more than they did for the other two groups. (The respective percentage increases are 27.8, 21.5, and 23.) The low group also bought slightly larger houses, while the other groups bought slightly smaller ones.[18]

While the changes in housing expenditures and sizes are very similar for all income groups, there are some slight differences. Some groups have elected to buy slightly larger houses, paying slightly more for them; others have chosen to buy slightly smaller ones, paying slightly less. But all groups are buying just about the same size house, at just about the same relative price, as they did in 1967.

Tables 8 and 9 also tend to indicate that the typical house in each income class was of about the same quality as well as the same size, in both years. For most income brackets, the percentage of houses having more than one bathroom changed by a few percentage points. However, the proportion of low income buyers of new housing with more than one bathroom increased by more than 33 percent, with the percentage of such houses rising from 34.8 percent in 1967 to 46.4 percent in 1972. Other characteristics of houses also changed over this period; on one hand, more houses had garages in 1972 but, on the other, fewer had full basements. Unfortunately, information on these and other quality characteristics is not available by income class for either year.

The findings of Tables 8 and 9 generally are consistent with those of Tables 6 and 7. Table 6 showed that people typically have bought better new houses in the most recent years; this is to be expected, since the average real income was rising throughout this period. In Table 8, however, an examination of typical new houses bought by families having about the same real income throughout the 1967–1972 period shows that they are buying about the same size house even though relative prices have increased, and the home purchase has required a larger proportion of their income. To the extent that these statistics on hypothetical families are indicative of the housing con-

[17] Unfortunately, there are few data on housing consumption by income class and there are some serious problems in using and interpreting the data that are available. For a brief discussion of these problems, see Appendix B to this chapter. Also, the terms "low," "medium," and "high" income refer to the income classes that buy FHA-insured houses, rather than to all households. For example, about one-third of all families in 1972 were below the median income of the "low" FHA group, and about one-quarter were above the median for the "high" group.

[18] Earlier it was noted that the average house purchased declined in size between 1967 and 1972. It was argued that this may have been the result of the Section 235 program, which increased the production of smaller houses. The data used in this section refer only to houses purchased under the 203 program, so they exclude any direct impact of the Section 235 program. But the fact that poorer people are on average moving to larger houses may reflect the indirect effect of Section 235's making more housing available to low and moderate income groups.

sumption patterns of groups with unchanged real income, it would seem that the groups studied here have reacted to rising housing costs not by buying less housing, but by buying fewer other goods. Of course, it should be remembered that a relatively small number of families experienced no increase in real income during this period.

For buyers of existing houses, there was no improvement in housing either for the family shown in Table 7 or for the real income classes shown in Table 9. These findings are consistent, because the median real income of the buyers of existing FHA houses showed virtually no increase over the period (2.7 percent in 5 years). In other words, a comparison of typical FHA buyers of existing homes is almost the same as a comparison of FHA buyers having the same real income. This differs from the situation for FHA buyers of new homes; the typical FHA buyer of a new home enjoyed a real income in 1972 that was 9.2 percent higher than that of the typical FHA buyer 5 years earlier.

Finally, these tables point out, again, that an increased purchase price of houses is only partially responsible for the recently accelerated rise in homeownership costs. The costs of other

Table 9. Existing Housing Consumption by Income Group*

	Low			Medium			High		
	3–500 Monthly Income 1967	5–600 Monthly Income 1972	Percent Change	7–800 Monthly Income 1967	9–1000 Monthly Income 1972	Percent Change	10–1100 Monthly Income 1967	12–1400 Monthly Income 1972	Percent Change
Average Family Income	6.1[illegible]	7,693	25.7	9,740	12,269	26.0	13,205	16,358	23.9
Median Total Acquisition	10,712	13,685	27.8	16,632	20,214	21.5	19,434	23,897	23.0
Median Number of Rooms	5.05	5.08	0.6	5.72	5.58	-2.4	6.06	5.92	-2.3
Median Number of Bedrooms	2.46	2.55	3.7	2.97	2.94	-1.0	3.08	3.04	-1.3
Percent with more than 1 Bath	11.8	14.2	20.3	45.0	44.3	-1.6	64.1	58.7	-8.4
Median Floor Area	930	946	1.7	1,165	1,125	-3.4	1,318	1,237	-6.1
Median Monthly Expense	112.58	156.85	39.3	164.59	220	33.7	189.31	255	34.8
Median Expense/Income Ratio	26.8	28.4	6.0	22.2	23.2	4.5	18.2	19.8	8.8
Median Age of Mortgagor	27.1	26.2	-3.4	31.7	29.6	-7.1	35.0	31.9	-9.7
Median Total Fixed Obligations	164.03	228.81	39.5	255.22	349.80	37.1	321.98	425.67	32.2
Average Principal and Interest	63.80	88.75	39.1	93.49	126.42	35.2	110.27	146.68	33.0
Average Mortgage Insurance Premium	4.72	5.42	14.8	6.75	7.79	15.4	7.91	9.05	14.4
Average Hazard Insurance	3.27	4.51	37.9	3.96	5.52	39.4	4.44	6.17	39.0
Average Real Estate Tax	13.64	20.02	46.8	24.96	35.18	40.9	30.71	44.77	45.8
Average Repair and Maintenance	7.52	10.99	46.1	9.43	13.49	43.1	11.01	15.12	37.3
Average Heating and Utilities	20.47	28.23	37.9	24.90	32.16	29.2	27.70	35.31	27.5
Average other Recurring Costs	56.54	75.58	33.7	98.37	132.46	34.7	136.27	174.39	28.0

*Total effective monthly income.

Source: Department of Housing and Urban Development, *1967 HUD Statistical Yearbook*, and unpublished data.

factors are rising even more rapidly. Mortgage payments, taxes, maintenance expenses, and insurance premiums—all typically show increases of 20 to 30 percent, and often much more, between 1967 and 1972. These increases are roughly similar to those in the Consumer Price Index.

Housing Costs and Mobile Homes

Increased housing costs are partly responsible for the tremendous growth in the demand for mobile homes. The mobile home share of the occupied year-round housing market has increased substantially since 1950. Mobile homes then constituted less than 1 percent of the occupied year-round units, but by 1970 this had grown to 3 percent. In 1972 mobile home shipments constituted 19.5 percent of all new units and 30.5 percent of all new single-family units. (See Chart 4.)

The increasing importance of mobile homes as a source of year-round housing has been accompanied by significant changes in their physical features as well as in the market for them. They are rapidly becoming more competitive with some conventional homes. For example, 8-foot-wide mobile homes were the rule until 1955, when 10-foot-wide homes were introduced. Twelve-foot wide mobile homes came into mass production in 1962, and by 1970 they comprised almost 80 percent of mobile home sales. Fourteen-foot-wide mobile homes, first available in 1969, already constituted 19 percent of the mobile home market by 1972.[19] While growing in size, mobile homes have also been increasing in durability, with life expectancy increasing from about 10 years for those produced prior to 1955 to 14 years or more for those produced after 1958.[20] (Their durability, of course, also depends on the amount of care and maintenance they receive, as well as on the wear and tear inflicted on them by residents.)

The average sale price of a mobile home more than doubled between 1950 and 1971, rising from $3,000 to $6,640. Because of increasing size, however, the cost per square foot of mobile homes declined from an average of about $11 in 1960 to $8.73 in 1972. This contrasts sharply with an average cost per square foot of $15.68 for conventional housing.[21] (See Chart 5.)

The mix of construction costs for a mobile home also differs markedly from that for a

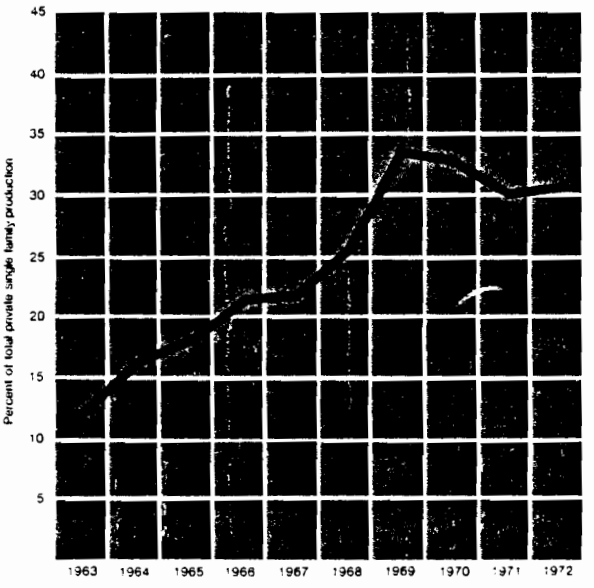
[19] The large double and triple-wides, counted as one unit (two and three mobile homes jointed horizontally on the site but shipped separately), and expandables now account for about 15 percent of the mobile home market. (By way of contrast, less than 1 percent of the mobile homes sold today are 8-feet wide or 10-feet wide.)

[20] Mobile Home Manufacturers Association, *Mobile, Sectional and Modular Homes*, June, 1972. The increase in length of loans tends to confirm this.

[21] Mobile home prices per square foot are strictly comparable only with those for conventional homes as represented by Curve I in Chart 5, in that neither includes the value of the lot, and its improvements, in sales price. This sales price statistic is available for conventional homes only since 1969. Curve II permits a longer term comparison of price trends, even though it contains the upward bias from including improved-lot value in sales price.

