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# HOUSING POLICIES TO COMBAT DEPRESSION

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With helpful suggestions by David M. Blank and Louis Winnick

The objective of this paper is to outline various possible housing policies to combat depression and to raise questions for further exploration, rather than to recommend specific actions.

The mere fact that housing policies are included in this symposium on policies to combat depression illustrates a significant development. The establishment of the Federal Home Loan Bank System, the mortgage insurance program of the Federal Housing Administration and mortgage guarantee program of the Veterans' Administration, a government-owned secondary mortgage lending facility (the Federal National Mortgage Association), and federally supported public housing and urban redevelopment programs created instrumentalities which it is widely believed can be used for purposes of economic stabilization.

All of these instrumentalities are products of the past twenty years or so. Their potentials in economic stabilization programs are uncertain and untested, but there is fairly general agreement that they can influence and modify the market forces operating on the volume of residential construction and, indirectly, of nonresidential construction usually associated with house building. There is much less certainty about the extent and implications of their influence.

The principle of meshing housing policies with general economic stabilization policies has slowly gained recognition. It was embodied in several provisions of the Housing Act of 1949.<sup>1</sup> It was put into

This paper was originally drafted in the fall of 1953 and was revised in June 1954. Legislative and other changes since that time have not been taken into account. The opinions expressed in this paper are exclusively those of the author and do not in any way necessarily represent the views of any organization with which he has been or is now associated.

<sup>1</sup> Section 102(e) of the act stipulates that the annual amount of the federal notes and obligations authorized for loans to local public agencies for urban redevelopment may be increased by specified amounts "upon a determination by the President, after receiving advice from the Council of Economic Advisers as to the general effect of such increase upon the conditions in the building industry and upon the national economy, that such action is in the public interest." Section 304(a) of the act contains identical language in regard to the maximum amount of annual contributions which the Public Housing Authority is authorized to contract for with local housing authorities. Public Law 171, 81st Cong.

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practice after the outbreak of the Korean hostilities when mortgage credit was restricted by the institution of Regulation X and accompanying limitations on FHA- and VA-insured loans. It was expressed in the Housing Amendments of 1953 which gave the President stand-by authority to liberalize FHA maximum terms. A further extension of the principle is found in the President's Housing Message and Economic Report of January 1954, which propose executive authority to vary, within certain limitations, the maximum terms for both VA and FHA mortgage loans.

Some quantitative relationships may help define the potential role of housing policies in economic stabilization programs:

1. Expenditures for new housekeeping residential construction (inclusive of additions and alterations) in the postwar period 1946-1953 equaled 36.2 per cent of total new construction expenditures and 20.5 per cent of gross private domestic investment.

2. The ratio of residential construction expenditures to total gross capital formation (Kuznets' definition) has shown a secular decline at least since 1890. In five-year moving averages in 1929 prices, the ratio fell from about 30 per cent in the nineties to about 25 per cent in the twenties and about 13 per cent in 1950.

3. The residential mortgage debt in 1952 was 45 per cent of the total net private long-term debt and exceeded net corporate long-term debt. This percentage was only 16 in 1900 and roughly 30 in both 1929 and 1939.

4. From 1946 to 1953, about 43 per cent of all privately financed new dwelling units were acquired with loans insured by the Federal Housing Administration or guaranteed by the Veterans' Administration.

5. The estimated balance outstanding of FHA and VA loans at the end of 1952 approximated 40 per cent of the aggregate residential mortgage debt.

6. Under the low rent public housing programs of the federal government, about 400,000 dwelling units were completed from 1937 to 1953 or were under construction at the end of 1953 (exclusive of war housing). The largest annual volume during the postwar period (in 1951) was roughly 7 per cent of all new non-farm dwelling units started.<sup>2</sup>

Housing policies to combat depression include federal aids in-

<sup>2</sup> For data on the quantitative importance of government housing programs see Leo Grebler, *The Role of Federal Credit Aids in Residential Construction*, National Bureau of Economic Research, Occasional Paper 39, 1953. Other data in this section are from a forthcoming monograph by Leo Grebler, David M. Blank, and Louis Winnick, *Capital Formation in Residential Real Estate: Trends and*

