

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Housing

Office Correspondence

Date November 21, 1947

To Chairman Eccles

Subject: Inflationary aspects of

From Ramsay Wood

residential building and mortgage lending

In accordance with your request, transmitted through Mr. Thomas, I have prepared the attached memorandum and tables on inflationary aspects of residential building and mortgage lending. I hope to have some additional material on Monday.

I am also attaching a copy of a statement sent to Dr. Jack Levin for the use of Senator Flanders' Subcommittee on Cost Factors and Cost Reduction in Housing.

RW

Attachments

INFLATIONARY ASPECTS OF RESIDENTIAL BUILDING AND MORTGAGE LENDING

Summary

The current housing shortage can be alleviated only in part by production of housing. The demand for housing at current prices is so far in excess of the supply of houses available plus what can be built quickly, that, if corrective measures are not taken, inflationary pressures will persist in this part of the economy until prices have been pushed up to the point at which few families can afford to buy.

The volume of residential building is already in excess of capacity at stable costs, and costs have risen. The recent stabilizing of costs is attributable in large part to a better flow of materials during the summer, and a consequent improvement in efficiency on the job. Shortages are again appearing, however, and prices of materials and wage rates have continued to advance.

The demand for housing is being supported by the large volume of readily available credit. Over half of the mortgage credit being extended is sponsored in some fashion by the Federal Government, and an additional portion is amenable to some Federal control. It seems desirable that steps be taken to curtail as much as possible the availability of credit, especially that underwritten by the Federal Government.

The volume of building

Residential building has increased markedly in the past two years, as Tables 1 and 1-A show. The predominant feeling, both in Federal housing agencies and in trade circles, is that the housing shortage will be cured only by continuing, or increasing, the current rate of building, and that any attempt to restrict mortgage credit will reduce building, make the housing shortage worse, and add to inflationary pressures.

Actually, it would probably be better to reduce somewhat the current rate of residential building, if, at the same time, measures were adopted to reduce the demand for housing in the market. We are now probably building beyond our capacity. The argument that we are building fewer houses in 1947 than in 1925 overlooks the fact that the rise in the early 1920's was more gradual than in the last three years, and that, in the earlier period, the whole economy had time to adjust to the higher level of building. It also overlooks the fact that many of the worst houses built in the 1920's were

built in 1925 and 1926, and the fact that the 1925 rate was not sustained.

Evidence that we are trying to build too much is to be found in the fact that, as Table 1-A shows, the number of unfinished houses has been increasing almost without interruption. The widespread complaints of shortages of nails, cast iron pipe, sheet steel, mill-work, and similar items, and the "grey market" for nails, steel, and lumber (some of which are mentioned in the attached Notes on Building Materials Supplies) are further evidence that supplying industries cannot, at present, support the current level of building. The quality of building is also declining, and the Veterans Administration has had to institute an inspection procedure for new houses built with guaranteed or insured loans.

Mortgage lending

Probably the largest single factor responsible for the present inflationary boom, aside from the inadequacy of the housing supply, is the availability of easy credit. A great many families are encouraged to believe that they can improve their housing conditions because they can borrow on easy terms, and while the number of potential buyers remains large, builders have little incentive to hold their costs down. The volume of mortgage lending has been increasing, and the great bulk of this lending is on old houses.

Lending sponsored by the Federal Government has been increasing, both in amount, and in proportion to the total, as Table 2 shows. There is some duplication in the table, since the loans of insured savings and loan associations include loans insured by the Federal Housing Administration and insured or guaranteed by the Veterans Administration. It is not clear, however, that, if FHA and VA guarantees were not available the total of loans made by insured associations would have been substantially less.

A general reduction of the availability of mortgage credit would reduce the demand for housing -- both old and new -- and, if it were not too severe, would hold demand to a level which would permit the largest volume of building consistent with reasonable stability of costs and prices. If credit is not curtailed, there is a serious danger that housing will be "priced out of the market." It seems wiser to curtail building slightly in the next few months, if necessary, and make possible more stable building for a longer period, than to encourage a higher level of building at increasing costs, which will result in a cessation of building before the housing supply has been increased appreciably.

Table 1.

Non-farm Dwelling Units Started
in the United States
(Thousands)

<u>Year</u>	<u>Total</u>
1922	716
1923	871
1924	893
1925	937
1926	849
1927	810
1930	330
1933	93
1936	319
1939	515
1941	715
1942	497
1944	169
1945	225
1946	776
1947	860 <u>e/</u>

e/ Estimated.