Chart 4

Mobile Home Shipments as Percent of Private Single Family Structures Started Plus Mobile Home Shipments



Source: Department of Commerce, Bureau of the Census, Construction Reports, C20, Table 8.

conventional house. For conventional homes, construction costs break out as follows: 38 percent for materials; 40 percent for labor; and 22 percent for overhead, operating expenses, and profit. For mobile homes, the comparable figures are 66 percent, 12 percent, and 23 percent.[22] The much lower labor cost component of mobile home manufacturing is the result of the use of assembly line techniques and semiskilled labor. The cost of materials is a more significant portion of mobile home construction costs, but increases in material costs between 1967 and 1972 have been smaller than increases in the cost of labor. Moreover, because mobile homes are not subject to building codes, manufacturers have been able to utilize new technology, volume production, and lower standards—all of which tend to reduce production costs.

A significant portion of the purchaser's cost of a mobile home is the financing charge. While savings and loan associations may make conventional home mortgage loans for mobile homes, about 90 percent of the retail financing is handled through commercial banks and finance companies, where they are financed with chattel mortgages—the same way that automobiles are financed. They are generally considered consumer durables by financial institutions.

Financing terms have been liberalized since the 1950's, when a 33 percent downpayment was required and loans were made for 3 years at 7 percent add-on interest. Typical terms now involve 20 percent down, 9-year loans (12 years for larger mobile homes or with FHA-insured or VA-guaranteed loans) at 7 or 7.5 percent add-on interest. The add-on method of quoting interest may be misleading to those who are unfamiliar with this technique, since interest is calculated on the full amount of the loan until the loan is fully retired. This results in a true interest rate almost double the stated add-on rate. (Truth-in-lending legislation requires the disclosure of the actual rate of interest.)

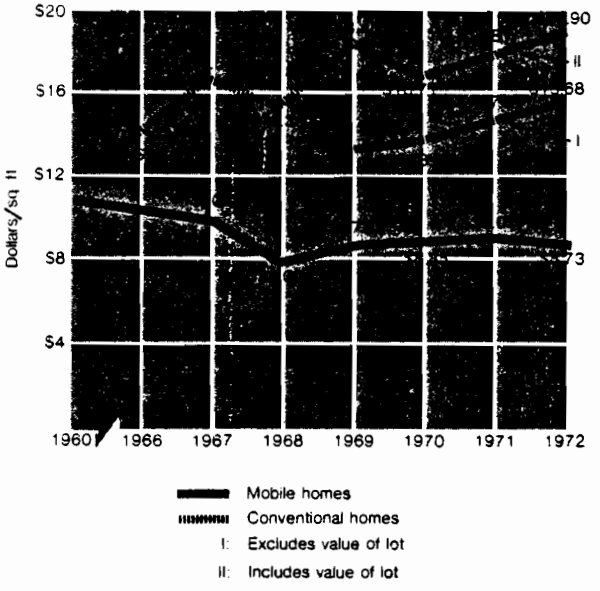
For the first 6 months of 1973 the actual rate was 11.52 percent. As an example of the differences between methods of computing interest, a conventional $1,000 loan for 10 years at 7 percent interest results in total interest charges of $435, but the same loan at 7 percent add-on interest yields $700 in interest charges over the 10-year period. While mobile homes may be more expensive to finance than are conventional homes, mobile home financing historically has not been as severely affected by the periods of tight credit that afflict mortgage markets. Mobile home financing is less sensitive to monetary and fiscal policy changes.

Site rental is another important component of monthly mobile-home housing costs. Average monthly site rental increased from $33 in 1967 to $55 in 1972, a 67 percent increase for the period. Part of this increase can be explained by changes in mobile home parks and the increase in the cost of land and its development. Newer mobile home parks now are usually more than merely places that provide a pad on which to place a mobile home. Most new parks have paved and lighted streets, are landscaped, and provide recreational and com-

[22] "Mobile Housing Manufacturer's Cost and Profit Survey," *Mobile-Modular Housing Dealer Magazine*, 1972.

Chart 5

Costs Per Square Foot for Mobile and Conventional Homes



Source: Mobile Home Manufacturers Association; Department of Commerce, Bureau of the Census, Construction Reports, C25-71-8, C25-73-3.

munity facilities such as community centers, swimming pools, laundries, and tennis courts.

In addition to site rental, many mobile home parks charge substantial entry and/or exit fees and they often charge extra for children and pets. (Entry fees of $1,000 were reported in 1972 in New York parks.) Because these charges are not standard, they cannot easily be estimated on a monthly basis.

The cost of providing utility and maintenance service to the mobile home, as well as tax levies on it, have increased at about the same rate as they have for most other types of housing. However, these costs typically do not loom large in overall mobile home housing costs and, to some extent, increases in these costs reflect the availability of increased and/or improved services to mobile home occupants.

The cost of utilities has been estimated to have increased from an average of $18 per month in 1967 to $23 per month in 1972; the cost of repair and maintenance of mobile homes increased from about $3 in 1967 to an estimated range of $5 to $7.40 per month in 1972.

Mobile homes receive differing tax treatment in the various States. Some States levy no taxes whatsoever (using annual license fees in lieu of taxes) while others impose personal property or real estate taxes. Due to their lower cost and relatively rapid depreciation, mobile home dwellers generally pay less in taxes than do conventional homeowners, even in areas where real estate taxes are levied. Estimates of monthly mobile home taxes for 1972 range from $5 to $9 compared to almost $40 per month for a conventional single-family home financed under FHA's Section 203 program.

There are several other cost factors of mobile homes that must be considered. Mobile homes have a much lower life expectancy than do conventional homes and, therefore, must be replaced relatively frequently. The subject of flammability of mobile homes is a controversial issue.

Finally, mobile homes depreciate to only a small fraction of their original cost after 10 to 15 years while most conventional homes appreciate in value. This means that while the short-term costs of purchasing and occupying a mobile home may be lower than comparable costs for conventional homes, in the long run there is a cost involved that either is not considered by, or is irrelevant to, mobile home purchasers. More than 25 percent of mobile home owners have incomes under $4,000. These families are able to purchase mobile homes because of their lower selling price but may be unable to purchase conventional housing.

If recent trends in housing costs continue, the shift to mobile homes can be expected to continue. The reasons for this are clear; the primary factors contributing to the increased cost of conventional housing are the very same factors that have helped make mobile home prices so competitive, and mobile homes have adapted themselves well to match the increased demand—through increased size, reduced cost per square foot, increased life expectancy, and declining finance costs.

The cost of construction labor has been rising rapidly in recent years, but labor comprises a relatively small component of mobile home construction costs; maintenance costs are rising rapidly at the same time that maintenance needs for mobile homes decline as their life expectancy increases; and, with land costs for new housing sites rising rapidly, mobile homes offer a further advantage because they require a smaller lot than do conventional houses.

As land prices continue to rise, the advantage of mobile homes increases. Actual site rentals paid, however, may be increasing more rapidly than land costs, because mobile home parks increasingly are providing additional facilities, such as laundromats, tennis courts, and swimming pools. The newer mobile home parks are thus similar to the new apartment complexes.

Paralleling the marked increase in production and use of mobile homes in recent years has been the extraordinary development of the condominium concept of homeownership. Condominiums increased from 11 percent of total housing built for sale in 1970 to 30 percent in 1972 and, in 1973, it is projected that condominiums will account for over one-half of all units built for sale in this country. This increased popularity of condominiums undoubtedly is due in part to the favorable tax treatment of homeowners under current income tax provisions. The growth of condominiums, however, is also

partly a result of the recently accelerated rise in homeownership costs. In particular, this type of housing saves on land costs and economizes on maintenance and repair expenses.

Geographic Patterns of Homeownership Cost Changes

In addition to observing the housing cost and consumption patterns of different income groups, it is useful to examine the way housing costs vary on a geographical basis. Because the national housing market is really a set of geographically separate and distinct local markets, housing costs can vary significantly among regions or cities for many reasons.

For one thing, resources used to produce housing services are not available at the same prices in all parts of the country. Such prices would be uniform everywhere only if the resources were easily moved between regions in response to price differences. Although some housing inputs (e.g., raw materials) are fairly mobile, others are not. Workers often have strong ties to the city or locality in which they live and will move only if wage differentials become very large; land is entirely immobile, of course. Also, regional cost variations can result from differences in the kinds of housing services that are wanted in different areas; a rise in the price of central air conditioning, for example, would contribute more to housing cost increases in the South than elsewhere.

All parts of the country have faced greatly increased housing costs in recent years, but some areas have been harder hit than others. All available evidence indicates that new home prices have risen most rapidly in the Northeast and least rapidly in the Western States, with the relative rises in the South and Midwest somewhere in between, depending on the measure of housing cost used. The Census index of new home prices, for instance, rose by 44 percent in the Northeast between 1967 and 1972, compared to 31 percent in the South, 27 percent in the Midwest, and 25 percent in the West. Prices of new houses insured by FHA rose by 41 percent in the Northeast, 35 percent in the Midwest, 30 percent in the South, and 20 percent in the West, in about the same period. Some data on rents are also available; these will be analyzed in a later section of this chapter.

In addition to regional differences, housing costs also vary by the size of the housing market. The Bureau of Labor Statistics has begun to publish a Consumer Price Index based on the size of the urban area; this index has been calculated for five groups of different size for the period since 1967. It shows that housing costs are higher in the larger urban areas, and lowest for the smallest-size group—urban areas with populations between 2,500 and 50,000. These figures are similar to those for the overall Consumer Price Index by size. Data on the components of the housing index are not available by size of urban area.

In 1972, housing costs for the smallest-size group were 26.5 percent higher than they had been in 1967; costs for the largest-size group (metropolitan areas with more than 3.5 million people) were 31.4 percent higher.

