Tentative

SUGGESTIONS FOR MESSAGE ON HOUSING

One of the most urgent problems that business and government to-day have in common is to make the housing construction industry a major factor in our economic and social life. By the very nature of its product, which is one of the three prime necessities of life, this industry ought to be one of our largest and most dependable sources of business activity and employment. Actually, it has remained in a depressed state for the past eight years.

This is an urgent problem for business because the long-continued lag in housing construction is a drag on all industry and trade. All business needs the infusion of orders and the diffusion of purchasing power that come when housing construction is thriving. It is an urgent problem for government because the lag in housing construction is the most deep-rooted retarding factor in national income, budget balancing, and full employment of labor. Government needs, as business does, the benefits of the greatly augmented national income that would result from a vigorous revival of housing construction.

Three or four years ago the fundamental nature of this problem was well recognized. Industry, labor, and government were all agreed that the revival of housing construction on a large scale was an essential prerequisite of widespread and sustained recovery. Nevertheless, what then seemed self-evident to everyone was for a time apparently contradicted by what was actually experienced. We did have a great recovery of business generally from 1933 into the present year. But housing construction, far from being the moving force and mainstay of the recovery movement, had only a belated and minor part.

In the construction of housing, we had a partial recovery in 1935, some further improvement in 1936, and continued gains this year. Last spring, however, a sudden unseasonal downturn occurred in this industry. The result was that the total number of dwelling units erected during the 1937 building season fell far short of what had been widely anticipated. As to the causes of this early downturn and its continuance during months ordinarily marked by very active building, I shall have more to say presently.

What I wish to emphasize at this point is that the failure of housing construction to make adequate headway in common with business generally has been a most serious factor in arresting industrial activity and bringing on a recession of industrial production and buying. The recovery which took place from 1933 to 1937 lacked the continuing impetus and support that could come only from a much larger volume of housing construction--a volume large enough to keep pace with the steady growth in our population, to maintain or improve our housing standards, and to give work and income to the great numbers of people that directly or indirectly must look to this industry for employment.

Taking counsel with men both within and outside the government who have given much practical thought to the broad economic aspects of housing, I have obtained their assistance in developing suggestions for legislative and administrative action to deal with this problem in a big and decisive way. The purpose of the measures which I shall submit for your consideration is to bring about the private construction and financing on a nation-wide scale of housing for sale or rent on terms that are within the reach of the mass of our people.

This is something that private enterprise in this country has not, by and large, been able to accomplish up to the present time. When we look about for the reasons why this is so, we find that it is partly because of conditions within the construction industry and partly because our methods of financing are not sufficiently adapted to the present realities of the housing market. Government cannot directly improve the practices of the construction industry. It can, however, by improving the financial mechanisms for building and owning housing, make practicable a more efficient and more economical operation on the part of that industry.

The National Housing Act, which was enacted by the Congress in 1934, provided a financial mechanism applicable to all types of lending institutions that make loans for housing purposes. Pursuant to this new method of financing, enabling legislation was subsequently enacted by all the States. It is the most far-reaching means we have yet devised to simplify the operations of private enterprise and private capital in the housing field.

Under this act, the Congress established the Federal Housing Administration, which insures mortgages on certain types of housing, but which itself makes no loans. The agency is designed to become ultimately self-sustaining through the operation of a mortgage insurance fund, into which premiums are paid by borrowers who obtain loans under the provisions of the act from private lending institutions. An ultimate guaranty of loans that may default is given by the Federal Government, but this guaranty becomes operative only in the event that recoveries from the sale of defaulted properties, together with all the monies in the insurance fund, should be insufficient to pay the insured claims. Hence, even if any cost should result to the Federal Government, it would be negligible when measured by the volume of construction and employment induced by the fact that the guaranty is there should it ever have to be availed of.

What is now proposed is an improvement and enlargement of the framework of this existing legislation in the light of practical experience. The changes suggested are of a threefold character: first, to effect further reductions in financing costs; second, to extend the insurance of mortgages to types of housing operations not now adequately provided for in the act; third, to make the funds of institutional and individual investors more easily available for the financing of large-scale operations.