Table 1-A

Permanent New Nonfarm Family Dwelling Units
(In thousands)

Period	Started	Completed	Under construction (end of period)
Monthly			
1946			
January	38	16	160
February	42	17	185
March	62	19	228
April	67	21	274
May	67	25	316
June	64	31	349
July	63	37	375
August	65	43	397
September	58	50	405
October	58	56	407
November	48	61	394
December	39	63	370
1947			
January	40	63	347
February	44	60	331
March	58	58	332
April	69	60	341
May	73	60	354
June	77	63	368
July	80	66	382
August	86	70	398
September	92	77	413
October <u>p/</u>	92	82	423

Note:--Data from Department of Labor. Only new permanent family dwelling units built in nonfarm areas are represented, including units financed with public funds and with private funds, and units built by conventional methods and with varying amounts of prefabrication. Single person accommodations, conversions, trailers, and all temporary structures are excluded.

p/ Preliminary

Table 2

New Mortgage Loans Made Under Federal Sponsorship
1-to-4 Family Houses
(Amounts in millions of dollars)

	All loans made	Loans made under Federal sponsorship				
		Total	Percent of all loans made	Associations Ins. by Fed. Savings and Loan Ins. Corporation	Ins. by Federal Housing Adm.	Ins. or guaranteed by Vet. Adm.
1939	2,873	1,250	44	581	669	-
1941	3,810	1,773	47	883	890	-
1945	4,701	2,023	43	1,449	474	100
1946	9,453	5,523	58	2,799	422	2,302
1947 <u>e/</u>	11,000	7,054	64	2,922	830	3,302

e/ Estimated by Federal Reserve

Note:--Loans made by associations insured by the Federal Savings and Loan Insurance Corporation include some loans insured by the Federal Housing Administration and insured or guaranteed by the Veterans Administration. In 1947 such loans may have amounted to about one billion dollars. If such duplication could be eliminated, the proportion of all loans made under Federal sponsorship, might be about 50 per cent in 1946 and 55 per cent in 1947.

Dr. Jack Levin
Adviser on Housing
Legislative Reference Service
Library of Congress
Washington 25, D. C.

Dear Dr. Levin:

We are enclosing certain materials, in duplicate, which we hope will be of use to you and Mr. Henderson in your work for Senator Flanders' Subcommittee on Cost Factors and Cost Reduction in Housing.

The materials enclosed are copies of:

1. A telegram sent to the head of the Research Department at each Federal Reserve Bank.
2. The report from each Bank which was able to supply the information requested.
3. A general statement on "The Housing Cost Problem" which has been prepared at the Board of Governors.
4. Pamphlet No. 6 in the series of Postwar Economic Studies, published by the Board of Governors about a year ago. The first article, "Housing Needs and the Housing Market," may be of interest to you.

If you plan to publish any of the materials supplied by the Federal Reserve Banks, we should appreciate it if the Banks were given an opportunity to make revisions for publication, and to make sure that no confidences are violated.

Dr. Jack Levin

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If we can be of further assistance to you in your inquiry, please do not hesitate to call on us.

Sincerely yours,

Ramsay Wood
Division of Research and Statistics

Enclosures

HW:djk

THE HOUSING COST PROBLEM

Discussion of the high cost of housing has run predominantly in terms of high costs of construction. This emphasis has obscured some of the problems involved in reducing the cost of housing to the point at which all families can be decently housed. Preoccupation with cost of new houses has led to neglect of the cost of acquiring old houses and of the continuing costs of operation of both. Emphasis on cost of construction has usually meant that the importance of demand in determining costs has been minimized. It has also usually meant that costs have been discussed in terms of costs incurred by builders in construction rather than in terms of costs incurred by householders in purchasing properties, including land as well as houses.

The importance of demand

Costs of production, by themselves, never set prices. Before prices high enough to cover costs can be obtained, consumers must be willing and able to pay the prices. On the other hand, when consumers are willing to pay prices substantially higher than the costs of production, pressure is put on costs to rise, unless output can expand smoothly and rapidly to meet the increased demand. Analysis of the cost of housing must deal with both the demand and the supply sides of the picture.

