Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date December 4, 1935

To Governor Eccles

Subject: Memorandum on low-cost housing.

From J. M. Daiger

GPO 10—852

I am attaching a memorandum which was dictated and typed before our discussion at lunch today, but which I thought it advisable not to refer to or to give to Mr. McDonald until after you had read it. I wish that you would look it over as soon as you have an opportunity and then let me know whether to give Mr. McDonald a copy.

December 4, 1935

TO Mr. Eccles

Mr. McDonald

FROM J. M. Daiger

Memorandum on Low-Cost Housing Under the National Housing Act.

On my recent trip to New York I undertook to bring to a head the negotiations that I began last August, with the assistance of Governor Harrison, to have an underwriting syndicate formed to handle bond issues under the low-cost-housing provisions of the Housing Act. Several amendments designed to make such bond issues practicable were included, as you know, in the Banking Act of 1935, and an amendment having the same purpose in view was also made to Section 77b of the Bankruptcy Act; but because of certain legal questions that have waited clarification by the Attorney General it has not up to this time been possible, as a practical matter, to do any financing under the Housing Act by means of bond issues.

As far as I am able to determine, however, the way is now clear for this kind of financing, and I therefore recommend that a prompt effort to bring it about be made through the cooperative action of the Administrator of the Federal Housing Administration, the Chairman of the Securities and Exchange Commission, the Chairman of the Board of Governors of the Federal Reserve System, and the

Governor of the Federal Reserve Bank of New York.

There are several reasons why I attach great importance to this kind of housing and this kind of financing. To begin with, I would point out a dual consideration that seems to me to be fundamental, but that I think is overlooked in most of the current discussion and promotional effort emanating from Washington where housing is concerned. I refer to the fact that, if we are to have a well-sustained housing boom, it must be, first, a low-cost-housing boom, and, second, must include a large proportion, perhaps as much as half, of low-cost housing built to be rented rather than sold.

I might emphasize this dual consideration by pointing out the fallacy of regarding the building operations of the 1920's as a housing boom. That activity was not a housing boom; it was a construction boom. The great bulk of the construction carried on during the 1920's was wholly outside the field of housing. Of that part which was in the field of housing, nearly half was represented by apartment operations--that is, housing for rent. These operations were in large part carried on, directly or indirectly, not by concerns chiefly interested in housing--that is, in building ownership and management--but by concerns chiefly interested in promoting construction contracts and mortgage-bond issues. The families that could pay relatively high rentals, on the basis of which the projects were capitalized, held the bag for a little while; then it was passed to the bondholders;

and only then did it become evident that, in many of these large-scale properties, there was not, and never had been, any real equity interest.

In other words, much of the housing built during the 1920's, when residential construction reached an all-time high in both volume and cost, was built because the investment market would take bond issues and not because the housing market would take houses. The yearning for high-coupon rates, not the much-prated yearning to own a home, was the decisive factor. Insofar as the building of high-cost apartment houses went to satisfy a housing demand it was a rental and not a sale operation. And because the rentals, based as they were on high-cost construction and high-cost financing, were necessarily high, the apartment field was the one in which vacancies were subsequently greatest and the decline in rentals most severe.

Of the individual houses built during the 1920's, these were for the most part relatively high-priced. A boom in this class of housing was then shown to be impossible even under the most favorable economic conditions. Long before the onset of the general industrial depression in 1929-30, houses built during the latter stages of the construction boom were backing up on the market.

Most of the so-called revival of residential construction during the past year has apparently been of this same general character—that is, individual houses built to sell at relatively high prices. But, though the percentage increase currently shown by residential construction is very large in comparison with 1932-33, the absolute volume is extremely small. Hence a revival of this kind, which has progressed in two years only from 90 to 95 per cent below a theoretical normal to 80 or 85 per cent below a theoretical normal, may run on for some little time and give the illusion that the construction industry is recovering and that the housing needs of the country are by way of being met.

It is my frank opinion, however, that if this kind of revival is not soon arrested and replaced with widespread activity in the building of low-cost housing--housing for which there is a continuously large sale or rental market--the inevitable result will be a rent crisis that will retard rather than advance the recovery of the construction industry. I say this because we shall manifestly not get enough housing to meet the population needs if residential construction continues in the direction in which it is now headed and in which it is being encouraged by the Treasury, the Federal Housing Administration, the Public Works Administration, and the member institutions of the Federal Home Loan Bank System and the Federal Reserve System.

