

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date June 19, 1937To Mr. GoldenweiserSubject: The Equity Plan proposed byFrom Mr. GarfieldMr. TarnowskyThe Plan

The Equity Plan is designed to promote the building of low-cost planned communities in the outskirts of medium-sized cities, with houses to be sold on purchase contracts with little or no down payment but with monthly payments large enough to pay off the loans more rapidly than values decline and thereby to build up an equity for the purchaser. This equity the purchaser could draw upon to a limited extent for payments in time of distress or could transfer in case he moved. Low initial costs would be achieved by using cheap land, building on a large scale, paying wages on an annual rather than hourly basis, and offering bargains that would eliminate most of the sales costs. Financing costs would be kept low by having the Federal Government, State governments, or other responsible parties guarantee bonds to be issued. Repairs and other operating costs would be on a large scale basis and therefore kept at a minimum. Altogether the proposition would be expected to appear so attractive to buyers that the value of existing properties would be seriously depreciated and allowance is made for about 10 percent of the payments by buyers to go toward mitigating the losses on selected existing dwellings.

The administration of each community enterprise would be in the hands of a "management corporation" controlled by a regional "trustee

company" which in turn, according to a supplementary letter from Mr. Tarnowsky, would be subject to some supervision by the agency guaranteeing the bonds. Each trustee company would have a revolving fund of at least \$100,000, issue bonds at 3.5 percent "redeemable in 30 years maximum," buy and control land, link management of different community units, determine long-time policies, and receive a service charge. The monthly payment, amounting to \$42 for a house priced at \$4000, would be collected by the management corporation which "keeps the management fee, the repair fee and the taxes, sends the balance to the trustee company who keeps the principal and interest and service charge; the balance, or premium is then sent to the agency in charge of the investment insurance." If all payments were met the house would be paid for in 19 years but if purchasers took advantage of the provisions for flexible payments it might be 30 years before the purchaser would obtain title to the house. There are many other provisions, including one for fluctuating payments based on a purchasing power index, but these are the leading features of the proposed plan.

The principal experience cited to prove the workability of the plan is the record of the Veterans' Welfare Board of California, which has operated since 1921, financing the purchase of houses by veterans on a down payment of 5 percent. The Board has been able to meet payments on the bonds without calling for aid from the State, which guaranteed the principal and interest on the bonds.

Comments

Judgments as to the feasibility of such a plan may easily differ, depending on one's general viewpoint with respect to many matters, including the extent to which the government should act in a field ordinarily regarded as one of private concern until distress conditions call for government relief; but there can be little doubt that the efforts of existing governmental agencies in this field should be appraised carefully before any new proposal is considered seriously. Such appraisal of the existing situation as appears incidentally in the statement advocating the Equity Plan is clearly inadequate.

Many real problems have been considered in drawing up this plan but in almost every instance the advantages of the proposed solution are stressed without much consideration of possible disadvantages or of the problems involved in putting into effect the proposed solutions. The size of the market for this type of house at \$42 a month seems to be very much overestimated. The disadvantages of low down payments, of purchase contracts, and of community enterprises are not discussed. The plan for having 10 percent of the payments go to offset losses by some owners of existing properties is set forth in some detail but appears unworkable, both from the point of view of the purchasers of new houses and the owners of existing properties.

Many risks are recognized in calculating the \$42 figure, but the protection furnished is largely for purchasers, the management corporation, and the trustee company, while provisions for protecting the agency issuing the guaranteed bonds are clearly inadequate. In answer

to an inquiry concerning the relation between the agency guaranteeing the bonds and the trustee company, Mr. Tarnowsky said that "this would be a matter of bargain. My suggestion is that the guarantor would be given as a 'big stick' the power to remove trustees in a given region after proper hearings." The individual purchaser is protected against the loss of his property as a result of a reduced income for a period but he apparently assumes an indefinite liability in connection with the whole community enterprise. On these important points, as on many others, such as the source of the revolving fund of the trustee company, the plan is vague.

Judgments as to the adequacy of allowances for vacancies, depreciation, management costs, and other items should be sought from the housing agencies, which are most directly concerned with these matters, and from any agency to be requested to guarantee the bonds.