The current high levels of housing costs arise in large part out of the postwar inflationary situation in the economy generally, and the unsatisfactory housing conditions of earlier years. The greatly increased personal incomes and holdings of liquid assets generated by wartime and postwar economic activity have enabled people to bid for better housing than they were accustomed to previously. The size and quality of the stock of housing brought over from the past, however, were not such as to permit people to improve their housing rapidly and additions to the stock have been small, partly because of material and other shortages and partly because additions to the housing supply, even under the most favorable circumstances, are always small in any short period. The result has been that prices of houses, both old and new, have risen to exceptionally high levels. Increases in cost of materials, labor, and contractors' services have reflected in considerable part this basic strength in the market for houses.

Whereas consumption of most consumer goods comes out of current production, housing services represent almost entirely the use of existing stocks. Consequently, the cost to the consumer of new houses is set mainly by what consumers are willing to pay for old houses. When prices of old houses rise, prices of new houses also rise, and with them, the profits of builders. When builders' profits rise, there is more incentive to increase building operations and, because the supply of labor, materials, and land cannot be expanded smoothly and rapidly, the prices of these factors are bid up. In other words, costs rise. The rise in costs, in turn, provides a reason for sellers of both old and new houses to test the market at higher levels.

In a period such as the present, in which there is generally full employment, and in which inflationary pressures are widespread, some of the increase in residential building costs comes from factors other than the increased demand for housing. Demand for other types of structures competes directly for building labor and materials, and to some extent, for land. Demands for other kinds of goods and services also compete, either directly or indirectly. Furniture production requires carpenters, lumber, and nails; automobiles are made of sheet steel and cast iron which are also needed for guttering and radiators; the transportation of agricultural products requires freight cars which are also needed for the movement of lumber and cement. Because not all of these demands can be met at once with the resources available, the prices of the resources rise, and the resources are used in providing those goods and services for which consumers will pay most.

The importance of operating costs

The price paid for a house is only one of the elements influencing the continuing housing cost of a home owner. Interest charges, depreciation, repair, maintenance, replacement, and heating costs are, in varying degrees, independent of the original capital cost. Reduction of these recurring costs is worthy of thorough study, for if they could be reduced substantially, an important cause of the instability of home ownership would be removed. Greater attention to these costs would also disclose points at which further reduction of original cost leads to greater costs of operation.

Amortization of the mortgage, which is usually regarded as savings, is a current outlay, and whether it is, in fact, savings depends in large measure on the state of the market when the owner sells his house. Amortization payments should not be counted in their entirety as offsets to current operating costs.

These operating costs, of whose magnitude an owner-occupant is usually only vaguely aware at the time he purchases, are not met regularly, but when they come due they are substantial. If an owner has committed himself to the limit of his budget for the more obvious items such as interest, amortization, taxes, insurance, utilities, and heat, a large job of repair, maintenance, or replacement may have to be neglected, with consequent impairment of value or danger to health, or, if it is undertaken, may require reduction of expenditure for food, clothing or medical attention. The three related facts that these costs, as time goes on, are so large, are concealed at the time of purchase, and cannot conveniently be accrued, are responsible for a substantial amount of the difficulty which home owners encounter in times of economic reversal. These costs, rather than the original price paid for a house, often make a reduction or interruption of income a more serious matter for a home owner than for a tenant.

The present situation

The present situation is unlike that of earlier booms in several ways. At the start of the war rents and prices were relatively low, and vacancies were high. The first effect of the increased wartime incomes was to fill the vacancies and raise rents and prices somewhat. The withdrawal of 12 or 15 million persons from civilian life into the armed forces reduced the need for civilian housing somewhat, although the migration of war workers and families of members of the armed forces gave rise to acute shortages in some areas. The financing of a large part of war costs by sale of Government securities to individuals, and the restriction, by price and rationing controls, of the spending of individuals, left consumers with a large volume of claims on goods and services which could be exercised after the war. At the end of the war, demobilization of the armed forces began, there were no vacancies, families were established or reestablished at a rapid rate, and liquid assets and easy mortgage credit as well as high current incomes were used to compete for the limited supply of housing, both old and new.

As a result, prices of old houses have risen very rapidly to levels much higher than at the end of the war, and the pressure on costs has been great. In addition, the high level of economic activity generally, the large volume of capital goods production, and the relatively low capacity of the building industry, have resulted in pressure on costs. Bottlenecks have appeared in one line after another, in materials, transportation and labor, limiting increases in supplies and contributing to higher costs.

An important reason for the continuation of this inflation is the existence of the large volume of liquid assets and readily-available credit in the economy, which has permitted veterans and others to pay the sharply advanced prices for houses.