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volving primarily transfer payments as well as expenditures operating directly on income and employment. Federal aid in this field is not limited to measures having an income-producing effect. Transfer payments may be necessary to relieve financial distress and are required by legal obligations in FHA insurance and VA guarantee of mortgages. Consequently, these five types of policies are considered in this paper:

1. Financial "holding operations"
2. Financial "rescue operations"
3. Stimulation of *new* residential construction
4. Stimulation of repairs and modernization
5. Aids to slum clearance and redevelopment

Transfer payments are involved in 1 and 2 and partly in 5. Income-producing expenditures are involved in 3 and 4 and partly in 5.

The applicability and effectiveness of each of the above policies and of various combinations of them will depend upon, among other things, the specific characteristics of a depression. For the purpose of this essay, four situations are envisaged:

1. A decline in rents, house prices, and residential construction without appreciable decline in general business activity for some considerable period of time. The 1926-1929 period is perhaps the closest historical example of this situation.
2. A short but possibly sharp business recession, of the 1920-1921 or the 1949 variety.
3. A long, moderate depression of general character involving widespread (rather than localized) unemployment.
4. A long, severe depression of general character, as above.

Any such classification raises, of course, questions of definition and diagnosis, which cannot be discussed in this paper. In addition, specific conditions in housing and mortgage markets would have a bearing on the desirability and timing of various courses of action. Some of the additional information needed to diagnose conditions in housing and mortgage markets is outlined in the Appendix.

Policies to combat a sector depression of type 1 would be important primarily because of cumulative effects on the economy, although these may be delayed, particularly if other types of building construction hold up well.

The following questions would have to be raised in connection with a type 1 depression:

*Prospects*, Princeton University Press for National Bureau of Economic Research, in press.

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Is this situation worth considering? And if so, would intensified government aids to housing be warranted? Or would such aids serve only to delay the reduction of specific maladjustments in the housing market? Declining occupancy, rents, and house prices will produce financial difficulties. Is it reasonable to expect that the difficulties will not be of sufficient magnitude to call for financial "holding" operations other than those involved in existing FHA insurance and VA guarantee of mortgages?

As to depression type 2, many of the housing policies of an income-producing character would be ineffective in a short business decline or, for that matter, in the first stage of a longer decline. The time lag between legislation or regulation and execution is long, particularly when new programs (rather than modifications of existing programs) are involved. For example, Congressional adoption of the first major public housing program in 1937 was induced partly by the recession of that year. But the recession was over before the first foundation of any housing project under the United States Housing Act of 1937 was dug. Stimulation of repairs and modernization, which could operate fairly rapidly, is likely to be more immediately effective than any measure to raise the level of *new* construction. The main problem of public policy in this situation will be to resist pressures for new or intensified programs which must be judged on other merits, rather than on their effectiveness in dealing with a short recession or the first stage of any recession.

For the purpose of this paper it is assumed that housing programs will be used primarily as means to combat depressions of type 3 (long but mild) as well as type 4 (long and severe). The difference would lie solely in the admixture of policies and in the scope and intensity of programs. All of these policies might be appropriate ingredients for both types of long depression—except for financial "rescue operations," which would be required only in the case of a severe depression, if at all. To clarify this point, the next few paragraphs discuss the need for, and content of, "financial holding" vs. "financial rescue" operations.

### *Financial Holding and Rescue Operations*

Any substantial and fairly general decline in economic activity will create financial difficulties in the housing field. Home owners and owners of rental housing will default on mortgages. The federal government will be involved directly through its potential contingent liabilities in FHA insurance and VA guarantee. The

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following considerations are relevant to an appraisal of the need for financial holding or rescue operations:

1. Because of the massive volume of new mortgage lending associated with the postwar building and real estate boom, a large proportion of residential mortgages now outstanding are unseasoned loans. More than four-fifths of the residential mortgages outstanding in 1950 were originated or assumed after the beginning of 1946, and roughly one of every eight home mortgages in 1950 was 80 per cent or more of the estimated property value. The present ratio of unseasoned loans is probably not lower and may be higher.