This index does not include a separate category for rural areas, and there are no comprehensive cost data available for these areas. In the absence of data, it is not appropriate to extrapolate from the trend of housing costs by size class to assume that costs are lowest in rural areas. It is probable that mortgage interest rates in rural areas are about the same as those in the lowest-size class of urban area; both may face higher rates than prevail in larger metropolitan areas.[23]

Cost information on particular local areas is difficult to attain; in general, the smaller the geographical area, the scantier and less reliable are the housing cost data. However, the available data do confirm the general picture just outlined.

Perhaps the best source of local data on home costs is the Office of Technical and Credit Standards Division of the Federal Housing Administration, which each year collects information on the cost of building a typical house in each of the 177 FHA areas. For many

[23] E. Quinton Gordon, Emily A. MacFall, and Edna Hopkins, "Trends in Rural Non-SMSA Housing, 1950–1970," report for the National Housing Policy Review, 1973.

areas, these houses have had the same basic characteristics since 1967—the same floor space, the same number of rooms, and the same building materials.

Changes in the cost of 42 such typical houses, located all over the country—in big cities, small cities, and suburbs—have been calculated as part of this study for the period 1967–1972. (Chart 6 shows the changes for all 42 areas, arranged by region; Appendix C contains a description of the cost data.) Houses in the Northeast showed the largest increases, significantly higher than those in any other region; the North Central, South, and West, closely bunched, followed, in that order.

When homeownership costs in individual areas are examined, other patterns emerge. As occurred with the housing component of the Consumer Price Index, prices in large metropolitan areas have increased more rapidly than in nearby smaller Standard Metropolitan Statistical Areas, or in small cities. The increase was 29 percent in Houston, and only 19 percent in nearby Texas City, for example. Portland, the largest metropolitan area in Oregon, showed an increase of 26 percent; Eugene, the second largest, only 17 percent. In most instances, the differences were small—about 32 percent in Cleveland and 29 percent in nearby Akron; 25 percent in Milwaukee, 22 percent in Madison. In a few instances, the smaller area experienced greater increases; prices rose slightly more rapidly in Erie than in Pittsburgh, and in Dayton than in Cincinnati.

The rate of growth of the area also appears to be related to the rate of cost increase. Small cities such as Mankato, Minn., and Pittsburg, Kan., showed low increases; they are also among the lowest in population growth. The very lowest price increases, however, were in New Orleans and Los Angeles, which grew rather rapidly during the period studied.

These figures measure only the change in the cost of the structure. Data on land prices are available for many of the same areas, although not for all of them. Land prices show patterns somewhat similar to those of structure prices; they have risen most rapidly in the East, for example, and are rising more rapidly in larger, faster growing areas. Again, there are exceptions: Chicago has a low land price increase; Boise, Idaho, a high one.[24]

When the change in the price of the typical lot is added to the change in the price of the typical structure, roughly the same pattern emerges. Price increases have been most rapid in the East, least rapid in the South.

The question of who is being affected the most, then, by rising housing costs can be answered on a geographical basis, as well as on the basis of income. Table 10 compares changes in per capita income with changes in structure costs, land prices, and land and structure costs combined.[25]

Structure prices outran income in only four areas out of 39 for which the comparison could be made: Burlington, Baltimore, Cleveland, and Muskegon.[26] In four others, both grew at the same rate: New York, Chicago, Gary, and St. Louis. Most of these areas are in the Northeast and North Central regions, and are among the largest.

The pattern for land prices is very different. Eight of 26 areas show price increases greater than income increases: four were in the West (Boise, Honolulu, Los Angeles, and Portland, Oreg.), with the others geographically scattered. In another Western city, San Jose, land prices increased as rapidly as income. (Land price data are available for fewer areas than are structure price data.)

When land and structure prices are com-

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[24] The land price data are based on FHA–insured homes, and are averages of prices of sites actually sold. They may not accurately represent changes in the cost of the same type of land over time, since there is no attempt to compensate for differences in location, accessibility, or other characteristics. (See Appendix D for details.)

[25] Per capita income by city is published in the *Survey of Current Business;* the most recent data available, however, are for 1971. Consequently, Table 10 compares price changes from 1967 to 1972 with income changes from 1966 to 1971. It is unlikely that the conclusions would change significantly if exactly the same periods were compared. The income figures are total per capita rather than disposable, data for which are not available for individual areas. However, the ratio of disposable to total per capita income for the Nation as a whole changed by less than 1 percent from 1966 to 1971, so a comparison of costs with disposable income should show virtually the same patterns.

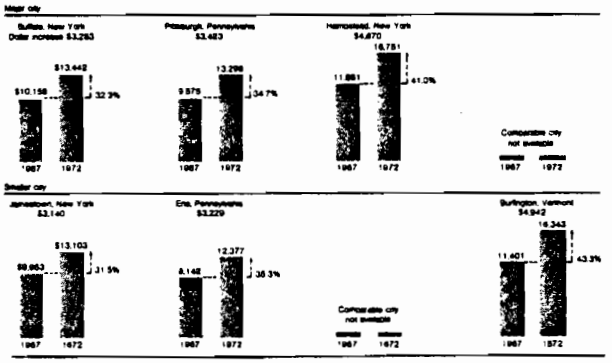
[26] Income figures were not published for three of the 42 areas.

bined, only four cities show price increases greater than income increases: New York, Detroit, Los Angeles, and Portland, Oreg. In all other areas, families are able to buy the same house, on the same size lot, that they could have bought in 1967, without having to reduce their consumption of other goods and services.

Chart 6

Total Dollar and Percentage Increase of Construction Costs Comparisons of Major and Smaller Cities, by Region, 1967-1972

Northeast



There is no especially clear geographical pattern in this, although there is a tendency for larger areas to incur greater cost increases, relative to income increases, than smaller areas do.

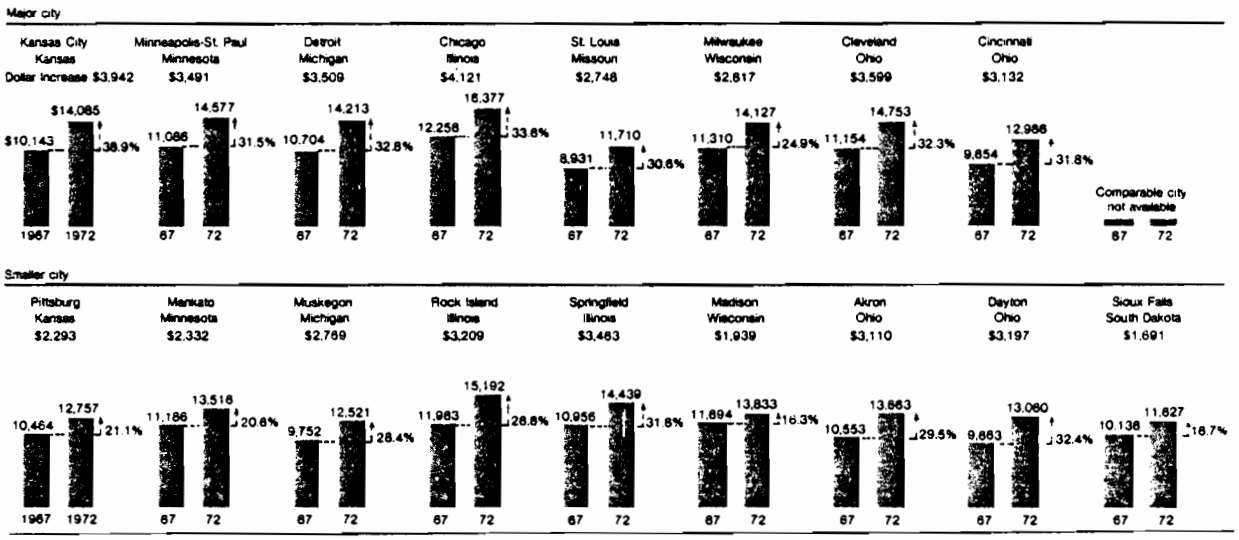
All of the geographical data discussed so far concern home purchase price only. The Consumer Price Index also includes information on the "cost of homeownership" in large metropolitan areas. In 15 of the 18 areas for which comparisons are possible, the cost of homeownership increased faster than the cost of the typical house (structure only). The exceptions were Baltimore, St. Louis, and Cleveland; and, in all three areas, the difference was less than 2 percentage points. In 14 areas, land price estimates were also available, so that an overall cost of the house, including land, can be compared to the cost of homeownership. Again, the cost of homeownership outpaced the cost of the house in all but three areas: Los Angeles, San Diego, and Honolulu. In these three areas, rapid increases in land prices explain the greater increase in the cost of a house.

The comparison between the increased

Chart 6 (continued)

Total Dollar and Percentage Increase of Construction Costs Comparisons of Major and Smaller Cities, by Region, 1967-1972

Northcentral



cost of homeownership and the increase in per capita income is confined to the period 1967–1971 because income data are not available on a regional basis for 1972. Over this period, the cost of homeownership increased more rapidly than did per capita income in nearly all metropolitan areas; the four exceptions were Atlanta, Buffalo, Honolulu, and Washington, D.C.[27] (See Table 11.)

When these data are considered together, the local patterns are very similar to the national one. Incomes have increased more rapidly than has the cost of a house, but the cost of homeownership (including mortgage payment, property taxes, and maintenance expenses) has increased more rapidly than either. People in nearly every part of the country can afford to buy as good a house as they could 5 or 6 years ago, and still have more left over to spend on other goods and services; but they have had to pay relatively more for the other total costs of homeownership. In most major metropolitan areas, the house is not more of a financial burden, but the maintenance and taxes are.

