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CHAPTER XVIII

THE FUTURE ROLE OF GOVERNMENT

THE net effects of market forces will probably be modified in substantial degree by government action, and no appraisal of future prospects for capital formation in residential construction would be complete without considering the important role of the federal government in this field. Opportunities for the investment of private savings in new residential real estate and the sources of funds will be greatly influenced by the use of existing, and possibly the introduction of new, federal credit aids. Finally, while public housing is outside the scope of this study and, because of its relatively small volume to date, could be ignored in the analysis of the past record, possible interactions between public housing, urban redevelopment, and the volume and financing of private residential construction cannot be dismissed when the future is considered.

Credit Aids to Private Construction

Whichever of the data presented in Chapters X and XVI are reviewed, it is clear that up to roughly half the market for private residential construction and mortgage financing of new housing has come to operate directly under federal credit aid programs. The flow of mortgage funds into residential construction has been increasingly influenced by the terms and other stipulations, prescribed by laws and administrative rulings, under which the Federal Housing Administration and Veterans' Administration will accept mortgages for insurance or guarantee. For up to half the total market the pattern of interest rates, downpayment requirements, and amortization periods, as well as borrowers' credit ratings and location and physical design of new construction, has been subject to governmental as well as private decisions. Market forces operating on the mortgage interest rate have been modified by opening or closing the gates of the Federal National Mortgage Association and by using this government agency occasionally as a primary source of funds almost equivalent to direct federal loans.

The scope of the government programs is such that political decisions can influence the volume and composition of building activity in an appreciable though as yet not fully determinable measure. This drastic change in the channeling of funds into investment has come about in the brief span of about twenty years and, accentuated by the exigencies of World War II, has reached a peak during the postwar period.

The size alone of the federal programs, in both absolute and relative terms, suggests the vast dimension of their implications. The full effect of these operations on housing production and the flow of mortgage funds, as well as on the economy as a whole, defies simple measurement. Their share in total residential construction and mortgage lending does not take account of their far-reaching indirect influences on building types in residential construction, land planning in new subdivisions, the structure of the house-building industry, the extent of home ownership, general lending practices, sources of funds, terms of conventional mortgages, and other facets of this complex business. Only a few of the implications of the governmental activities are selected for discussion here—those which have a bearing on the future course of capital formation and financing in this field.

An appraisal of the future role of federal credit aids must concern itself with at least three questions: (1) Does the observed increase in scope and intensity of federal aids since 1935 suggest a trend, or is it perhaps more adequately explained as a response to temporary pressures and maladjustments in housing markets? (2) Are there limits to the effectiveness of present means of federal assistance, and if so, what are the alternatives? (3) If the assumption of a trend is warranted, what consequences will arise for the volume and stability of capital formation and financing in this field? In considering these questions, the investigator shifts from the relatively secure ground of historical analysis to a more treacherous field, where judgment plays a larger role; and his only qualification at this point is perhaps the development, through training and experience, of an attitude that should assure judicious consideration of all relevant factors and minimize if not prevent the injection of his own biases.

A Trend?

Each of the federal credit aids for private residential construction had a special justification when it was established. The mortgage insurance program of the FHA was enacted originally to assist in economic recovery and to improve the mortgage system. The principal steps toward more liberal credit terms for FHA-insured loans were taken to meet crises in war housing and to help relieve the postwar housing shortage. The guarantee of veterans' home loans was adopted as part of a program to ease the adjustment of ex-servicemen to civilian life. The use of the Federal National Mortgage Association for practically direct government lending operations was authorized as a stop-gap solution when the supply of mortgage funds for FHA and VA loans at fixed interest rates threatened to diminish.[1]

[1] For a more detailed account see Miles L. Colean, *The Impact of Government*

One might thus be led to believe that many if not all of these operations could be withdrawn when their original purposes had been served. However, here as in the interpretation of other events, it is necessary to distinguish sharply between the incidents that give rise to political actions and the more deep-seated forces that underlie the actions.

Basically, the development of federal aids for housing, comprising not only the activities analyzed in this study but also public housing and assistance in urban redevelopment, must be viewed as part of a long-term social change which vests housing conditions, and not only those of the poor and indigent, with broad and probably intensifying public interest. This change seems to reflect basic attitudes of the community at large, although its intensity and therefore the pace and form of federal programs may vary over time and in different political and economic climates.[2] This broad concept received Congressional recognition in the "Declaration of National Housing Policy," which forms the preamble to the Housing Act of 1949. It is reflected in the organizational assembly in the Housing and Home Finance Agency of federal agencies concerned with housing and credit for housing (except the Veterans' Administration). It was reaffirmed in the President's Housing Message to Congress of January 25, 1954, in these words: "The development of conditions under which every American family can obtain good housing is a major objective of national policy."