2. Many recent home purchasers having high-percentage home loans probably also have large debt obligations on consumer durables.

3. Like earlier housing booms, the postwar boom has been associated with overcommitments by certain numbers of home purchasers in relation to their current and prospective incomes.

4. Measures to stimulate business activity may not operate with sufficient rapidity or effectiveness to relieve financial distress.

These points emphasize the need for financial "holding operations" in a long depression even of moderate dimensions. For perspective, it is important to add that in 1950 less than half the owner-occupied homes were mortgaged, and that the median ratio of debt to value of the mortgaged homes was only 42 per cent. Also, since most residential mortgage loans are on a regular amortization schedule, the difficulties arising from inability to renew straight loans will be avoided or minimized. Nevertheless, there will be a large enough number of borrowers unable to meet payments on unseasoned high-percentage loans to produce trouble. The debt-to-value ratio deteriorates rapidly when real estate prices fall and unpaid debt charges accumulate.

Financial holding operations may include:

1. Temporary waiver of amortization (complete or partial) or rewriting of loans for longer maturities, depending on borrowers' circumstances. In the case of FHA and VA loans these steps would require sanction by the agencies through regulation without new legislation. In the case of conventional loans the approach would be to encourage financial institutions to waive amortization or rewrite loans and to assure sanction of these measures by federal and state supervisory authorities.<sup>3</sup> Waiver of amortization will, of course, reduce the flow of funds into financial institutions, but so would

<sup>3</sup> This is important. There have been cases in the past in which federal agencies encouraged a given policy, but institutions found themselves criticized by federal as well as state examiners for adopting it.

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foreclosures. Looking back over the thirties, one wonders whether mortgagees as well as mortgagors would not have been better off if lenders had "played along" with many of the borrowers who went through foreclosure. The case for "playing along" is strengthened by the difficulties of mass foreclosures against veterans. Waiver of amortization will also minimize the tendency of borrowers to "walk out" on the mortgagee and rent or buy more cheaply somewhere else. Consideration must be given to consistent criteria for waiver, at least for FHA and VA loans. Because of the absence of home-ownership motivation and the possibilities of "milking" properties, great discrimination will be required in the case of rental housing.

2. Expansion of advances of Home Loan Banks to member institutions to improve their liquidity position. If the banks have difficulty in selling their debentures in the capital market, the Secretary of the Treasury's authority to buy the banks' obligations would be used and perhaps expanded. This measure will be operative primarily for savings and loan associations. Few institutions of other types are members of the Home Loan Bank System.

3. Expansion of the purchase program of the Federal National Mortgage Association for FHA and VA loans in good standing, to improve the liquidity position of institutional leaders. In such action, purchase at discount would be carefully considered to prevent wholesale dumping of loans by financial institutions. As an alternative to purchase, and one that is preferable in many respects, the FNMA may be authorized to make loans to financial institutions on the security of FHA and VA mortgages.<sup>4</sup>

4. Use of existing emergency authority of the Federal Reserve banks for discounting of or loaning on mortgages, particularly conventional mortgages.

This outline of financial holding operations assumes that in view of the insurance of bank deposits and savings and loan shares, no general runs on financial institutions will develop. The absence of general runs on financial institutions should make it possible for mortgagees to minimize resort to foreclosure and should act as a brake on any tendency of institutions to exchange VA and FHA loans in default for cash (in the case of VA) or for debentures convertible into cash (in the case of FHA).

<sup>4</sup> There is a great deal of discussion on the establishment of a truly comprehensive secondary mortgage bank system, in lieu of or in addition to the FNMA and possibly incorporating the Home Loan Bank System. If such a system existed at the time of action, it could perform the above function with special government aid.

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Even in the case of a severe, long depression (type 4), it is this writer's hope that financial *rescue* operations can be avoided and that a combination of "holding operations" and of positive measures to sustain general income and employment, if taken in time, will make major rescue operations unnecessary. Mass financial difficulties in the mortgage market are typically delayed, and preventive medicine has a good chance to be effective in time. Also, difficulties of this kind are symptoms of the disease rather than the disease itself.