[27] These figures would be very slightly changed if disposable income were used rather than total income; the ratio of disposable to total income changed by less than 0.5 percent between 1967 to 1971.

Housing Costs for Renters

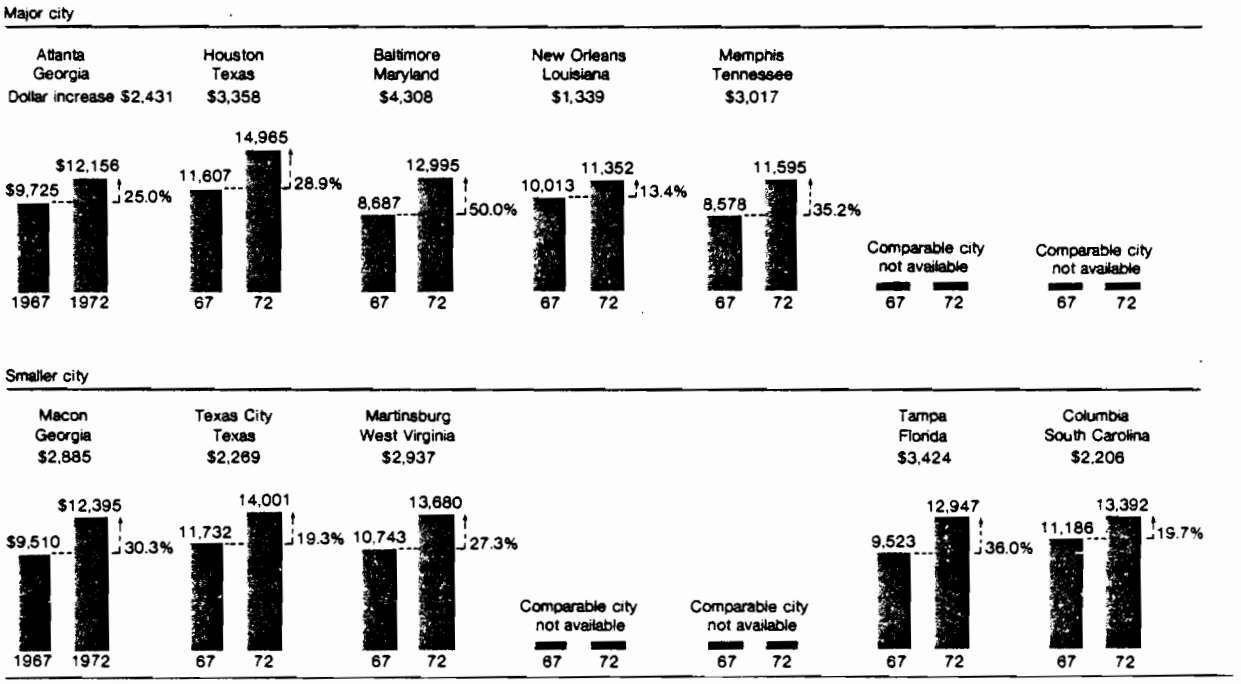
Rents v. Homeownership Costs

This chapter has concentrated on the costs of owning a home, partly because there are much more detailed data available on the various cost items involved in homeowning than in renting, and partly because the cost of

Chart 6 (continued)

Total Dollar and Percentage Increase of Construction Costs Comparisons of Major and Smaller Cities, by Region, 1967-1972

South



homeownership has been increasing much more rapidly in recent years. Rental costs have increased much less rapidly than income, even in the past 5 years, and less rapidly than the overall Consumer Price Index. Thus, renters generally have not been adversely affected in recent years, although rising rents obviously are a problem for those whose incomes have not kept pace, just as higher prices for other goods and services are a problem. This is particularly significant because renters tend to cluster toward the lower end of the income distribution.

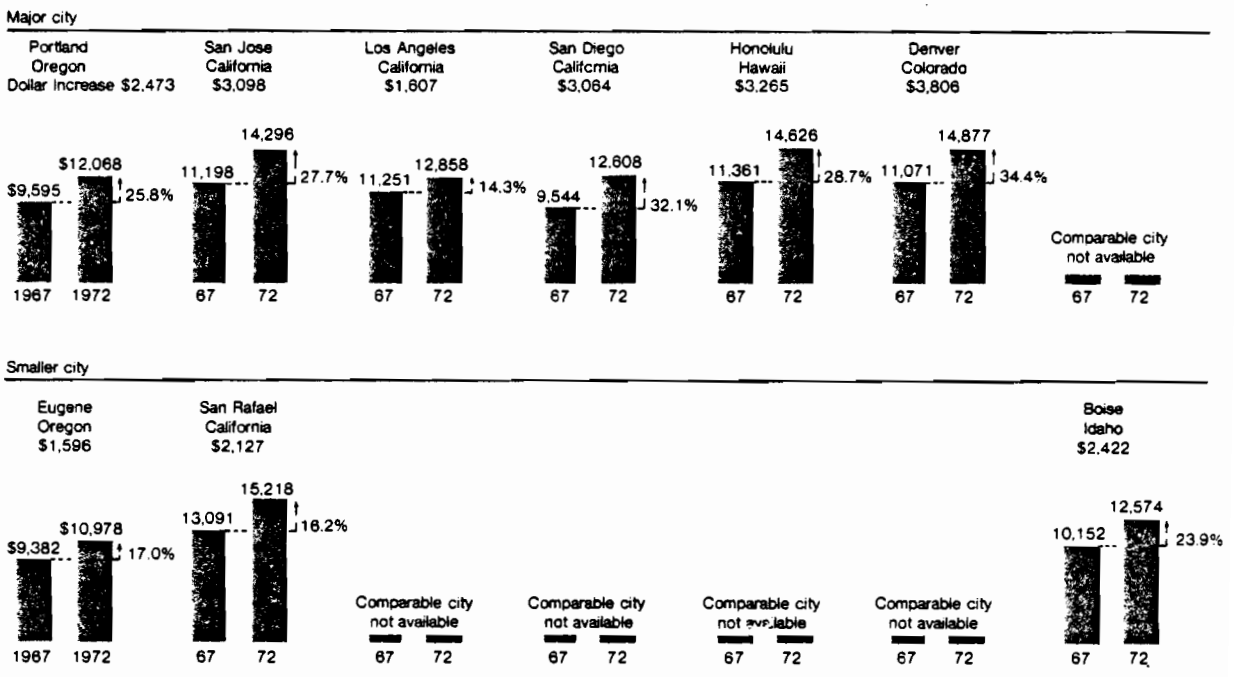
The sharp differences between the movements in rent and homeownership costs, however, are themselves important. The discrepancies are perhaps somewhat surprising, since would-be home buyers typically choose to rent rather than buy when the cost of buying increases. The rapid rise in homeownership costs, therefore, should have induced some families to seek rental units, thereby driving up rents and gradually bringing the two indexes closer together. There is no evidence, however, that this has been happening in recent years; if anything, the spread between them is widening.

It is difficult to find any factor in the rent index itself that is likely to account for the difference. The rent index is calculated by comparing rent changes for the same apartment from month to month and year to year. Because the apartments are the same, most aspects of housing quality automatically are held constant over time; each apartment has the same number of rooms and bathrooms, the same floor area and the same amenities each time it is priced. The rent index is thus more precise than the home purchase index, because the latter is based on the prices of different houses from month to month. While the home purchase index does attempt to

Chart 6 (continued)

Total Dollar and Percentage Increase of Construction Costs Comparisons of Major and Smaller Cities, by Region, 1967-1972

West



Source: McKinsey and Company, Inc., "Analyzing Trends in Housing Construction and Operating Costs," a study for the National Housing Policy Review, 1973.

Table 10. Changes in Home Costs and Incomes by Metropolitan Area, 1967–1972

Area	Percentage Increase In: Structure Cost	Land Cost	Combined Cost	Per Capita Income (66–71)
Northeast				
Buffalo	32			39
Burlington	43			39
Erie	35			37
New York (Hempstead)	41	51	43	41
Pittsburgh	35	25	32	37
North Central				
Akron	30			36
Chicago	34	7	27	34
Cincinnati	32	10	26	38
Cleveland	32			30
Dayton	32	25	30	32
Detroit	33	53	38	34
Gary	27	24	26	27
Kansas City	39	15	34	40
Madison	23			36
Milwaukee	25			32
Minneapolis-St. Paul	32	36	33	38
Muskegon	28			26
Rock Island	27			29
Sioux Falls	17			65
Springfield, Ill.	32			50
St. Louis	31	16	27	31
South				
Atlanta	25	14	22	49
Baltimore	50			41
Columbia	20	59	27	48
Houston	29	25	28	47
Macon	30			56
Memphis	35	36	35	46
New Orleans	13	37	21	33
Tampa	36	26	34	56
Texas City	19	24	20	48
West				
Boise	24	58	30	43
Denver	34	15	30	51
Eugene	17	12	16	35
Honolulu	29	67	48	49

(Continued on p. 232.)

(Continued from p. 231.)

Los Angeles	14	75	36	34
Portland	26	74	37	35
San Diego	32	39	35	41
San Jose	28	37	31	37
San Francisco-Oakland (San Rafael)	16	32	21	38

Source: Department of Housing and Urban Development; Department of Commerce. *Survey of Current Business*. May issues.