The use of federal credit aids as tools in a broad program to improve housing conditions is supported by the still broader, widely accepted social objective of maintaining reasonably full employment. It is almost inconceivable that aids to housing production will not be incorporated in programs to combat unemployment if and when the time for such programs comes. In fact, existing aids will most probably be intensified and supplemented under such conditions, or they will be extended beyond their original expiration date. Such a contingency, for example, may affect the termination of the home loan program for veterans of World War II, now scheduled for 1957.

The employment of federal credit aids is supported also by a widely held notion that the house-building "industry," however defined, is

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on Real Estate Finance in the United States, National Bureau of Economic Research, 1950.

[2] It is of interest to note in this connection that the platforms of the Democratic and Republican Parties for 1944, 1948, and 1952 do not touch at all upon the FHA mortgage insurance and VA home loan guarantee programs or on the operations of the Federal National Mortgage Association. In contrast, they differ substantially upon public housing and slum clearance and redevelopment whenever these items appear.

backward in comparison with other industries meeting essential consumers' needs. In this view, new housing historically has been a luxury product available only to the upper income groups, and government action is necessary to compensate for the apparent inability of the industry to meet the need for houses of good standards within the reach of every family or the average family, or however the "need" may be defined.[3]

The "trend" suggested by these observations is strengthened by the conviction of strategic groups that continued government aids are indispensable to the effective operation of the processes by which new housing is built and marketed. Critical issues during the past ten years provide vivid illustrations. One is the termination in 1945 of the wartime Title VI of the National Housing Act, with its "firm commitments" to builders and its generous financing terms, and its re-enactment in slightly modified form in 1946 as part of the veterans' emergency housing program.[4] Another is the liberalization in 1950 of financing terms for rental and cooperative housing projects under Title II of this act when Section 608, designed to encourage rental construction under war and postwar conditions, was allowed to expire.[5] A third is the increase in 1950 of the guarantee for veterans' home loans from 50 per cent of the loan amount not exceeding $4,000 to 60 per cent not exceeding $7,500, plus an extension of the maximum maturity from twenty-five to thirty years[6]—a revision that followed the decrease in the volume of these loans in 1948 and 1949 and contributed to the spectacular increase of housing starts in 1950. Still another example is the Congressional action in 1951 which eased housing credit restrictions imposed in 1950.[7] There is further the Congressional

[3] This viewpoint permeates much of the housing literature of the past twenty years, government reports, and Congressional deliberations. See *Toward More Housing*, U.S. Congress, Investigation of Concentration of Economic Power, Temporary National Economic Committee Monograph 8, 76th Cong., 3rd sess.; *Hearings before the Temporary National Economic Committee*, U.S. Congress, Investigation of Concentration of Economic Power, 76th Cong., 1st sess., Part II, Construction Industry, 1940; Charles Abrams, *The Future of Housing*, Harper, 1946, Chaps. 5 and 13; Robert Lasch, *Breaking the Building Blockade*, University of Chicago Press, 1946, pp. 7-10; and numerous statements at Congressional hearings on the Taft-Ellender-Wagner bill: *General Housing Act of 1945; Hearings before the Committee on Banking and Currency on S. 1592*, 79th Cong., 1st sess., and *Housing: Hearings before the Committee on Banking and Currency on S. 287, S. 866, S. 701, S. 801, S. 802, S. 803, and S. 804*, 80th Cong., 1st sess., *passim*. See also *High Cost of Housing: Report of a Subcommittee on the Joint Committee on Housing*, 80th Cong., 2nd sess., H. Doc. 647, 1948, and Nathan Straus, *Two Thirds of a Nation*, Knopf, 1952.

[4] Public Law 388, Chap. 268, 79th Cong., 2nd sess.

[5] Public Law 475, Chap. 94, 81st Cong., 2nd sess.