Because it takes the ordinary buyer of a house or investor in housing a long time to pay for the property, the cost of financing is in the long run one of the largest items in housing costs. In the case of rental housing it is a determining factor, first in whether construction shall be undertaken at all, and second in arriving at the scale of rentals to be charged. Likewise, to the family building or buying a house for its own occupancy, a saving of 1 per cent or even $\frac{1}{2}$ of 1 per cent a year in financing costs amounts, over a period of years, to a considerable sum.

At the present time, institutions making loans under the general provisions of Title II of the National Housing Act are permitted by regulation to make an interest charge up to 5 per cent and a service charge of $\frac{1}{2}$ of 1 per cent, or a total of $5\frac{1}{2}$ per cent. It is proposed to reduce this to 5 per cent net by amending the administrative regulations.

As a means of further reducing the cost to the borrower, however, I would ask the Congress to authorize the Federal Housing Administrator to fix the mortgage insurance premium as low as $\frac{1}{2}$ of 1 per cent on the diminishing balance of an insured mortgage instead of on the original face amount as now required by the act. Further, as a means of giving special encouragement to the construction of houses for sale or rent to families of moderate income, I would ask the Congress to authorize the Federal Housing Administrator to fix the mortgage insurance premium as low as $\frac{1}{4}$ of 1 per cent on the diminishing balance of an insured mortgage in cases where the estimated value of the property to be built does not exceed $6,000 and where the mortgage is insured prior to July 1, 1939.

This latter rate is frankly an experiment. It would be applicable, however, only for a limited period and to a class of risks in which the average mortgage, I am informed, would probably be less than $4,000 over the country as a whole. Building costs vary considerably in different localities, but the type of houses to which this lowest rate of mortgage insurance would apply manifestly represents the widest sale and rental market for new housing, so that in any event the insurance risk would not be great.

Another change that I would ask the Congress to make in the existing legislation is to raise the insurable limit from 80 per cent of the appraised value of the property to 90 per cent in cases where the estimated value of the property to be built does not exceed $6,000. I regard this change as of the utmost importance in stimulating the construction of houses within reach of the mass of wage and salaried workers.

The purpose of this proposed change is to take practical recognition of the fact that most persons who desire to own homes of their own cannot make a first payment as large as 20 per cent of the purchase price. This is particularly true after the severe depression of recent years, in which the savings of millions of prudent and thrifty families were depleted. The number of families that can and would pay from $250 to $500 to get into a new home is of course enormously greater than the number that can pay from $500 to $1,000 or more. Moreover, the lowering of the initial investment required would similarly stimulate the building of moderately-priced houses for rent.

The fact is not generally recognized, I believe, that the majority of our urban families are not home-owners. In the larger cities, the proportion of rented dwellings runs from 60 to nearly 80 per cent of the total. The encouragement of private enterprise to build houses and apartments for rent is therefore an essential part of any comprehensive program to stimulate housing construction.

With this in view, some of the measures suggested for your consideration are designed especially to facilitate the construction and financing, under the economies of a blanket mortgage rather than piecemeal operation, of fairly large groups of houses for rent, or for rent with an option to purchase. Such operations would afford economies in construction as well as in financing, and would therefore, I believe, lead to the formation of substantial companies to avail themselves of the opportunities in this particular field. Similarly, these measures are designed to encourage the construction of apartment buildings of moderate size, such as are particularly adapted to the requirements of our smaller cities.

In the construction of large-scale rental properties, a small but creditable beginning has already been made under the existing provisions of the National Housing Act applicable to limited-dividend companies. These provisions are in need of some clarification, however, in order to encourage a more extensive development of large rental projects in the communities where they are needed.

Among the most important of the measures to which I would invite your consideration are those designed to facilitate the financing of these large projects. Here there is a great gap in our financial mechanisms. The large projects thus far constructed under the provisions of the National Housing Act have been closely regulated as to rents, charges, capital structure, rate of return, etc., and the excesses and abuses which widely characterized the financing of apartment properties in the 1920's have thereby been avoided. The very size of the loans in the case of these large projects, however, makes it difficult to finance them by means of a single mortgage.