The need for another Home Owners' Loan Corporation is reduced by the insurance and the guarantee program of the FHA and the VA, respectively, which practically involve HOLC's of their own. The problem here is to devise consistent and noncompetitive policies as to resale, renting, and pricing of properties taken over by the two agencies, so as to avoid further deterioration of the real estate market.

In an emergency, consideration may be given to authorizing the FHA to take over directly home mortgages with specified defaults, without the mortgagee being required to foreclose. This procedure is now used for VA loans at the option of the Administrator of Veterans' Affairs and has the advantage of permitting a government agency capable of setting uniform policies to make decisions affecting the borrower.

As to conventional mortgages in default, the measures outlined earlier—viz. the temporary waiver of amortization, expansion of Home Loan Bank advances, and mortgage loan discounts by the Federal Reserve banks—combined with general policies to sustain income and employment, should minimize the need for another HOLC.

### *Stimulation of New Residential Construction*

Turning to income-producing aids to housing, there is a general problem of choosing criteria for determining the place of housing programs as against the place of general monetary and fiscal measures and of public works. From a housing point of view, any significant decline in general business and construction activity appears to liberate resources that can be used for the advancement of worthwhile housing objectives. From the point of view of the best strategy in combating a depression, the effectiveness of government aids for housing, relative to that of other policies, is less clear. Clarification is perhaps more important for decisions in connection



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with a long but mild depression than for those in connection with a long and severe depression, on the ground that measures to combat the former can and should be more selective.

### QUERIES

Do we know enough about criteria such as effectiveness in obtaining any results, speed of results, multiplier effects? Even if some housing programs, such as slum clearance, should rank low on economic criteria, they might rank high in terms of community benefits. How can these benefits be equated with strictly economic criteria of effectiveness?

Stimulation of new residential construction may be approached in various ways, of which the following are here considered:

1. Within the framework of FHA and VA programs (more liberal terms and/or more liberal insurance and guarantees)
2. Direct federal loans on new owner-occupied houses and new privately sponsored rental housing
3. Tax incentives
4. A new or intensified public housing program

Any attempt to stimulate new residential construction through modification of FHA and VA programs will start with a severe handicap: The ammunition of liberal terms has been largely shot away during the postwar boom, and there is comparatively little left. The possibilities of stimulating construction through more liberal financing terms under the FHA and VA would be far greater if we entered a depression with a more conservative pattern of maximum terms. But this statement is almost theoretical today.

Assuming that interest rates must fall into a pattern making FHA and VA loans attractive to financial institutions, the three "handles" for stimulation of demand are higher mortgage ceilings, lower minimum downpayments, and longer maximum contract terms. Higher ceilings for FHA mortgage loans and VA guarantees, which make larger loans and higher-priced houses eligible for government aid, would probably have small effects on the demand for residential construction in a period of declining employment and growing uncertainty. As to lower minimum downpayments, there is some leeway under the FHA program but none under the VA program with its 100 per cent maximum loans. The present maximum maturities, 25 to 30 years for FHA and VA home loans and 30 to 40 years for FHA rental housing and cooperative housing loans, can theoretically be extended. But the effect on borrowers' monthly payments

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and therefore on demand would be relatively small unless extreme maturities, probably unacceptable to financial institutions, were contemplated. Moreover, the percentage reduction of periodic ownership outlays (or rent) is roughly but half the percentage reduction of debt payments associated with more liberal terms. More liberal terms do not affect real estate taxes, maintenance and repair, and similar operating costs.

Some leeway may exist even within the present framework of maximum terms. In the past few years the FHA and VA, as well as lending institutions, in many cases did not apply maximum terms. As a result, average terms have been substantially less liberal than maximum terms. In a buyers' market, maximum terms might be applied to a larger percentage of cases without seriously lowering underwriting standards.

New legislation could permit loans to be written on the basis of partial rather than full amortization, that is, the amortization schedule would provide for repayment of, say, 50 per cent of the mortgage principal within a given maturity of the loan. This step, however, would be a radical departure from the principle of full amortization and would dilute one of the few lasting reforms of our mortgage debt structure.