[6] *Ibid.*

[7] Public Law 139, Chap. 378, 82nd Cong., 1st sess.

authorization of June 1953 (not acted upon), which permitted the President to reduce downpayment requirements and extend maturities for FHA loans on new homes in certain price classes when "conditions in the home building industry and the general economy require it"—following on the heels of builders' complaints over a jam in mortgage lending and unsteady production.[8] Finally, the recommendations of the President's Advisory Committee on Government Housing Policies and Programs and the proposed Housing Act of 1954 included liberalizations for FHA-insured loans to encourage a larger volume of new residential construction.[9]

In all these instances consumers' and builders' and sometimes mortgage banking interests combined to produce demands for more potent federal aids when a decline in the volume of building occurred or threatened. The apparent dependence on the federal programs developed under conditions which, on the whole, were favorable to a high level of residential building activity. It will unquestionably be felt more acutely when circumstances are less favorable. Under such circumstances any diminution of aids would be considered widely to be a calamity, and complete withdrawal would be held to spell disaster—regardless of what the real as distinguished from the anticipated impact of withdrawal may be.

In conclusion, war and postwar dislocations unquestionably accelerated the scope of government activities in this field, but it would seem more reasonable to anticipate that the federal government will take a continued and growing role than to expect a diminution or withdrawal of aids in the long run. This "trend" will not necessarily apply to the FHA mortgage insurance system or the VA home loan guarantee program as they now stand. In fact, there seem to be narrow limits to the intensification of these aids in the future, and the trend toward a greater role of the federal government in residential construction and its financing may express itself in the use of new financial devices.

Limits to Present Types of Aids

If the assumption of a "trend" is warranted, what are the limits to the use of the present types of aids, and what are the probable alternatives?

[8] Public Law 94, 83rd Cong., 1st sess., June 30, 1953. As to the position taken by home builders see *Washington Letter*, National Association of Home Builders, Nos. 467, 468, and 469, June 11, 23, and 30, 1953.

[9] See *A Report to the President of the United States*, President's Advisory Committee on Government Housing Policies and Programs, December 1953. For the proposed Housing Act of 1954 see S. 2938, 83rd Cong., 2nd sess.

This question is perhaps most pertinent if declining employment and incomes are assumed. For it is in such a situation that the demands for increased federal aids will become most pronounced. The record of experience is not instructive on this point, since the federal programs so far have operated on a broadly rising market.

Little is known about how the demand for new construction responds to liberalization of credit terms during the downward phase of a business cycle. How much would the demand for new housing be stimulated if, under conditions of falling incomes, terms under a government mortgage insurance program were changed from, say, a 10 per cent minimum downpayment to zero downpayment, a 25-year maximum maturity to 35 years, and 4 per cent interest to 3½ per cent? Arithmetically, this change would produce a monthly mortgage carrying charge (level-payment) of $4.13 per $1,000 of purchase price of a single-family house, as against $4.75 before. The reduction in loan payments would be 13 per cent, but the decline in total monthly outlays for housing would be much less, perhaps only 6 to 8 per cent; for real estate taxes, maintenance, heating, and other operational expenses would not be affected by the decline in mortgage payments. The complete elimination of downpayment may be a stimulating factor when consumers as well as business firms prefer liquidity. But, even without downpayment, cash outlays of several hundred dollars would still be required for closing costs, additional landscaping, and other incidental expenses usually associated with house purchase; and uncertainty would still discourage the undertaking of fixed commitments.

The extension of maturities will have rapidly diminishing effects on mortgage carrying charges compared with the effects of past actions in this direction. The amount by which monthly level payments are reduced when the maturity of a 4 per cent loan is extended from thirty to forty years is $.59 per $1,000 of loan, as against $1.29 for an extension from twenty to thirty years. The percentage reduction is a little over 12 per cent compared with 21 per cent.[10] More effective than an extension of maturities is a change from full to partial amortization of mortgage loans. If, say, only half the principal amount of loans were to be repaid in periodic installments, the monthly debt charge would be reduced substantially. But such a change would involve suspending, if not abandoning, the principle of full amortization, one

[10] Cf. Ernest M. Fisher, *Urban Real Estate Markets: Characteristics and Financing*, National Bureau of Economic Research, 1951, pp. 71-72. For a general discussion of the effects of changes of loan terms in installment financing see also Avram Kisselgoff, *Factors Affecting the Demand for Consumer Instalment Sales Credit*, National Bureau of Economic Research, Technical Paper 7, 1952.

of the outstanding improvements of the mortgage structure during the past twenty years.

Moreover, in a falling market the large supply of existing housing at declining prices or rents, often in the nature of distress sales or rentals, would limit the volume of new housing that could be marketed even at greatly liberalized credit terms. An annual production of 1 million dwelling units, for example, equals little more than 2 per cent of the number of existing nonfarm dwelling units—about 42 million in 1952. If only one-tenth of the existing supply were offered at distress prices or rents, the quantity of old dwelling units coming on the market would be four times as large as the volume of new construction—a competing supply which would reduce the marketability of new housing even though the latter might be more attractive in respect to both physical characteristics and liberality of debt financing.