Table 11. Changes in Income and Homeownership Costs, 23 Major SMSA's,* 1967–1971

SMSA	Percentage Change in CPI	Percentage Change in Homeownership Component of the CPI	Percentage Change in Per Capita Income
Atlanta	21.7	36.9	40
Baltimore	23.4	43.9	33
Boston	22.7	38.1	33
Buffalo	21.8	28.6	31
Chicago	20.8	30.1	28
Cincinnati	20.7	33.5	29
Cleveland	22.8	26.2	25
Dallas	21.3	39.1	28
Detroit	21.7	41.4	31
Honolulu	18.9	25.8	39
Houston	20.9	37.4	34
Kansas City	20.5	32.8	30
Los Angeles	18.5	28.6	27
Milwaukee	20.1	29.8	25
Minneapolis	21.7	34.6	29
New York	25.9	44.2	31
Philadelphia	23.5	37.1	28
Pittsburgh	21.5	36.7	29
St. Louis	19.6	26.1	24
San Diego	19.8	40.4	29
San Francisco	20.1	31.6	30
Seattle	16.4	28.7	13
Washington	22.7	32.9	35

*Standard Metropolitan Statistical Areas.

Source: Department of Labor. Bureau of Labor Statistics. *Monthly Labor Review*. April 1973. Table 26; Department of Commerce. *Survey of Current Business*. May 1973. Table A.

standardize for several dimensions of housing, it cannot be as precise as the rent index, since houses differ in many ways besides those taken explicitly into account in the home purchase index.

There is, however, one way in which the rent index is less precise than the home purchase index. Each year, the apartments included in the index sample are 1 year older; during that year, they may have depreciated. No attempt is made in the rent index to adjust rents for depreciation; depreciation appears in the index as a decline in price, rather than as a decline in quality. For this reason, many statisticians regard the rental price index as inherently biased downward.[28]

This problem does not arise for the home purchase index, because houses are categorized on the basis of age, among other characteristics; 20-year-old houses sold in 1972 are compared to 20-year-old houses sold in 1973, for example.

This introduces a source of bias into the rent index, but it is unlikely that the major difference between the indexes can be explained by the treatment of depreciation alone.

A second possible explanation for the rent patterns in the most recent periods is that, during late 1971 and much of 1972, rents were controlled under Phase I and Phase II programs to fight inflation. The divergence between rent and homeownership costs, however, was widening even before 1971. In the past 2

[28] New units regularly added to the apartments included in the rent index, and old units dropped from the sample, but the new units are never substituted directly for the old ones. The depreciation problem arises because new units built in 1972 are not compared with new units built in 1971; instead, the 1972 price of the unit built in 1971 is compared to the 1971 price. This practice makes it easier to standardize for many characteristics of the apartment, but it also means that the unit is older each time it is priced, and the index is not adjusted for this depreciation.

years, rents have increased about as fast as the overall Consumer Price Index, while homeownership costs have increased only slightly faster.

Another possible explanation for the smaller increase in the rent index may be changes in neighborhood amenities such as local public services. Apartments are relatively more common in central cities; houses—especially new houses—are more common in the suburbs. Crime, fire, and similar problems appear to be more serious in central cities, as discussed in Chapter 6; central city neighborhoods therefore are likely to be less desirable. This might cause overall rent averages to rise less than rents in suburbs. Also, if public services (such as education) deteriorate in the cities, or even improve less rapidly than in suburbs, central city rents would rise less than would suburban rents.

The same would be true for the difference in prices of houses between central city and suburbs; however, to the extent that apartments are relatively more common in the city and houses more common in the suburbs, a relative improvement in public services in the suburbs would appear as an increase in the price of single-family houses relative to apartments in the Consumer Price Index. This phenomenon might also partially explain the increases in the prices of new houses relative to existing houses in recent years, because existing houses are more likely to be located in central cities.

For both reasons, the rent index may be too low. There is also, however, an important reason why the home purchase index, and thus the cost of homeownership, may be too high, particularly in recent years. The purchase price of a house reflects expectations that prices will rise in the future, as well as the value of the housing services provided currently.

In a period of inflation, housing prices are likely to be high because homebuyers expect that the house will be worth more in the future; they are buying an asset that they anticipate will appreciate in value. Rents, on the other hand, reflect only the value of the services currently provided, since leases are typically renegotiated at short intervals of a year or two; in some instances, rents are set month by month, without leases.

The price of a house is thus likely to overstate the cost of the housing services it provides in any short period of time, because the house is also an investment that is expected to appreciate in value. The rent index is a better measure of the actual price of current housing services alone, while the home purchase index is a better measure of expected future housing costs.

The differences between the indexes thus are caused by both downward biases in the rent index and upward biases in the home purchase index. In periods of inflation, such as the present, the upward bias in the home purchase index is likely to create the greatest distortion in the measurement of housing costs.

Despite its limitations, the rent component of the Consumer Price Index is a reasonably reliable guide to the cost of housing for renters. This is especially true for changes in the index over relatively short periods of time, such as the last 5 years, because depreciation and possible neighborhood changes are likely to have a smaller impact; their effects tend to be gradual and cumulative over fairly long periods for the Nation as a whole.

Geographical Patterns of Rent Increases

Although there are relatively few data on rent costs for different geographical areas, or for population subgroups, the Consumer Price Index does include a rent series for 25 large metropolitan areas, including most of the largest areas in the country. Table 12 shows the changes in the rent component of the Consumer Price Index for these 25 areas, for the 1967–1972 period. With the single exception of Honolulu, the increases are less than the increases in homeownership costs for the same areas as shown in Table 11. In most cases the differences are substantial. Table 12 also shows per capita income for these areas over the 1966–1971 period; for all areas, incomes increased far more rapidly than did rents. The typical renter in each area was able to afford a better apartment or home in 1972 than in 1967.

When the pattern of rent increases is examined more closely, pronounced regional differences can be seen. The increases are much greater in Eastern and Western areas

than they are in the Midwest and South. The seven areas with the greatest increases are all Eastern or Western areas; San Diego heads the list. The area with the smallest increase is Seattle, but the next five above it are located in the Midwest or South. By contrast, the changes in the cost of homeownership showed a much less marked regional pattern.

Other patterns in the rent data are less clear. There is some tendency for rent and income increases to be positively correlated, but the correlation is weak. Rent increases appear to be unrelated to the size of the area, or its rate of growth.

Table 12. Changes in Income and Rents, 25 Major SMSA's

SMSA	Percent Change in the Rent Index 1967–1972	Percent Change in Per Capita Income 1967–1971
Atlanta	17.0	48.8
Baltimore	12.6	41.4
Boston	29.2	45.2
Buffalo	20.1	38.8
Chicago	13.2	34.3
Cincinnati	9.6	37.5
Cleveland	13.0	30.4
Dallas	11.8	40.2
Detroit	20.2	33.9
Honolulu	27.7	49.2
Houston	10.9	47.2
Kansas City	10.7	40.3
Los Angeles	18.5	33.6
Milwaukee	17.9	31.5
Minneapolis—St. Paul	21.1	38.2
New York	27.2	40.5
Philadelphia	24.4	36.5
Pittsburgh	17.0	37.4
Portland	17.4	35.2
St. Louis	8.6	31.0
San Diego	33.6	40.6
San Francisco	29.2	38.1
Scranton	26.1	43.3
Seattle	5.7	22.2
Washington, D.C.	18.6	42.1

Source: Department of Labor. Bureau of Labor Statistics, unpublished data; Department of Commerce, *Survey of Current Business*, May 1973.

Rental Costs and Rental Values

The rent index can be used to measure the extent of quality improvement for renters, in the same way that changes in the price indexes for owner-occupied housing were used to measure quality improvements for owners.[29] Table 13 compares the change in the actual rents paid by all renters, and by population subgroups of renters, to the change in the rent index, over the period 1960–1970.[30] The 1960 median rent for the group is multiplied by the ratio of the 1970 rent index to the 1960 index, in Column 2; this measures the median rent that would have been required in 1970 for the same apartment that was occupied in 1960.

For renters as a whole, as well as for every subgroup, the median rent actually paid (Column 3) has risen by much more than the median rent required for the same apartment; the difference (Column 4) is a measure of the improvement in quality over the decade. For all renters, for example, the quality improvement according to this measure was $23, or 27 percent, from 1960 to 1970.

In general, quality improvements have been least for households headed by elderly persons, or for single-person elderly households, although such calculations indicate that even these groups have had improvements of at least 15 percent during the decade.

The figures by income class are especially impressive because these classes have the same dollar income in both years, even though the cost of living rose by 31 percent. The improvement for each group is consistent, however, with the fact that the rent index rose by less than the cost of living over the period; a hypothetical household, with the same money income in both 1960 and 1970, chose to buy better housing as its price, relative to those of other goods, became cheaper. For groups that

[29] See the section, "Housing Cost v. Housing Value," earlier in this chapter.

[30] Data on rents actually paid are available only in the decennial Census of Housing, so comparisons for the last 2 or 3 years are not possible.

had the same real income in both years, the improvement is even more striking. For instance, the $3,000–$3,999 class in 1960 had about the same real income as the $4,000–$4,999 class in 1970; rental housing for the 1970 group was 21.5 percent better than for the 1960 group. Similarly, when the $6,000–$6,999 group in 1960 is compared with the $7,000–$9,000 group in 1970, housing is seen to have improved by 18.6 percent.[31]

[31] These groups are comparable on the basis of real income, using the midpoints of each group to represent income for the typical household in the group, as is conventional. The increase in real income for the lower group was 29.7 percent over the decade; for the higher group, it was 30.8 percent. Both are very close to the 31.1 percent increase in the Consumer Price Index.