The effectiveness of the mild doses of credit liberalization still left under the FHA and VA programs must be considered quite uncertain. The price elasticity of housing demand (including mortgage loan terms) probably is quite low. Reluctance of consumers to enter into long-term commitments even at more favorable terms will be great when incomes decline or are uncertain. Under such conditions many bargains in existing housing will compete with new construction. These uncertainties must be taken into account in weighing the effectiveness of more liberal FHA and VA terms against the effectiveness of other policies (such as business or personal income tax policies, public works, or public housing).

In addition to stimulating borrowing, there may be need for stimulating lending under the FHA and VA programs. "Apart from higher interest rates there is little leeway left for making investments in insured or guaranteed mortgages more attractive under unfavorable business conditions. Further inducements might be covering more or all of the risks still left with the mortgagee (such as the excess of foreclosure costs over the maximum covered by 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 in making the interest rate

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and terms of FHA debentures exchanged for foreclosed properties more attractive. In the case of VA loans, the maximum amounts and percentages of the guaranty could again be raised. The effectiveness of these inducements must be weighed against the conditions that would create caution and reluctance in lending on new construction.”<sup>5</sup>

In summary, liberalization of loan terms and loan insurance provisions under the FHA and VA programs would stimulate new construction only mildly. To give a crude and blunt illustration, these methods would probably be insufficient to raise the level of housing starts more than 10 to 15 per cent over the volume that would obtain without them.

Under conditions of declining employment, public demands will unquestionably develop for “stronger medicine” in the way of federal credit aids. While many “schemes” will be proposed, demands for direct use of public credit for privately owned new housing are probably the most realistic ones to contemplate. The precedents of the HOLC, of direct VA loans for home purchase, of the use of the FNMA as a primary source of funds, of the Connecticut and other state programs for veterans’ housing, and of New York City’s non-cash-subsidy public housing program point in this direction. Quite apart from interest rates, the downpayments, borrowers’ credit ratings, and maturities in public lending programs could be adjusted to a degree of liberality not acceptable to portfolio lenders even with FHA or VA protection.

The use of public credit could be compatible with *pro forma* maintenance of the institutional framework of private building and mortgage servicing operations, as under a program using the FNMA as a primary source of funds. Or it could be executed as a direct federal agency operation similar to that of the HOLC. Credit terms, and therefore much of the effectiveness of a program, would depend on whether or not the operation were designed to be self-liquidating. If it were, assuming a going federal long-term interest rate of  $2\frac{1}{2}$  to 3 per cent, the contract interest rate might be 3 to 4 per cent. Even though such a rate might not be much lower than the rate for FHA and VA loans, the case for public credit would rest on an “insufficient” volume of credit for new construction at the going terms for FHA and VA loans or conventional loans. If designed as a non-self-liquidating operation, the interest rate could, of course, be lower.

<sup>5</sup> Grebler, *op. cit.*, p. 61.

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In spite of the precedents mentioned earlier, the substantial use of public credit would be a radical departure from past institutional arrangements. If a public lending program should be instituted as a countercyclical device, it would be most difficult to withdraw it when it was no longer needed for countercyclical purposes. Such a program has long-run implications exemplified by the paralysis in the flow of private capital into residential real estate in some of the European countries, where there is a real question whether the total flow of funds into this field in the long run has been augmented or diminished by injection of public credit. These observations do not necessarily argue against the use of public credit for specific long-term programs of social betterment. They do argue against sliding into permanent public financing through the back door of temporary countercyclical measures.

Among the many problems associated with public credit is the establishment of standards for its use. Upper limits on appraised values and mortgage loans (and on rents in the case of rental housing) would be one approach. More direct "need tests" or demonstration of the unavailability of private credit would be another. But it is easy to foresee the pressures for more liberal standards no matter how the standards are designed originally.

### QUERIES

In view of these difficulties, should the use of public credit be reserved for a long depression of great severity? What should be the objective of standards? Maximizing the volume of housing construction? Limiting public credit to housing for certain income groups, defined in what fashion?