Under unfavorable business conditions, limits would also exist to the stimulation of mortgage lending by private institutions. Whether mortgage insurance would induce lenders to continue the financing of new construction in the face of rising vacancies, defaults, and foreclosures is an open question. Investments in insured or guaranteed mortgages might be encouraged if the government covered more or all of the risks still left with the mortgagee (such as the excess of foreclosure costs over the maximum covered by the FHA and liberalization of the "waste provisions" under which the mortgagee bears the risk of unusual damage to property after institution of foreclosure proceedings), or if the interest rate and terms of FHA debentures exchanged for foreclosed properties were made more attractive.[11] In the case of VA loans the maximum amounts and percentages of the guarantee could again be raised. The government might be reluctant, however, to weaken the lenders' responsibility so much as to encourage the misuse of credit. In any event, the effectiveness of these inducements must be weighed against the conditions that would create reluctance in lending on new construction. The insurance of bank deposits and of accounts in savings and loan associations may serve at least to relieve pressures that would otherwise accentuate the liquidity preference of some types of financial institutions.

The greatest leeway for intensification of present programs exists perhaps in the stimulation of alteration and modernization of existing dwellings under Title I of the National Housing Act. The financial charges for insured loans under this program are still fairly high—for single-family houses, $5 discount for $100 face amount of loan per year

[11] For an instructive discussion of these points see *Mortgage Financing, Hearings before the Senate Committee on Banking and Currency*, 82nd Cong., 2nd sess., February 6-8, 1952.

for a term of three years and thirty-two days, including insurance premium, which equals an effective interest charge of over 9 per cent. A downward revision in periods of recession, combined with longer maturities, would probably raise the demand for these loans fairly rapidly.[12]

If there are narrow limits to the effectiveness of more intensive use of mortgage insurance programs under conditions of business contraction, demands for "stronger medicine" will undoubtedly develop. The direction of any attempts to meet them can be inferred from scattered examples already on the record. Among these is the direct home loan program of the Veterans' Administration, now of small magnitude and on legal maximum terms identical with those of private mortgage lenders making VA loans. Another is the Connecticut postwar program under which the State Housing Authority granted direct mortgage loans at 1½ per cent interest with a maximum maturity of twenty-five to thirty years. These loans are serviced by mortgage lending institutions at the usual fee of .5 per cent. The state funds are obtained by short-term borrowing.[13] A third example is the New York City program of rental housing without cash subsidies, designed for income groups above the admission limits for public housing with cash subsidies. In this case, rentals are set to meet a debt charge based on low-cost, tax-exempt public financing, as well as operating costs and partial exemption of real estate tax. Various schemes along similar lines have been enacted in other states. Finally, as was pointed out before, the Federal National Mortgage Association provides an instrument that can be used for primary lending on nonmarket terms even though private lending institutions may originate and service the loans. The Housing Act of 1954 restricted the use of the FNMA as a primary source of mortgage funds while continuing its authority to assist special housing programs (such as the program for FHA insurance of mortgages in cooperative housing) through the issuance of loan purchase commitments. In a period of serious economic contraction, however, there will be renewed pressure for employing the FNMA as a vehicle for what amounts to public financing of housing construction.

If these observations are correct, the boundaries between "private" and "public" residential construction will become less determinate. To date the term "public housing" has been reserved broadly for the programs under which public capital funds or subsidies are made available

[12] The President's Housing Message of January 25, 1954, and the proposed Housing Act of 1954 (S. 2938) include an extension of the maximum term to five years for single-family houses and a larger maximum amount of loan under Title I.

[13] Chester Bowles, "The Role of the States," in Nathan Straus, *Two Thirds of a Nation*, pp. 236 ff. See also *Housing Act of 1954*, Hearings before the Senate Committee on Banking and Currency, Part I, pp. 383-386.

for projects owned and managed by public agencies. The record of European housing since World War I is replete with arrangements under which the distinction between private and public housing is difficult if not impossible to maintain. It is at least conceivable that forces at work in this country point in the same direction.

Consequences for Capital Formation and Financing

On the whole, past and projected federal policies in this field may be interpreted as efforts to raise permanently the proportion of total resources devoted to housing construction above the level that would be obtained from the interplay of market forces. To the extent that the efforts succeed, new residential construction will be maintained at a higher volume than would be possible without existing and prospective government aids.

