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The Prospects for Meeting National Housing Goals

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ABSTRACT

Due to unique historical conditions, the housing industry's ability to maintain its share of the economy's output has been declining steadily, in the process depriving an increasing number of families, especially in the lower income levels, of access to housing. This has weakened the industry's position in competing for credit, manpower, and technological resources, and compelled the federal government to assume a progressively greater role in providing subsidies and other assistance to meet the demand for housing. The Housing Act of 1968, which called for the construction of 26 million dwelling units in a decade, is the latest phase in this trend. Although the necessary resources are projected to exist, an analysis of the housing industry's position in the economy and of its internal operations reveals that these will not be effectively mobilized in time to meet this target. In view of the evidence to date that existing programs and budgetary allocations have not satisfied the fundamental need for adequate and sustained funding, the concept of a housing trust fund to ensure a sufficient and predictable source of funds for lower income housing is receiving increasing study.

Origins of Housing Industry

The housing industry attained its present configuration in response to three major factors: the nation's tradition of small scale land ownership and development; the states' delegation of land use control powers to their municipalities; and the dependence of builders and homebuyers on loaned funds.

As these constraints compelled the development of a fragmented,

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complex housing industry, the growth of the industrial corporation produced unprecedented economic expansion in the United States. These new economic units, operating under unified policies and with independent capital, steadily outstripped in productivity the conventional housing industry's group of components, each with its limited capitalization and often divergent aims, and all highly vulnerable to market behavior.

The housing industry's declining share of real national output, from the 6 to 8 per cent at the end of last century to the present 2.5 per cent, placed it at a progressive disadvantage in the competition for the nation's credit funds and manpower. And as its periods of expansion and contraction slipped out of phase with the rest of the economy, it became relegated to function as a user of residual resources.

Typical Housing Cycle

Typically, a general business recession will cause a decline in industrial and commercial construction that leaves a surplus in manpower and equipment to flow into house building. Another consequence is a drop in the aggregate demand for credit, making more funds available for mortgage investments. Prospective homebuyers, attracted to easier mortgage rates and downpayment terms, are tempted to borrow more heavily, and a housing boom is eventually underway.

Once the economy begins its recovery cycle, however, other industries enter the bidding for the nation's labor force and credit funds. Small entrepreneur-builders find it difficult to retain their crews and equipment in the face of this accelerating demand, while the rise in mortgage rates and downpayment terms discourage shoppers from buying homes. As the economy moves fully into its expansionary cycle the housing industry is left with reduced resources and diminished consumer demand, and its production swings into a decline.

Government Assumes a Role

The founding of the FHA in 1935 indicated that in the wake of the Depression free market forces were no longer operating effectively in the housing industry, and government assistance would henceforth be necessary to balance the market cost of housing with consumer purchasing ability. The enactment of the first public housing act in 1937 gave further evidence that the housing market was not structured to supply the housing needs of the poor. Thus, within the span of three years the Federal Government for the first time was called upon to assume a share of the responsibility for meeting the nation's housing needs.

The backlog in housing demand deferred by the Depression and the war and an unusually favorable post-war economic environment created by a moderate rate of inflation, rapid expansion in per capita income, and a slow rise in construction costs, and aided by FHA programs, combined to stimulate the housing industry. It resulted in the production of 20,500,000 units during the Forties and Fifties, and reached a record annual peak of 1,908,000 units in 1950. At the same time, 257,368 public housing units were completed.

Despite this most prosperous period in its history, the housing industry was unable to regain the share of the economy's output it had commanded in previous decades, and could not prevent it from experiencing five severe recessions averaging 30 per cent cutbacks in volume.