Table 13. Rental Costs and Rental Values, 1960 and 1970

Renters by Household Type and Income	(1) Median 1960 Gross Rent	(2)* Cost of 1960 Apartment in 1970	(3) Median 1970 Gross Rent	(4) Quality Improvement (3)−(2)	(5) Percentage Quality Improvement (4)÷(2)
All renters	71	85	108	23	27.1
Household type					
2 or more persons					
Male head, wife present					
Under 45 years	76	91	118	27	29.7
45–64 years	75	90	114	24	26.7
65 years and over	68	82	102	20	24.4
Other male head					
Under 65 years	74	89	120	31	34.8
65 years and over	65	78	92	14	17.9
Female head					
Under 65 years	69	83	106	23	27.7
65 years and over	66	79	93	14	17.7
1 person households					
Under 65 years	61	73	97	24	32.9
65 years and over	52	62	78	16	25.8
Income class					
Less than $2,000	52	62	79	17	27.4
2,000–2,999	60	72	85	13	18.1
3,000–3,999	66	79	91	12	15.2
4,000–4,999	72	86	96	10	11.6
5,000–5,999	76	91	102	11	12.1
6,000–6,999	81	97	106	9	9.3
7,000–9,999	87	104	115	11	10.6
10,000–14,999	99	119	133	14	11.8

*Column (1) multiplied by the change in the rent component of the consumer price index, taken from Department of Labor, Bureau of Labor Statistics, *Handbook of Labor Statistics*, 1972, table 127.

Source: Department of Commerce, Bureau of the Census, *Census of Housing*, 1960 and 1970.

When changes in rents are compared to changes in incomes, it appears that both have grown at about the same rate for population subgroups classified on the basis of household composition and age of the household head. Table 14 contains the rent-to-income ratios for renters as a whole and for these subgroups. Only one group shows a change of more than 1.5 percentage points in either direction. Of the nine categories, rent-income ratios have risen in five, declined in three, and are unchanged in one; nor does there seem to be any particular pattern to the changes. These data are consistent with the conclusion of recent studies on housing expenditure-income relationships that expenditures increase approximately at the same rate as income.[32] The change for the renter group as a whole is primarily caused by changes in the composition of renters; there were more elderly renters with higher rent-income ratios in 1970 than there were in 1960.

When rent-income ratios for income groups are examined, the pattern changes; rent-income ratios are up for all groups. (See Table 15.) This is caused in part by changes in the proportions of elderly and single-person households in the different income groups; single-person households, which typically have high rent-income ratios, comprised only 28 percent of those with incomes below $5,000 in 1960, compared to 42 percent in 1970.

The income figures used in these comparisons are for total income, rather than disposable income, which is not available in the Census statistics. During the decade of the 1960's, the ratio of disposable to total income declined by about 2 percent, which would imply that rent-income ratios increase slightly more when disposable income—rather than total income—is used. The differences are slight, however. Also, it is likely that rent-income ratios for the lowest income classes would be affected least by this adjustment.

Table 15—using objective measures such as plumbing and crowding conditions—also shows that between 1960 and 1970 housing quality had improved for every income class. Households in all income classes had rising rent-income ratios and better housing. Indeed, it is correct to say that the households had higher rent-income ratios because they had better housing. Had renters been willing to occupy the same quality of housing in 1970 as they did in 1960, they could have reduced their rent-income ratios substantially, because median income of renters rose by more than 50 percent during the decade, while the rent index component of the Consumer Price Index rose by only 20 percent.

The relatively small increases in rents and the improvement in housing quality for renters are especially important because renters are relatively more common among lower income groups. Table 16 shows that about half of all households with incomes below $6,000 are renters, compared to 37 percent nationally. Information on these low income groups is valuable, because the limited data on home-ownership costs available by income group do not cover households with incomes below

[32] Margaret G. Reid, *Housing and Income*. Chicago: University of Chicago Press, 1962; Frank de Leeuw, "The Demand for Housing: A Review of Cross-Section Evidence," *Review of Economics and Statistics*, February 1971.

Table 14. Rent-Income Ratios, by Household Composition, 1960 and 1970

Household Composition by Age	Median Rent-Income Ratio	
	1960	1970
Male head, wife present (2 or more persons)		
Under 45 years	17.3	16.0
45–64 years	15.4	14.0
65 years and over	23.6	23.6
Other male head (2 or more persons)		
Under 65 years	18.9	22.8
65 years and over	25.1	26.4
Female head (2 or more persons)		
Under 65 years	29.4	30.4
65 years and over	28.4	27.6
One-person households		
Under 65 years	22.3	22.6
65 years and over	49.5	49.8

Source: Department of Commerce, Bureau of the Census, *Census of Housing*, 1969 and 1970.

Table 15. Rent-Income Ratios and Rental Housing Conditions by Income Class, 1960 and 1970

Income Class	Median Rent—Income Ratio		Percent of Households With Central Air Conditioning		Percent of Crowded Households		Percent of Households Lacking Complete Plumbing*	
	1960	1970	1960	1970	1960	1970	1960	1970
Total	35.3	39.6	1.0	8.6	15.6	10.1	19.5	8.0
Less than $2,000	57.8	64.0	0.5	4.2	15.9	7.4	40.3	18.1
2,000–2,999	28.7	51.8	0.5	4.4	20.6	9.7	22.3	12.6
3,000–3,999	22.3	31.8	0.7	5.1	19.2	12.6		
4,000–4,999	18.3	26.7	0.9	5.8	17.5	13.1	10.9	8.2
5,000–5,999	16.6	22.4	0.9	6.8	16.2	12.9		
6,000–6,999	15.0	20.2	1.0	7.5	14.5	12.1	5.3	4.3
7,000–9,999	12.3	16.8	1.4	8.4	12.1	11.6		
10,000–14,999	10.2	12.7	2.6	11.8	10.9	10.1	2.8	1.8
15,000 and over	6.7	9.0	5.5	19.3	8.4	8.4		

*Income classes: Less than $2,000
2,000–3,999
4,000–5,999
6,000–9,999
10,000 and over

Source: Department of Commerce. Bureau of the Census. *Census of Housing*. 1960 and 1970.

Table 16. Renters by Income Class, 1970

Income Class	Renter-Occupied Units as Percent of U.S. Total
$0–$1,999	50.8
2,000– 2,999	49.1
3,000– 3,999	49.7
4,000– 4,999	49.7
5,000– 5,999	49.0
6,000– 6,999	46.9
7,000– 9,999	38.7
10,000–14,999	27.4
15,000–24,999	19.5
25,000 and over	15.5
Total	37.1

Source: Department of Commerce. Bureau of the Census. *Census of Housing*. 1970

$6,000 to any appreciable extent. As a result, this chapter has little to say about homeownership costs for low income households. For the half of low income families who are renters, however, the available data indicate that rent increases have not adversely affected them. These households usually occupy housing of lower quality than does the typical household, but the evidence on rental costs provides some verification for a logical assumption—that they occupy such housing because they have low incomes.

Appendix A: Three Housing Cost Indexes—Bureau of Labor Statistics, Bureau of the Census, Bureau of Economic Analysis

There are three available indexes of the cost of houses. All show small increases in recent years, compared to factor prices, and compared to the overall "cost of homeownership" component of the Consumer Price Index. (See Table 17.)

The U.S. Bureau of Economic Analysis Index for single-family homes calculates the price of finished structures having set specifications, excluding land prices. This index shows an estimated price increase of 4 percent between 1967 and 1970 relative to the Consumer Price Index. The recent increase reverses a downward trend existing since World War II. A more comprehensive index, prepared by the Bureau of the Census, takes eight characteristics of new houses into account in estimating price increases. On the basis of these characteristics, new houses are subdivided into 35 categories for calculating the index. This index has increased by 5 percent relative to the Consumer Price Index since 1967. Finally, the "Home Purchase" series of the Consumer Price Index is based on FHA-insured houses, both new and existing; it subdivides houses only on the basis of size and age, and is thus less comprehensive than the Census index. This series has increased by 3 percent relative to the Consumer Price Index since 1967.

Table 17. Three House Cost Indexes

Year	Structure Costs [1]	Housing Sales Price Index (Census) [2]	Home Purchase Index (BLS) [3]
1963	1.02	0.98	1.03
1964		0.98	1.03
1965	1.01 (EST)	0.99	1.03
1966	1.00	0.99	1.00
1967	1.00	1.00	1.00
1968	1.02	1.01	1.00
1969		1.03	1.01
1970	1.04 (EST)	1.01	1.04
1971		1.02	1.03
1972		1.05	1.03

Source: [1] Department of Commerce, Bureau of Economic Analysis, Index of Construction Costs. The index was adjusted to a 1967 base and made relative to the CPI.
[2] Census index of one-family sales prices. Taken from Department of Commerce, Bureau of the Census. *Construction Reports*, Series C-25, and made relative to the CPI.
[3] Developed by Department of Housing and Urban Development, National Housing Policy Review, based on Department of Labor, Bureau of Labor Statistics Data and made relative to the CPI.

Appendix B: Data Used for Housing Comparisons by Income Class

There are few available data on housing consumption by income class apart from that in the decennial Censuses of Population and Housing. Unfortunately, housing cost increases have accelerated since 1967, so that comparisons of 1960 and 1970 data do not provide much information pertinent to the problem. Apart from the Census, the most comprehensive data are compiled by the Federal Housing Administration, which collects and publishes the characteristics of houses insured by FHA. From these data it is possible to compare housing purchases by income class over a period of time.

Because only FHA-insured houses are involved, FHA data refer only to a small fraction of all home purchases; moreover, these houses typically are less expensive than the average home, particularly the average new home. However, the data are appropriate in that they are used to compile the Consumer Price Index, which has shown the most rapid increase in housing costs. Calculations based on FHA data, therefore, are more likely to reveal changes in housing consumption by the various groups studied; if anything, they will overstate the effects of increased housing costs.