Enough has been said about the uncertainties of consumers' reactions to more liberal credit terms to indicate that the quantitative effects are unpredictable. It is possible, however, to sketch some of the problems and consequences of governmental efforts to raise the level of residential construction.

One of the problems concerns the interaction between new construction and the market for existing residential facilities. A high volume of new construction offered at advantageous financial terms might aggravate declines in occupancy and in the price of old housing. The federal government itself, however, has a great stake in the residential mortgage debt on existing property, represented at the end of 1953 by the contingent liabilities involved in $32 billion of outstanding FHA and VA loans.[14] The government therefore has a substantial fiscal interest in avoiding any decline in prices that may directly or indirectly affect its contingent liabilities. Because the markets for new and old housing are closely interconnected, any drastic revision of financing terms in favor of new construction might involve corresponding changes for loans on existing residential real estate,[15] and possibly a transfer of insured or guaranteed loans from private to public holdings.

There is a question as to the effect of continued or strengthened government support on the productive efficiency of the house-building industry. The implied assurance of output may tend to slow technological change or improved production processes and may thus retard

[14] This amount is the total of such loans outstanding. In the case of VA-guaranteed loans, the guarantee itself covers only a portion of the principal, averaging roughly 50 per cent of the total amount of such loans.

[15] Existing houses originally built under FHA inspection are already eligible for loans on terms equal to those for the financing of new construction under the FHA. The proposed Housing Act of 1954 (S. 2938), if adopted, would establish more nearly equal maximum terms for FHA loans on new and on existing houses.

progress toward lower-priced or better products. It has been alleged, for example, that the government support received by the British house-building industry over the past thirty years has operated in this direction.[16] The record in this country, however, is none too clear and has never been adequately analyzed. To the extent that the FHA insurance program has accelerated the development of large-scale operative builders, it has tended to raise efficiency. Moreover, the industry was not noted for advances in efficiency during the period before federal aids when fluctuations in output were extreme, and implied assurance of more stable production may foster rather than retard progress. Such an assurance will be more effective if the past practice of short-term and last-minute changes in housing legislation is modified. This practice has sometimes created uncertainties no less aggravating to builders and mortgage lenders than the uncertainties of market forces.

Finally, a trend toward a larger role of the federal government in the financing of residential construction would loosen if not break the nexus between the savings process and investment in new residential real estate. Historically, the flow of funds into housing construction has been determined by the economic forces affecting the volume of savings and the alternative attractions of different types of investment; that is, new residential construction has competed with all other potential uses for savings. While insurance or guarantee has influenced the attractiveness of residential mortgages relative to other investment outlets, direct government lending (already foreshadowed in the operations of the Federal National Mortgage Association) would tend to divorce the level of investment in new housing more clearly from the competition of other potential uses for savings. The federal government may have to borrow money and may have to accommodate itself to changing conditions in the market for capital funds. But it has means of influencing that market which are beyond the power of private financial institutions. The restraints on federal financing for housing or any other purposes are less direct than those which operate on private financial institutions, and the choice of the use of federal funds for alternative investments is a matter of public decision rather than of relative attractiveness of investment outlets.

In conclusion, it appears that the level of residential construction during the next few decades will continue to depend on political decisions as well as on the market-oriented decisions which were controlling before the thirties, and that the impact of political decisions

[16] *Productivity Team Report: Building*, Anglo-American Council on Productivity, 1950, p. 4, par. 9.

may be even greater than it has been from the mid-thirties to date. Government interest and activity in this field will attempt to maintain a high volume of capital formation in residential construction. The test of the effectiveness of such a policy under adverse conditions is yet to come. In any event, the effort will most likely involve major changes in the institutional arrangements for allocating funds to new building activity. Under the FHA and VA programs the government to date has sought to meet its objectives by incentive and persuasion in association with its assumption of risks. In this framework many of the existing institutional arrangements in the creation and ownership of residential mortgage debt have been preserved. There is a real question whether these arrangements will or can be maintained as the public demand for new financial tools, such as direct lending by government, grows in intensity.

Urban Redevelopment and Public Housing Programs

Capital investment in "urban redevelopment" looms large in most of the projections of total capital requirements prepared in recent years. It has a direct bearing on capital formation in residential construction, for the estimates of potential expenditures for urban redevelopment are based entirely on calculated replacement needs for residential structures considered substandard, although renewal of the nation's urban plant should by no means be limited to residential facilities. The calculated replacement requirements are an important component of the "housing need" estimates outlined in Chapter XVII.