The Sixties were marked by rapid growth in state and local government programs, continued expansion in business plant and equipment and a general shortage of productive capacity, and by unexpected heavy Vietnam war-related expenditures. By the middle of the decade these created the most adverse economic environment for housing in modern times. The housing industry felt the effects of inflation and its cure simultaneously. As inflation pushed land and labor costs upward, restrictive Federal Reserve policies designed to control that inflation drove credit rates to extraordinary heights, reducing production to its lowest level in 20 years and pricing housing beyond the reach of the poor to exclude one-half the nation's families.

This latest downward trend in the recurrent cycles of housing production served to confirm growing awareness that the conventional system of supplying housing was due for major modification, and led to the adoption of the Omnibus Housing Act of 1968. Chief among its features are larger subsidized interest rates to facilitate home purchases by low income families; other forms of subsidies for some types of apartment rentals; the expansion of Federally guaranteed securities to attract more funds into mortgage investments; and the encouragement of research in construction technology.

These and other proposals, if properly funded, are calculated to stimulate the production of 24 million new, and 2 million rehabilitated, units within a decade. In addition, they are required to meet the needs of the 13.4 million new households that will be formed in that time, among them 3 million in the low income groups; replace 8.7 million substandard and deteriorating units plus 3 million standard units that will be removed from the market by accident or demolition; and to add 1.6 million units to the nation's vacancy pool.

There is general agreement that aggregate resources in funds, land, materials, equipment, and labor will be available to attain this goal. But reservations arise as to whether these resources can be adequately attracted, distributed, and processed, and if so, what effect their mobilization will have on the rest of the economy.

Resources Needed to Meet Goals

To achieve this projected growth the housing industry would have to expand its share of the Gross National Product from its 2.7 per cent in 1968 to 4.9 per cent in 1976. For the entire decade ending 1978 it must contribute an average 4.2 of the GNP, a 31 per cent growth above the last decade. Housing production has exceeded such a share of the nation's output only once in modern times, when it reached 5.6 per cent in 1950.

The 26 million units represent a nearly 40 per cent increase in the nation's housing stock, and would have to be produced at an average annual rate of 2.6 million units (about a 70 per cent rate above the recent 1.5 million average conventional new housing starts in recent years). These units with their public and private support facilities would occupy, at present densities, some 8 million acres of land at a consumption rate of better than 60 per cent above current annual levels. Assuming ordinary improvements in construction practices, manpower in the housing industry would have to be increased from the present 3.25 million to 4.5 million workers by 1978. No difficulties are foreseen in supplying the necessary materials.

Studies estimate that in a highly competetive economy of expanding business and government programs and other consumer markets, $40 billion in total credits must be attracted to finance the construction of 26 million units, double the present residential mortgage requirements. Capital flow projections for the next decade predict, however, that the total of investible funds will not grow at an equal rate. This indicates that mortgage requirements for new and existing buildings will have to increase their share of total capital market funds from their current one-fourth to probably as high as one-third.

The 1968 Housing Act specifically calls for the construction of 600,000 new low income units per year for the decade, a marked increase compared to the 800,000 units produced since the inception of public housing programs. The cost of fully subsidizing 600,000 units per year is estimated at $12 billion annually, or about $100 billion for the decade, of which the Federal Government is expected to assume obligation for $13 billion. This extra low rent housing volume, volume that would not ordinarily be produced by the housing industry, is the value of an average year's growth in the GNP, and is equivalent to the introduction of a major new component into the market system that could have several possible ramifications. Since it would have to be created by deflecting $80 billion from other means of capital formation or consumer goods output, depriving these sectors of resources they would otherwise expect to utilize could seriously strain the market and deplete the nation's credit pool. In view of the fact that all levels of the housing market are interlinked, the massive production of new subsidized housing to satisfy the needs of one income level may also have adverse repercussions on the availability of housing for other income groups. By driving construction costs upward, subsidies for 600,000 units a year would tend to make housing more expensive for those who are not directly subsidized and discourage middle and upper income groups from purchasing homes. At the same time, the extra subsidized growth in housing stock would reduce consumer demand and thus act as a restraint on the normal rise in the price of private housing, thereby limited profit incentives and eventually reducing production in the nonsubsidized market. The net result could well provoke demands for extending larger and more direct subsidies across all levels of the housing market.