In view of the limited possibilities of stimulating new construction through the FHA and VA programs and of the problems involved in the use of public credit, it is perhaps appropriate to consider stimulation of new housing construction through means other than debt financing, which has been ridden so hard during the past twenty years.

### QUERIES

How can equity financing supplemented by conservative mortgage financing be encouraged (1) for rental builders and (2) for owner occupants? Low income tax rates for

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rental housing corporations conforming to certain operational standards? Accelerated depreciation and/or permission to carry loss deductions for rental projects over longer periods? Deduction from current taxable income of a portion of equity investment in new houses by owner occupants? Are these devices possible legally, tolerable from a fiscal point of view, and promising as to effectiveness? <sup>6</sup>

Interrelationships between the markets for new and existing housing must be considered in any program of easier credit for new construction. These interrelationships limit the extent to which mortgage loan terms on new and existing construction can be differentiated. If new construction is pushed too hard, it will be more difficult to maintain an orderly market in existing residential real estate, in which the federal government has a great stake, and the need for financial holding or rescue operations in existing construction may be increased. Thus a balance must be maintained between federal measures to stimulate new construction and federal measures to prevent a collapse of the market for old housing.

Finally, a period of declining or low employment would be appropriate for reinstituting or expanding a public housing program involving periodic subsidies as well as public financing of capital expenditures. It is impossible here to deal with the controversial aspects of the present program, which evolved from the United States Housing Act of 1937. There is urgent need for an impartial study that would lead to such modifications of the program as would assure more general public support in a period of business decline.

If public housing with federal support is adopted or continued as a matter of long-run policy, public housing should be an important element of housing policies to combat a depression (and should be substantially reduced in scope during periods of high income and employment). In terms of effectiveness of antidepression measures, a public housing program would offer several advantages. It would be unhampered by the uncertainties of consumer and lender reaction to programs involving private credit. It could be so designed as to minimize competition with markets for other housing construction or with market segments in need of financial holding or rescue operations. Consequently there would be minimum "leakages" for a given amount of public capital expenditures.

<sup>6</sup> Since this paper focuses on federal policies, local real estate tax exemption on new construction is not considered.

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### *Stimulation of Repairs and Modernization*

Stimulation of expenditures for maintenance, repair, and modernization should have high priority in programs to combat a depression. Potentials in this field are large. Decade totals of expenditures for maintenance, repairs, additions, and alterations in residential real estate relative to expenditures for new residential construction run as follows:

1920-1929	33%
1930-1939	107
1940-1949	64

These percentages are underestimates reflecting substantial understatements of repair and modernization expenditures in official statistics. In a period of declining and uncertain incomes, expenditures of this type probably respond more readily to easy credit than does new construction. The fact that many houses built during the postwar period are without garages, porches, and similar facilities and have structural provisions for additions (such as unfinished attics) adds to the opportunities.

The principal vehicle here is the FHA Title I program for the insurance of loans for repair and modernization. This program was perhaps more effective in encouraging construction expenditures during the middle and late thirties than was the FHA mortgage insurance program. Its relative importance during recent years has diminished, but it could be stepped up if the need for such action should arise. The President's Housing Message of January 1954 recommends larger maximum amounts and longer maturities for loans under this program. There may be an opportunity also for reducing the maximum interest charges, which are equivalent to an effective interest rate of 9 to 10 per cent including the insurance premium.

In the conventional loan field, lenders could be encouraged, where circumstances justify, to make additions to existing mortgages at costs much below those of personal loans and other credit sources for the financing of modernization and repair. Because of the many other demands on their funds, financial institutions during the past few years have given little attention to these possibilities.