More specifically, because the rate of residential construction is too slow and the price per unit being built too high (these two factors are interrelated) we shall go from the frying pan of moratorium legislation, which is still a drag on the mortgage market and on the construction industry, into the fire of rent legislation. The various State moratorium laws, the HOLC, and the FCA are evidence enough that rent legislation will be forthcoming if the housing shortage now in early prospect is permitted to become acute.

Assuming that I am substantially correct in these points that I regard as highly practical and fundamental, then I would say that the essence of the housing problem is industrial and not financial. And if the essence of the problem is industrial, then it can not be effectually remedied, but at best only slightly and temporarily mitigated, by further exhorting lending institutions to lend, by government-financed sales campaigns to make house renters and apartment renters home-buying conscious, by pushing the mortgage interest rate down to the British building-society level of 4 1/2 per cent, by reducing the down payment on new houses to 10 per cent or 5 per cent, or by directing a national flow of mortgage money through a mortgage-discount bank. The essential industrial problem now holding the housing market back would still remain unsolved.

The mortgage jam was broken six months ago. There is now more first-mortgage money pressing for investment than at any time in the past, and it is available at lower rates and for longer terms than at any time in the past. Loans are being made freely without benefit of FHA insurance, below the maximum rate authorized by the FHA, and for as long as the maximum term permitted by the FHA--all which, regardless of numerous individual exceptions, is evidence enough that the mortgage market as a whole is open and functioning. Even the second-mortgage market, which it is an aim of the National Housing Act to discourage, has reopened. This is evidenced by the fact that new high-cost houses can again be bought on a shoestring.

On the other hand, from the industrial point of view, there is much to be said about the housing problem, and the first and most important thing to be said about it is that it is a housing problem, a problem of industrial production--the production, both for sale and for rent, of housing units that the market will take. As I have frequently remarked from time to time since I was brought into housing discussions in Washington about two years ago, what this country needs is a good $5,000 house. With that figure as the upper limit for a modern unit, and with the rental market as well as the sale market built for, we can have a long-sustained housing boom and we can forget the gap that still remains between rents and costs; but even if we bridge that gap with a subsidy in some form we cannot have a housing boom or a sound mortgage market grow out of our present flurry of high-priced houses for the new up-and-coming young business man to buy on a shoestring or even on the FHA insured-mortgage plan.

About a year ago Mr. Henry I. Harriman, then president of the Chamber of Commerce of the United States and very active in housing matters, arranged at my request a small meeting in his office to discuss this industrial aspect of the housing problem. At that time I was expecting to return to New York very shortly and to have no further part in housing matters here. I said at the meeting that there was one idea I should like to get across before leaving Washington--namely, that the Federal Housing Administration and the Chamber of Commerce, unless they faced squarely the cost problem, the production problem, and the price problem, would wake up about six months or a year hence to discover that the mortgage market was wide open and that there were no takers for mortgage money, no honest-to-God entrepreneurs building houses, no types of housing capable of inducing the huge revival of construction that the Chamber of Commerce, the Durable-Goods Industries Committee, and other industrial organizations were talking about. I urged Mr. Harriman and his associates to devote that six months or year to quiet exploration by several small groups of industrial and financial leaders of the possibilities of large-scale, low-cost housing under the Housing Act.

The various large-scale, low-cost projects now tentatively approved by the FHA and awaiting financing do not have the kind of sponsorship that I was at that time seeking to bring into the picture, but they nevertheless represent a good start in the right direction. If they can be financed through Wall Street, so much the better for the prospect of acquainting some men with more money than initiative of the possibilities of profit in the low-cost-housing market.

The low-cost-housing provisions of the Housing Act constitute the only existing instrumentality, governmental or otherwise, which can give impetus and direction to private enterprise in this type of housing operation. The entrepreneur corporation proceeding under these provisions of the Act can build up its equity ownership more quickly and at less cost, and hence at less hazard, than under the method of financing hitherto prevalent for large-scale housing operations. At the same time this entrepreneur corporation can offer to the public a more reasonable scale of rentals than was economically possible under the old method of financing such operations.

From a political standpoint, I think that the reasons for trying to get this new financing under way as soon as possible after Congress reconvenes are obvious.