The magnitudes involved may be illustrated by one example. Projections of America's capital requirements for 1951 to 1960 by the Twentieth Century Fund include $26 billion in 1940 prices for replacement of substandard dwellings. This amount exceeds by about one-third the investment in residential construction projected to meet "new requirements," that is, those assigned to population increase and provision of a normal vacancy reserve. It is almost as large as the projected outlays for highways and is more than half the projected new investment in mining and manufacturing facilities. It represents fully 10 per cent of the nation's estimated aggregate capital requirements.[17] In terms of

[17] Robert W. Hartley *et al.*, *America's Capital Requirements*, Twentieth Century Fund, 1950. Housing data based on Table 31, p. 55; other data, on Table 16, p. 23. The replacement estimate of $26 billion (in 1940 prices) for 1951-1960 includes $18.7 billion for "accumulated deficiencies" and $7.4 billion for "current obsolescence" of dwelling units. It assumes that (1) no nonfarm dwelling unit in 1960 would be more than sixty years old, (2) no nonfarm dwelling unit would need repairs, and (3) no unit in *urban* areas would lack a private bath and flush toilet. "New requirements" are composed of "normal expected increase in families, additional increase resulting from undoubling, and provision of vacancy allowance of 5 per cent of total supply."

dwelling units, 6,705,000 units are scheduled in this projection for replacement as against 5,300,000 calculated to meet "new requirements" and normal demolition losses. Obviously, the volume of residential construction during the next generation would differ a great deal depending upon whether or not replacement of this or similar magnitude can reasonably be expected.

The purpose of projections such as these is to help in establishing goals for the community at large—a purpose quite different from the objective of this study, which is to examine the prospects for capital formation and financing in residential construction in the light of market forces observed in the past and of the probable role of government activity in this field. Urban redevelopment is unquestionably one of the new factors to be reckoned with in any appraisal of future prospects for capital formation in residential construction. The principle of federal and state aid for this purpose is already embodied in law, although programs to date have been of small magnitude.[18] But several questions, usually bypassed in numerical projections of housing replacement needs, must be raised before the impact of urban redevelopment objectives on future capital formation can be evaluated.

Will the community at large adopt urban redevelopment programs in anything like the size implied in most of the projections? Will it be willing to pay the price involved in federal and local aids, particularly if the costs of executing redevelopment programs should be larger than now contemplated? Is it desirable or feasible to concentrate urban redevelopment, a remedy for the acts of many past generations, within relatively short periods? Can the specific resources employed in such a spectacular undertaking be used in construction after the redevelopment program is completed and only "normal" demand and current replacement requirements are to be met? Granted that, numerically, demolition of a dwelling unit creates a "need" for a unit to be built, what are the prospects for actually marketing replacement units in the hoped-for quantities?

Only a few of these questions can be discussed here, but their consideration, it is hoped, may also throw some light on the others. Brief references to the mechanics of urban redevelopment will be necessary for an understanding of more basic issues.

Urban redevelopment programs typically involve land acquisition

[18] Title I of the Housing Act of 1949 provides for federal aid to local redevelopment projects. The execution of the federal program was slowed by the Korean war. By December 1953, sixty applications from twenty-nine localities had been approved for loans and grants or for grants only. Approved loans totaled $104 million, of which about $31 million had been disbursed, and approved capital grants were $105 million, of which about $9 million had been disbursed. *Housing Statistics*, Housing and Home Finance Agency, January 1954, p. 57.

and removal of structures by local governments and a write-down of the cost of the (cleared) land by local or a combination of federal and local aid. Thus, to take a somewhat simplified example, under the provisions of the Housing Act of 1949, if the cost of land acquisition and clearance is $1,000,000 and the re-use value is $500,000, two-thirds of the write-down may be borne by the federal government and one-third by the city. The emphasis in the act is on "maximum opportunity for the redevelopment of project areas by private enterprise" although the land may alternatively be used for public housing projects by local authorities.[19] Private developments must, of course, be designed to meet all operating costs and a return on capital. Residential redevelopment by private enterprise is, therefore, contingent upon demand expectations for new housing. Deferring discussion of the use of cleared sites for public housing, two questions then become of crucial importance for the volume of residential construction: the effects of large-scale residential demolitions on the demand for new residential construction generally; and the effects of lower land costs on rent levels in new residential developments on cleared sites, which influence specifically the demand for these developments.