On the other hand, as authorities on the problem have noted, the middle and higher income levels have for decades received indirect and hidden subsidies in the form of FHA guaranteed mortgages, low down-payment terms, and property and mortgage interest tax deductions that in effect have diverted government revenues away from the income level most in need of financial aid and toward those levels least requiring it.

The costs of housing and the consumer's purchasing ability at all income levels are affected differently by the forces at work in the economy and, thus, are to a great extent determined independently of each other. Especially in recent years, a decline in demand has not been acting as a constraint on the rise in house prices. It may be expected that the government will continue to be obligated to maintain these two sides of the market equation in balance by various subsidy and assistance programs. Yet, it is generally agreed that expanded Federal funding will not in itself ensure attainment of the Housing Act's targets, but must be joined with measures designed to trim the costs of housing.

Changing Trends in Housing

With conventional onsite labor representing about 20 per cent of initial housing costs, and construction union wages rising 12.3 per cent in the past year (twice the rate of factory workers), attention has been increasingly directed toward improving the industry's efficiency.

During the past decade the construction industry's productivity grew at an average annual rate of 1 per cent as the economy maintained a 2.5 per cent growth rate. Assuming some improvement in the industry's rate and continued conventional practices, its labor force would have to increase by 40 per cent to meet 1978 goals. This would require a 3.25 per cent annual manpower growth rate for the decade—twice the rate of expansion forecast for the nation's total work force.

The instability of an industry with an estimated 30 per cent of its 50,000 builders failing per year, the moderate average annual employee earnings (1970 median income for construction labor was $8,481 compared to $7,000 for basic steel), and stringent labor union membership requirements are expected to severely limit efforts to attract this additional labor force. But this forecast, together with certain emerging consumer patterns, is viewed as presenting an especially promising opportunity for introducing the technological capabilities of corporate industry into the housing market.

Since 1956, as a result of rising costs, competing pressures on desirable land and lenders' changing attitudes, the detached single family house's share of the housing market has diminished steadily. During this time apartment production grew and in 1969, for the first time, moved ahead to gain a majority. Most of the growth in population during the decade will occur in the 25 to 35 year age-group, and this group's high rate of family formation is projected to create another baby boom toward the end of the Seventies. The preference of this group, with its limited financial assets, for renting apartments rather than investing in homes, is expected to continue to favor multifamily unit construction. As these capture larger shares of the housing mix, the operations of small entrepreneur-builders will become less feasible, weakening their traditional domination of the industry and transferring responsibility for serving the housing market to large developers and corporate industry. In addition, the Federal Government is on record as actively encouraging new approaches to raising productivity, and has begun funding some of these on a small scale.

The Entry of Corporate Industry

The convergence of these favorable trends in conjunction with the formation of the largest untapped domestic market of the decade is creating the best environment to date for the large scale entry of corporate industry into housing. But five specific conditions appear to be essential before corporations may be induced to cross this threshold:

1. The volatility of the existing housing market must be damped to a level sufficiently stable to justify long-term planning, the commitment of high initial capital investments, the risks and costs of research and development, and the recruitment of large staffs.

2. Dense aggregations of demand, representing market areas large enough to absorb systems production for a minimum of 5 years, must exist within a 25 mile radius of the fabricating plant.
3. Housing demand within the economic radius of plant operation and shipping distances must be matched by predictable consumer purchasing ability.
4. Site resources must be available, identified, and assembled preparatory to the establishment of central production facilities.
5. Zoning laws and building code requirements must be adapted to new building systems, materials, and techniques.

In view of the fact that it is beyond the function of private industry to establish these conditions, and that most states and municipalities lack the financial and management resources to develop them even if they do have the jurisdictional powers, responsibility for bringing these conditions into existence, either directly or through inducements, is presumed to fall on the Federal Government.