It is important to choose carefully the income classes used to make comparisons. It would not be very useful, for example, to compare families earning the same dollar incomes in 1967 and 1972. Because prices increased substantially during this period, an income of, say, $5,000 represented a much lower real income for a family living in 1972 than it did for a family living in 1967. Furthermore, average income increased substantially during this period so that even families having the same real incomes in those 2 years are not strictly comparable. Because the 1967 average real income is no longer the average real income in 1972, the family maintaining that income is no longer typical.

Appendix C: Cost Data by Geographical Area

The Appraisal and Mortgage Risk Division of the Department of Housing and Urban Development regularly compiles data regarding changes in the cost of constructing a "typical" house in selected areas of the country. These data have been amassed for the years 1967–1972.

For each area, the "typical" house (defined in terms of such characteristics as floor area and type of building materials used in construction) was determined through interviews with builders, architects, and appraisers. Once the typical house was defined, one specific house having these characteristics was chosen and the amounts of labor and materials used in its construction were determined. Although this specific house was selected to represent the typical house for the entire area, it may have been located within the city, in a suburb, or in a rural setting.

Based on the quantities of various materials and labor used in its construction, and on price information obtained from subcontractors, contractors, and suppliers located in the area, the cost of constructing the specific representative house was estimated. This representative (or "typical") house was priced at more than one location within those areas showing substantial spatial variation in the prices of construction labor and materials.

After the initial pricing, the same house was priced three times yearly, thus measuring changes in the average cost of construction over a period of time. When the FHA appraisers (in consultation with builders and architects) decide that housing characteristics have changed too much to permit valid comparison from one year to the next, a new representative (or "typical") home is identified and priced. For areas with a changed "typical" house, of course, housing prices before and after the change are noncomparable. In fact, the typical house changed in many areas between 1967 and 1972; Boston and Washington are among the areas excluded from analysis for this reason.

Appendix D: FHA Land Price Data

Included among FHA-insured mortgages is a group designated "Section 203(b)." These mortgages can be obtained for up to 97 percent of the property value and for terms as long as 30 or 35 years. They can be used to finance the purchase of one-family to four-family homes, exclusively.

The FHA compiles considerable data about the characteristics of Section 203(b) homes and lots, both new and existing. In particular, data available for the years 1967–1972 include median lot size, median price of site, and median price of site per square foot. Moreover, these statistics are calculated for each of 44 selected Standard Metropolitan Statistical Areas.

FHA appraisers first try to estimate the market price of a particular residential housing site by finding an "equivalent" lot having a known value. (An "equivalent" lot is one having the same size, located in the same neighborhood, enjoying the same amenities, and having access to the same public facilities as the one being priced.) When a comparable, but not completely equivalent, lot is found, the appraiser must adjust the site's price as best he can to allow for its uniqueness. After estimating a market price for each of the Section 203(b) home sites, the median price, median lot size, and median price of site per square foot can be calculated.

Ideally, a lot price index for a particular city would measure changes in the average cost of the same lot from year to year, but the FHA data refer to all lots sold in each year and, therefore, a different sample of lots is priced from year to year. Moreover, there is no attempt to determine whether the lots sold in one year are similar to those sold in any other. For example, one year's FHA sales may be more concentrated in the suburbs, the next year's in the central city; the lot prices reported do not make any adjustment for this difference. Other possible differences could arise from locational factors: Lots may be closer to transportation facilities, on average, in one year than another; or located in more desirable neighborhoods; or nearer to the beach in coastal or Great Lakes cities; or on higher ground in cities with hills. When any of these phenomena occurs, the lot price per square foot will change, even though the price of the same site (or similar site) does not change.

A related problem stems from the sampling procedure used to accumulate the data on which land prices are based. Specifically, the sample of lots for which size and price information is obtained is apportioned among sections of the city according to the percentage of Section 203(b) homes located in each. If a particular city has five districts with, for example, 60 percent of the homes insured under Section 203(b) located in District A, and 10 percent located in each of Districts B, C, D, and E, then 60 percent of the sample also would be taken from District A and 10 percent from each of the remaining Districts. A bias exists, however, in that lots in the sample include only those financed under Section 203(b). For example, in the particular city described above, if the price of site per square foot is one-half as high in District A as it is in District B, C, D, and E, and if only 40 percent of all new homes financed during the year are located there, the calculated median price (based on 60 percent of the Section 203(b) homes located in District A) would tend to understate the true median lot price.

The conclusion to be drawn from these considerations is that the data on price of land used in this chapter are less reliable as a price index than are the other data used.

Appendix E: Housing Expenditure-Income Ratios

It is useful to examine two additional systems of measuring housing cost even though they are somewhat arbitrary. The first measure is based on a widely used, albeit questionable, rule of thumb that a family cannot afford a house if its value exceeds 2 1/2 times the family's income. The median value of houses purchased is then examined, and a determination is made of what proportion of the population has incomes less than 40 percent of this amount. If the proportion grows over time, it is assumed that it is becoming more difficult for families to afford housing. This measure has an enormous number of weaknesses that are discussed in detail below, but, for what it is worth, the proportion was the same in 1972 as it was in 1967: 41.8 percent, although there were decreases in 1968 and 1969 and increases in 1970 and 1971.[33]

The main problem with this system is that the results obtained from this analysis are crucially dependent upon the assumptions underlying it. For example, using a "2 times" rule instead of a "2 1/2 times" rule increases from 41.8 to 55.7 the percent of families unable to "afford" the typical new house sold in 1972, whereas a "3 times" rule reduces the percentage of such families to 37.8 percent. Moreover, the trends over time change, depending on which rule of thumb is used; using the "2 times" rule, the proportion of families unable to "afford" the typical new house declines from 1967 to 1972; using the "3 times" rule, the proportion increases. Quite different rules may be appropriate for families who buy new homes for differing reasons: e.g., some seek to amass equity in a home, while others simply want shelter. And different rules may be appropriate for the same family in periods of inflation and periods of price stability.

An alternative measure of housing cost is based on the median monthly housing expenditures by households. This measure includes the total mortgage payment, maintenance and repair expenses, hazard insurance, and fuel and utilities costs. Then, using the rule of thumb that a family should spend 25 percent of its income on housing, the monthly housing expense is multiplied by 48 to obtain the necessary or "qualifying" annual income. This is used to determine what proportion of the population cannot afford the "typical" house sold in that year. The proportion has risen from 53.5 percent in 1967 to 56.6 percent in 1972, although there has been a slight decline since 1970.

Here, again, the results of the analysis are crucially dependent on the assumptions being made. If one assumes that housing expense should constitute one-third of a family's income, then the proportion of the population required to spend more than this fraction in order to buy the median-priced house in 1972 drops to 39.3 percent. If 40 percent is used as the appropriate expenditure-income ratio, then the proportion of families above this ratio drops to 30.7 percent. Conversely, by assuming that only 20 percent of the family's income ought to go for housing, the proportion of families exceeding this percentage jumps to 70.6 percent. All of these ratios have risen slightly during the 1967–1972 period.

Regardless of which arbitrary rule is used, it remains difficult to interpret the statement that some percentage of families is unable to "afford" the median-priced new house sold. For example, the assertion that 41.8 percent of all United States families could not afford to buy the median-priced (or "typical") one-family new home in 1972 is dependent solely on the criterion that a family's income be at least 40 percent of the median purchase price of all new homes sold in that year. This does not say, however, that these families could not or did not buy a lower priced house, whether new or existing. Nor is it known how many families were seeking to buy any house in 1972, much less one of the size and quality represented by the median-priced new house sold in that year. In short, to calculate a "qualifying" income level, by whatever rule, is implicitly to set an income level that all families should attain, and/or to establish a standard house that all families should purchase. There is no economic basis for setting either standard.

[33] Data for this conclusion are based on FHA–insured houses.

In any case, these measures are consistent with the previous conclusions reached in Chapter 8, despite the obvious deficiencies of the approach. The increase in the median price of a house has been about the same as the increase in the median level of income, which is reflected in the stability of the proportion of the population "unqualified" to purchase the median house. On the other hand, the increases in expenditures for real estate taxes, maintenance and repairs, and fuel and utilities, are reflected in the increase in the proportion of those who are required to spend more than 25 percent of their income, (or 20 percent, or 33 $^{1}/_{3}$ percent, or 40 percent) for housing. These are the same factors that have contributed to the increase in the "cost of homeownership" component of the Consumer Price Index.

Background

National Housing Policy Review

Operations and Personnel

The National Housing Policy Review was instituted by HUD Secretary James T. Lynn to serve as a basis for the housing policy recommendations promised by President Nixon in his State of the Union Message on Community Development of March 8, 1973. The Secretary designated an Editorial Board, headed by the Assistant Secretary for Policy Development and Research, Michael H. Moskow, and including William Lilley III, Deputy Assistant Secretary for Policy Development; Rudolph G. Penner, Deputy Assistant Secretary for Economic Affairs; and James B. Hedlund, Administrative Assistant. Mr. Lilley was responsible for Chapters 1, 2, 4, and 5; Mr. Penner, for Chapters 3, 6, 7, and 8. Secretary Lynn and Assistant Secretary Moskow personally reviewed each chapter and directed the overall editorial effort.