It is illuminating to examine the "demolition" effects and the "write-down" effects separately. The demolition effects can be seen most clearly if it is assumed that the cleared sites previously occupied by residential buildings are used for nonresidential structures or for parks or are left vacant. In this case the effects of demolition on new construction will be indirect, and it is most unlikely that they will produce a one-to-one relationship between the number of demolished and the number of newly built dwelling units. The households dislocated by demolition will focus their demand primarily on the existing supply, for few occupants of substandard housing can afford new privately financed facilities. Some of them will fill vacancies; the proportion of those doing so will depend on the vacancy ratio, and the price and rental distribution as well as the location of vacant dwelling units. Others will bid for occupied units. Still others will double up with existing households—particularly the fairly large number of "broken families" characteristic of occupants of slums and blighted areas. With the filling up of vacancies and the bidding for occupied units, rents and prices will rise and forces leading to new construction will be set in motion.

Thus there would be attritions at many points in the chain of market processes from demolition to new construction. Attritions would be especially great if a large portion of the demolished residential areas

[19] Public Law 171, 81st Cong., secs. 102 (a) and 107.

had been occupied by Negroes and other minority groups severely restricted in their choice of residential location. As a result, demolitions would most probably result in new construction of a smaller number of dwelling units than the number of demolished units. Using the previously mentioned projection of the Twentieth Century Fund as an illustration, the demolition of 6.7 million units from 1951 through 1960, equal to more than 17 per cent of the total number of nonfarm units existing at the beginning of the period,[20] might generate new construction of only 5 million units.

The effects of the write-down of land costs for redevelopment projects can be seen most clearly if it is assumed that the sites to be cleared are wholly occupied by nonresidential structures and are to be improved exclusively with residential developments. Granting that housing demand is responsive to price (but less so than it is to income), the write-down of land costs then becomes the only factor operating on demand. While actual figures will vary from case to case, a 50 per cent write-down of land costs will rarely produce a rent reduction of more than 10 per cent as compared with rentals for the same kind of housing produced without benefit of the write-down of land costs.[21] Rent reduction of this magnitude will tend to widen the market for new construction in only moderate degree, since elasticity of demand to rent is probably low.[22] The write-down of land costs of itself does not produce rentals low enough to make occupancy of new housing possible for large numbers of households that otherwise could not afford it. The tenants for private residential redevelopment projects must come in large part from households that can afford new dwelling units anywhere, in central or outlying areas.[23] To the extent that redevelop-

[20] According to the Census of Housing, there were 38 million nonfarm dwelling units in April 1950, other than seasonally vacant units. Allowing for net additions during the remainder of 1950, the probable number at the beginning of 1951 would have been about 39 million.

[21] As a schematic example, it may be assumed that a redevelopment project without government aid may involve an expenditure of $300,000 for cleared land and $700,000 for improvements including architects' fees and carrying charges during construction. A write-down of land costs by 50 per cent would reduce the total investment from $1,000,000 to $850,000, or 15 per cent. However, operating expenses of the new project would not be affected by the write-down of land costs. Assuming an "operating ratio" of 40 per cent—i.e. an allocation of 40 per cent of gross income to operating expenses, including taxes, and of 60 per cent to return on investment—the reduction of gross rents made possible by the write-down would be only three-fifths of 15 per cent, or 9 per cent.

[22] If the Duesenberry-Kistin price elasticity coefficient of 8 per cent is accepted (Chapter VIII), a 10 per cent reduction in rent would raise demand by wholly insignificant amounts.

[23] This point is illustrated by the projected rents in redevelopment projects proposed by New York City's Committee on Slum Clearance under Title I of the (federal) Housing Act of 1949. The average monthly rent per room in

ment projects attract households that otherwise would have moved into new housing elsewhere, no net additions to the volume of new construction can be expected, although redevelopment may stimulate construction in central locations at the expense of outlying areas.[24]

Thus the "write-down" effects on demand are far more limited than the "demolition" effects, and if they alone were controlling, the scope of redevelopment would be reduced to the volume of new residential construction that could be absorbed by the additional demand generated by lower land costs in residential redevelopment projects. This volume would have little relation to the large numbers appearing in projections of capital requirements for urban redevelopment.