It has been observed that were the government in the position to assure these five conditions, it is highly probable that the conventional housing industry would have little difficulty attracting sufficient resources to achieve the 1968 Housing Act's targets. In fact, it is precisely the absence of these conditions that has impeded the housing industry's progress in the past, and that accounts in large measure for its unique configuration. As the situation stands, the 10 largest builders who have ventured to operate under existing constraints are estimated to produce about 1 per cent of all housing, with the largest of them all, Levitt & Sons, responsible for 6,800 of the 1.5 million units produced in 1968.

HUD's Role

The Federal Government has given little substantive evidence that it is prepared to undertake the massive new commitments these conditions demand. Instead, it prefers to advance more modest programs on the order of HUD's $15 million Operation Breakthrough. Without the legislative mandate and financial support regularly extended other departments, HUD has lacked the sanction and incentives to assert strong leadership and has had to exercise an essentially middleman's role. On the one hand, it encourages states to assemble large housing sites and relax zoning codes; on the other it requests from competing builders submissions for housing systems to be built on these sites. Operation Breakthrough's increasingly less ambitious scope indicates that its significance will probably be more symbolic than practical. In that respect it may have implications more extensive than its immediate impact.

In effect, it signals the Federal Government's determination to support the emergence of a corporate housing system to complement the traditional entrepreneurial housing industry. Such a course of action offers many tangible advantages, as well as some possible risks that merit public examination.

The entry of corporate industry into the housing market is expected to bring about the following major improvements:

- the application of rationalized housing production through comprehensive, integrated planning;
- long-range research, production, and market operations drawing on internal capitalization in place of reliance on the uncertainty of borrowed funds;
- heavy commitment to technological research and development, leading to more rapid product innovation;
- advertising leadership educating the public to accept more efficient design, instead of the conventional builder's catering to consumer desire for wasteful traditional styles;
- more efficient resource utilization;
- greater internal stability in the industry, permitting it to withstand market fluctuations;
- expanded consumer choice in housing.

Since housing production on the scale to be undertaken by industrial corporations would very often entail community development, the greatest potential hazards are perceived to revolve about the issue of responsibility for determining the characteristics of community-scale housing:

- Should government limit its responsibility to furnishing a site, a consumer market, and possibly some financing, and then depend on private corporations to exercise a benevolent disinterest in organizing the assembly of housing and support facilities?
- Can private corporations devoted primarily to optimizing their profits be reasonably charged with building-in, through land use planning, housing mix, and density, the economic and social parameters of a community?
- Should there be some public-private partnership form of control in producing these complex entities?
- Would housing production of this magnitude be more successful if implemented within a context of public policies for land use development, population distribution, resource conservation and management, and economic growth?

Corporate industry's proven performance record in many other markets has tended to obscure the likelihood that its operations in the housing market will not be one of the critical factors in bringing the market costs of housing within the reach of consumer purchasing ability.

Cost Components of Housing

The cost side of the housing market equation comprises initial development costs and continuing operating costs. Structure costs (including labor and materials) account for one-half the selling price of a housing unit and one-quarter of the monthly ownership expense. Assuming that inplant fabrication and onsite assembly can cut structure costs by 20 per cent, and no responsible proponent of industrialized housing has claimed that feasible, the 1971 selling price of a $25,000 house would be reduced by $2,500 and the monthly operating expense from $200 to $190.

The cumulative savings spanning a large scale production program would be considerable, and result in less subsidies for a fixed housing target or more units per project funds. But, bearing in mind that the sales price of the average new house rose from $18,000 in 1963 to $27,000 in 1968, and the annual rate of 3 to 6 per cent inflation in recent years, fabricated housing would not be the determining factor to the individual consumer, especially the low income family.

The issue presented is whether the substantial public costs involved in the form of tax write-offs for plant and equipment, financing guarantees, and funding for R&D programs, will not be disproportionate to the relatively negligible consumer dollar benefits to be derived from industrialized housing.