Input was solicited and received from numerous sources:

- Five study teams composed of more than 100 analysts drawn from the Department of Agriculture; Department of Commerce; Department of Health, Education, and Welfare; Department of Housing and Urban Development; Department of Labor; Department of the Treasury; the Veterans Administration; the Federal Reserve Board; the Federal Home Loan Bank Board; and the Office of Economic Opportunity;
- The Office of Management and Budget, the Council of Economic Advisers, and the Domestic Council;
- Members of Congress knowledgeable in the housing field and staff members of the related congressional committees;
- Public and private interest groups which deal with housing matters, and private consultants; and
- The general public in response to a notice published in the *Federal Register*.

The five study teams were organized to deal with specific issues, as follows:

- Team 1 focused on broad economic, social, and political questions related to housing with the objective of determining the appropriate role of government.
- Team 2 conducted a detailed analysis of the suspended subsidy programs.
- Team 3 undertook a detailed analysis of nonsubsidized Federal programs, including Federal tax policies affecting housing.
- Team 4 identified possible alternatives to existing programs.
- Team 5 directed the data collection and statistical analysis needed for the Review by all teams.

The teams were interdisciplinary in approach and composition; they included both persons knowledgeable in housing programs and policies and those with expertise in other areas.

After the study teams completed their data gathering and analysis, their work was assembled and assigned to eight chapter teams. The chapter teams organized the material produced by the study teams, as well as the work conducted by outside contractors, and drafted the final report. The chapter teams responsible for this effort were: Chapter 1: Arthur S. Newburg; Chapter 2: John Betz, Jack A. Meyer, and Harvey E. Weiner; Chapter 3: Ralph Bristol, Donald Edwards, and Ronald D. Utt; Chapter 4: David P. Lafayette (Director), Paul Burke, Frederick J. Eggers, Hugh Knox, John Morrall, and Edgar Olsen; Chapter 5: Robert M. Brown, and Gary Kane; Chapter 6: Norris H. Evans; Chapter 7: Heather Aveilhe, Duane T. McGough, and Joseph Sherman; Chapter 8: John Simonson and John C. Weicher. Lisa Gerard contributed to Chapters 1, 2, and 5. Harry A. Lenhart, Jr., contributed to Chapters 2 and 5.

Preliminary drafts of this report were circulated for review and comment within HUD and to other Federal agencies and departments and revised in light of the recommendations received. Thus, this report represents a comprehensive effort to analyze and assess the past, present, and future roles of the Federal Government in housing.

Contributors and Staff of the National Housing Policy Review

Study Team I

Chairman
Arthur S. Newburg

Mary C. Barth
James Dillon
John Garrett
Arthur Glass
Willis Goldbeck
Quentin Gordon
Paul Hill
Martin Klitzner
Harold Kumer
Emily MacFall
Jack A. Meyer
James Mulcahy
Sybil M. Phillips
David Segal
Rodney J. Smith
Alexander Stolzberg
Donald Stuart
Larry Thompson
Donald Tucker
John C. Weicher
William A. Wisner
Donald G. Zauderer

Secretarial/Clerical
Martha Eskridge
Andrea Fowler
Louise H. Jackson
Shirley Jerkins
Betty Jean Jones
Josephine Jones
Barbara Pate
Gailene Reinhold
Adelaide Scott
Phyllis Smith
Sharon Steiner

Study Team II

Chairman
David P. Lafayette

Marjorie A. Brown
William Brueggeman
Paul Burke
Frederick J. Eggers
Richard Eisenberg
Leslie M. Graham
Helen Helfer
William M. Heyman
Sheila D. Jones
Susan K. Kete
Hugh Knox
John Kraft
Patricia Lawhead
R. Lawrence McCaffrey
John F. Morrall, III
Michael Murray
Susan Nelson
Edgar Olsen
James Rathbone
Thomas Safran
Callie M. Smith
Raymond Yacouby

Secretarial/Clerical
Mary Carson
Stefanie Gordon
Joyce Hamm
Andrea Watson
Bettie L. Williams

Study Team III

Chairman
Judy Segal, succeeded by
Gil Blankespoor

Anthony B. Barton
John Blanchfield
Ellen Broderick
James Buchanan
Carolyn R. Davis
Rod Fujii
Richard Hage
Pamela Hussey
Sylvan Kamm
Dino Katsiaras
George Koch
Peter Ogilvie
Jane Ross
David C. Streich
Walter J. Stuart
Candace Sullivan
Harvey E. Weiner
Michael C. Wells
Courtland Wilson

Secretarial/Clerical
Lynda Brooke
Elaine Kearney
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Rita Scott
Kathleen Thomas

Study Team IV

Chairman
Robert Powell Sangster

Steven Barro
Ralph Brown
Robert M. Brown
David Engel
Charles Field
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John S. Maxim
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Claudia Pharis
Arthur Reiger
Dale Sloan
Margaret B. Sowell
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Secretarial/Clerical
Brenda K. Bredeck
Ruth Cary
Patricia Darby
Marie Drissel
Linda Gregg
Cecilia Hall
Sarah Leaks
Kimberly Magruder
Althea Tenson
Deborah Wilhide

Study Team V

Chairman
Roderick O. Symmes

Martin J. Bayuk
Howard C. Doolittle
Marilyn C. Fine
William L. Halpern
Nathan Krevor
Earl W. Lindveit
Duane T. McGough
James E. McQuarrie
Wayne A. Nickols
Christal L. Ott
Harold Rosenthal
John Seymour
Milo Sunderhauf
Allan F. Thornton
James Vollmer
Fordyce A. Voss

Secretarial/Clerical
Donna L. Eden
Dorothy Foster

Others (without specific team assignment)

Donald Edwards
Robert A. Kelly
Andrew Pike
Ronald D. Utt

Secretarial/Clerical
Iredia B. Irby

Administrative Support

Erzell G. Brockman
Ann Cannon
Dorothy E. Coleman
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Mary B. Landis
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Maria Rosado
Frances L. Signer
Patricia Spelios
Linda Van Nort
Robert Weidman
Linda D. West
Ollie Whitted

Production

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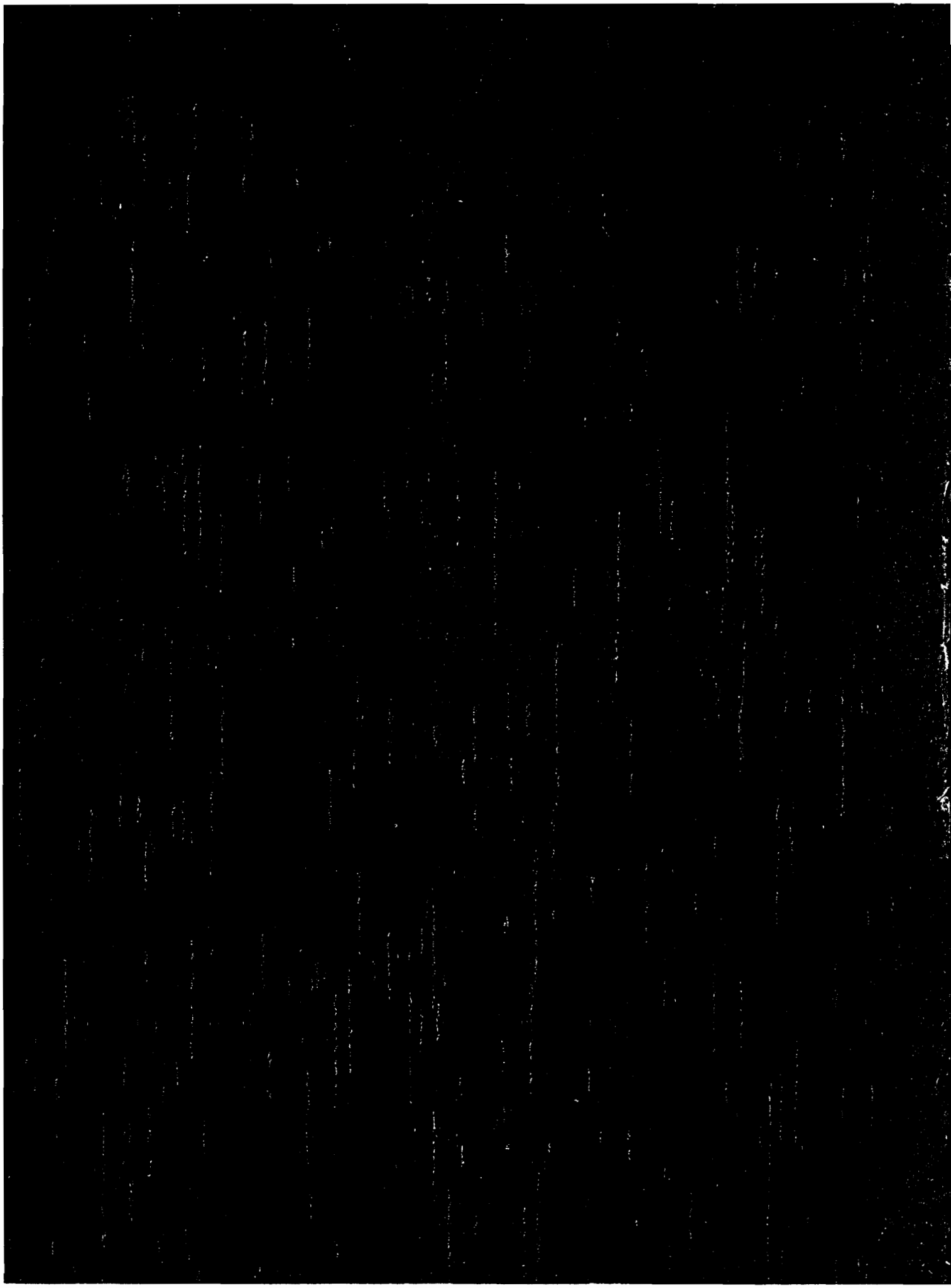


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