### *Slum Clearance and Urban Redevelopment*

Federal aids for slum clearance and urban redevelopment, already on the statute books, could be stepped up during a period of

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declining business activity and combined with more vigorous local enforcement of safety and sanitary codes. The immediate income-producing effects of this program would probably be small, for land acquisition involves transfer payments only and, so far as rebuilding is concerned, it would be difficult in a depression to find private sponsors willing or able to proceed with redevelopment. But the clearance operations themselves would provide employment; tenant relocation—a great obstacle during periods of full employment and low vacancies—would be much easier; the costs of acquiring land and old structures would be lower than during a boom; and the community benefits of slum clearance are large. Local law enforcement would be an important factor in reducing costs of land acquisition, for landlords in many instances would rather board up their properties than invest the funds necessary to remove violations.

Because an expansion of this program in a period of uncertainty will probably be handicapped by the difficulties of finding sponsors for private redevelopment of cleared areas, means should be examined of enabling cities to acquire, clear, and hold land even if actual redevelopment may be delayed for several years.

This difficulty, of course, does not apply to slum clearance for public improvements such as parks, highways, bridges, tunnels, public buildings, etc. But such improvements are in a different category—public works.

### *Appendix. Additional Information Needs*

Although data have greatly improved in this field, there are few if any comprehensive series designed to give early warning of troubles and their dimensions. The following items seem vital:

1. Mortgage loan collections. Foreclosure statistics (which do exist) come too late because foreclosure is the last step in a long series of events.

2. Continuous local and national vacancy statistics providing data classified by characteristics of vacant dwelling units.

3. Number and per cent of new houses completed by operative builders which are left unsold after specified periods—probably a highly sensitive indicator.

4. Because of the importance of multiple debt obligations of consumers, Consumer Finance Surveys and similar surveys should be designed to yield better data on concentration of home mortgage

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indebtedness and other indebtedness among certain consumer groups.

## COMMENT

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Grebler mentions the problems created by the close relationship between the markets for new and existing homes and by the fact that the stock of homes plays a dominant role in short-term market fluctuations. Existing homes are, of course, close substitutes for new homes. Further, the number of new homes built in any year is always small compared with the size of the existing housing stock. Over the last half century the ratio of new nonfarm dwelling units built in each year to the stock of such dwelling units in that year has averaged between 2 and 3 per cent. Housing construction is currently running at about 1 million units a year, the highest annual rate in our history with the exception of 1950; however, the stock of existing nonfarm dwelling units is well over 40 million.

Visualize, then, the effect on the demand for new construction if the market for existing structures weakened perceptibly. Thus if incomes declined merely enough to reduce demand for existing shelter by as little as 2 per cent, the development of vacancies and the consequent pressure on real estate prices would probably be sufficient to offset almost completely current rates of household formation and to reduce substantially the volume of new construction. Although the decline in new construction would probably be somewhat smaller if more favorable credit terms were available on new homes than on existing homes, it would still be of major proportions. The importance, therefore, of supporting the price and mortgage structure on existing homes through "financial holding operations" can be clearly seen.

The relationship between the two markets is, of course, reciprocal. If new construction is stimulated (e.g. through differential mortgage terms) when income and the prices of existing homes are dropping, the additional dwelling units thrown onto the market will increase the pressure on the market for existing homes. Such a result not only would go counter to holding operations that the federal government would probably be putting into effect at the same time, but would also have direct repercussions on the government's



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financial position, since it insures or guarantees about 40 per cent of the outstanding residential mortgage debt.

The development of housing policies to combat depressions thus is not a simple problem, and great care will be required to insure consistency among the housing programs selected to help alleviate a decline in income and business activity.

Grebler also has pointed out that, despite the fact that the great bulk of mortgage loans now outstanding are of recent origin and that federally insured or guaranteed mortgages have provided for high loan-to-value ratios, more than half of the owner-occupied homes in the United States were debt-free in 1950 and the median ratio of debt to value for mortgaged owner-occupied homes was only 42 per cent. A glance at the distribution of debt-to-value ratios of mortgaged owner-occupied homes further supports the view that there is surprising strength in the mortgage debt structure and that it would take a major decline in real estate prices to place a significant portion of the debt on the housing stock in jeopardy. In 1950, 19 out of 20 owners of mortgaged homes had more than 10 per cent equity in their homes; 9 out of 10 had more than 20 per cent; 4 out of 5 had more than 30 per cent.