The financing component of the initial cost and the monthly housing expense—mortgage points, interest rates, insurance and taxes, debt service—is a considerably more flexible variable, but one over which the housing industry exercises little control; it is determined mostly by the general state of the economy and particularly by government policies, as is the consumer's purchasing ability. Thus, the Federal Government occupies the central position in controlling the terms on both sides of the market equation: the initial cost and monthly ownership expense, and the consumer's ability to purchase and meet his monthly payments.

Suggested Federal Policies

An array of Federal policies have been proposed to balance the market price of housing with consumer purchasing ability and to assure that the Housing Act's targets are attained. Among them are: a high and sustained level of economic activity producing improved corporate profits and increased per capita income; reducing income taxes; creating Federal budget surpluses; moderating excessive interest rates; restraining investments in the other competing sectors of the economy and inducing these into housing production; and generating a smooth and prolonged flow of capital into the mortgage markets.

Several of these policies are contained in the latest economic program of the Administration. Should they prove to be successful these will significantly assist housing production, but they may be partially offset by other decisions. These decisions include the Administration's conversion to a policy of budget deficits, projected at $46 billion for this and next year combined; its support of the space shuttle project, at an estimated initial cost of $24 billion; and its willingness to forego $39 billion in business tax revenues for the coming decade to stimulate plant and equipment capital investments.

A Housing Trust Fund

The net result of these policies has not created the economic environment that would generate the volume of housing on the scale projected by the Housing Act, and thus has prompted a search for other means of attaining housing targets. One that has been receiving increasing attention is the concept of a housing trust fund, modeled partly on the successful Highway Trust Fund founded in 1956, and to be reserved solely for housing lower income families.

While this proposal will require extensive development before it can be properly assessed, some of its implications may already be traced. Its major departure from existing mechanisms is a reservoir of funds, substantial, dependable, and secure, that would separate housing production from its excessive vulnerability to political and market fluctuations. By offering the industry a measure of stability it has never enjoyed, the trust fund would free housing from functioning as a counterforce in balancing the rest of the economy. It would eliminate the ceaseless flow of skilled manpower and equipment into and out of housing construction, and would remove union pressures for high hourly wage rates to offset the uncertainty of steady annual employment. An improvement in just these two factors should produce significant savings. Equally important, the assurance of a continuous flow of funds would be the most encouraging single step in inducing large corporations to enter the industry and schedule the capital investments and marketing programs, organize the manpower, and undertake research, all necessary prerequisites for successful production, and all requiring long-term planning. The benefits to be gained from the economies of scale of corporate production would accrue additional savings.

Funding the trust is a highly complex problem that demands much careful thought. It is estimated that fully supporting the construction of 6 million units for lower income families could cost anywhere from a low of $50 billion to a high of $100 billion in a decade.

Various strategies have been proposed to create the trust fund. One is to maintain present Federal expenditure levels at close to their present levels, on the assumption that as the economy recovers and resumes its growth it will generate expanding tax revenues that could be directed into the trust fund. A second proposes reserving a fraction of existing taxes for the fund. Another suggests that those who benefit from government insured mortgages and possibly other federal urban development funds be assessed a special tax specifically set aside for the fund.

Adding housing to the nation's agenda will inevitably necessitate readjustments and the scaling down of ongoing programs, many of which in the past assumed precedence over prior commitments to housing. In a dynamic society such expansion and contraction of specific programs are common events, and most recently demonstrated by the Apollo program that cost some $22 billion in the past decade but is now being phased out.

The housing trust fund, like the highway fund, should be viewed not as a burdensome expense, but as an investment in the nation's physical plant, and as the agent for developing one of its most important resources. The broad political, economic, and social issues the concept raises are extremely difficult and warrant intensive exploration, but these should not obscure the fundamental principle of an adequate and predictable source of funding housing.

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