Under the mechanics of present federal aids for redevelopment, there will in fact be an admixture of "demolition" and "write-down" effects. For the Housing Act of 1949 permits federal aids for the removal of residential slums or blighted areas and preparation of such sites for any redevelopment, residential or nonresidential; and for the removal of nonresidential slums or blighted areas if the sites are to be redeveloped for predominantly residential uses. The admixture of demolition and write-down effects will depend on the relative quantities of residential and nonresidential demolitions and land uses on the cleared sites and, in the case of new residential projects on old residential sites, on densities before and after clearance.

To the extent that sites are used for public housing projects, demand limitations on the scope of urban redevelopment no longer apply. For public housing, through operating subsidies, does make occupancy of new housing possible for households which otherwise would be unable to afford it. If public housing is to be accorded a larger position in redevelopment programs, however, subsidies for an expanded public housing program must be added to subsidies involved in land acquisition alone. This factor may again tend to limit the scope of redevelopment programs. Regardless of the place of public housing in the programs, the implications for private capital formation and financing in residential construction are clear. Either because of a much larger

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projects proposed during 1951-1952 ranges from $27 to $35. At an average of 3½ rooms per apartment, the monthly rent per apartment would range from about $95 to $122. A sample study of new rental housing projects completed in the New York metropolitan area in various periods from 1949 to 1951 revealed average apartment rentals of $107 to $115. More than four-fifths of the apartments in these projects had 3 to 4½ rooms (Kathryn R. Murphy, "New Rental Housing Characteristics in Nine Areas," *Monthly Labor Review*, December 1951).

[24] Some net additions to the volume of construction may result from provision of new accommodations in redevelopment projects for minority groups whose choice of outlying residential locations is severely limited even if they are able to afford new housing.

admixture of public housing projects than is now visualized, or because of the limited effects of demolition and write-down on the demand for new private construction, the opportunities for private investment would appear to be much smaller than numerical projections of capital requirements for urban redevelopment suggest.

None of these observations detracts from the desirability of urban redevelopment or the removal of slums as a goal. The growth of a nation's capital equipment has no other purpose, except in wartime, than to produce a higher level of living. The persistence of slums is indeed a blot on the nation's record in meeting this objective. But there seems to be a need for much more thorough consideration of the means and costs of accomplishing slum clearance and of the consequences entailed in its realization. The usefulness of projections of capital requirements for urban redevelopment is greatly impaired if such consideration is lacking. To date, redevelopment programs have been so small that their relationship to demand could be ignored. If they are projected on a massive scale, however, it can no longer be assumed that capital requirements based on the *need* for replacing each demolished unit by a new unit will be translated into actual capital formation.

As was said before, public housing provides the operational means for enabling those otherwise unable to do so to occupy new housing. Public low rent housing programs, whether or not combined with slum clearance, will therefore raise the level of total residential construction, except to the extent that public housing in the future may compete for occupants with new privately financed construction and therefore reduce the volume of private construction. Whether or not such competition will occur is wholly conjectural, for it depends on statutory and administrative provisions as well as the volume of public housing. Under the federal peacetime programs to date, income limits for public housing occupants have been set so as to exclude income groups likely to seek new housing accommodations offered at full cost. The possibility of competition with new private construction has therefore been held to a minimum.[25] Pressures for an upward extension of income limits, however, are strong, for there always are income groups between those eligible for public housing and those able to afford new

[25] In addition to establishing criteria for income limits, Title III of the Housing Act of 1949 provides that no federal aid be extended unless the local public agency has demonstrated to the satisfaction of the federal authority "that a gap of at least 20 per centum has been left between the upper rental limits for admission to the proposed low-rent project and the lowest rents at which private enterprise unaided by public subsidy is providing (through new construction and available existing structures) a substantial supply of decent, safe, and sanitary housing toward meeting the need of an adequate volume thereof."

privately financed construction in any substantial volume, which appear to be left unserved. Whatever the merits of a position that assumes the desirability of a nearly proportional distribution of new housing construction over all income groups, it cannot be denied that it is gaining increasing public acceptance and is, in fact, one of the mainstays of programmatic housing literature with widespread influence.[26] These pressures for extending the income limits for public housing are already apparent in New York City's non-cash-subsidy projects, referred to earlier,[27] and, if successful on a large scale, might alter future opportunities for investment in private residential construction.

[26] See Lasch, *op. cit.*; Abrams, *op. cit.*; and Straus, *op. cit.*

[27] Families earning up to $4,900 a year are admitted to these projects. Although no cash subsidies are involved, the projects have tax benefits inasmuch as their real estate tax is based on the predevelopment assessed valuation of the parcel. Also, tax-exempt public financing is involved.