I would therefore urge the Congress to liberalize the provisions of the act under which the chartering of national mortgage associations is authorized, and, among other things, to give these associations explicit authority to make loans on mortgages insured under the provisions of Section 207 of the act. This is the section dealing with large-scale properties that are subject to special regulation by the Federal Housing Administrator.

The effect of the change here proposed would be to enable these properties to be financed by national mortgage associations through the sale of housing bonds or debentures amply secured by the insured mortgages on the properties. In order that one or more such associations may be promptly organized, I shall ask The Reconstruction Finance Company to make available, out of the funds already allocated to The RFC Mortgage Company, $25,000,000 for capital purposes. Under the amendments proposed, this would provide the basis for $500,000,000 of private funds obtainable through the sale of national mortgage association debentures.

As a means of obtaining these private funds on the most favorable terms, I would ask the Congress to give to the debentures of these associations tax exemption comparable to that afforded the obligations of the Federal Home Loan Banks, the Federal Land Banks, and the United States Housing Authority.

Another of the suggested amendments that I regard as of special importance would make the limitation of $2,000,000,000 on the amount of mortgages insurable under the National Housing Act apply to the amount of insurance to be outstanding at any time and would remove the limitation of July 1, 1939 now applicable to the ultimate guaranty of the Federal Government. These changes would measurably encourage private financing under the act without increasing the amount of the contingent guaranty provided in the existing legislation.

As I have indicated, some of the measures which I have in view can be accomplished by administrative action. Most of them, however, would require legislative amendments. Considered in relation to existing provisions of the National Housing Act, the Federal Reserve Act, the Federal Home Loan Bank Act, and extensive enabling legislation that has been enacted by the several States, the adoption of these measures would for the first time provide all the financial mechanisms essential to a vigorous and widespread revival of housing construction.

The terms of financing, moreover, would be the most favorable ever made generally available in this country for housing purposes. On 20-year amortized mortgages for 90 per cent of the value of houses up to $6,000, the maximum rate would be $5\frac{1}{4}$ per cent, including the cost of insurance. On 20-year amortized mortgages for 80 per cent of the value of houses up to $20,000, and multi-family properties up to $200,000, the maximum rate would be $5\frac{1}{2}$ per cent, including the cost of insurance. On larger projects, experience thus far has indicated that the rate will not exceed 5 per cent, including the cost of insurance. These costs are half, or less than half, the costs of loans of comparable proportions under the system of first, second, and third mortgage financing that was widely prevalent in the 1920's.

The program as a whole is calculated, therefore, to rouse the interest of private enterprise and private capital in what is virtually an unlimited market for labor, materials, equipment, transportation, and all the other elements that an active construction industry draws upon. Under the measures proposed, large and continuous activity and employment in housing construction, which is not feasible under our present limited methods of financing, would be put decisively on a practicable basis.

The success of such a program, however, cannot be assured by governmental action alone. It will depend rather, in very large measure, on the willingness of industry and labor to cooperate in producing housing at costs that are within the consumer's means. The goal at which both industry and labor will have to aim is sustained large-scale production that will, as the direct result of lowering costs to the consumer, give a greater income to labor because of longer employment and a greater income to industry because of larger output.

Because this was not the goal of industry and labor during the past construction year, the result soon proved injurious to both and to business and employment generally. The sharp rise that occurred in construction costs between September of last year and March of this year, apparently in anticipation of something like a building boom, lowered by 100,000 to 150,000 the number of new dwelling units that competent authorities had estimated were in prospect for 1937.

It is now clear that we cannot have a strong revival of housing construction on the terms that were exacted by industry and labor last spring. The rise in wage rates and material prices was too rapid and too great for the consumer to bear. Nor was it in the construction field alone that a rapid rise in costs checked production and buying.

Clearly, no industrial or labor group would deliberately adopt a policy calculated to defeat its own interests and undermine its own market. I am not, therefore, essaying to blame anyone for pushing up wages and profit margins too fast; I would simply point out the obvious cause and effect in what actually occurred. From what did occur, I think it is evident that we must retrace our steps somewhat. If we are to supply the housing that our people need, we shall have to be guided by the maxim that the surest way to gain our ends is to moderate our desires.

Our people as a whole have had a measurable success in their incomes since 1933. Nevertheless, the budget of the great mass of our families is not elastic, and for most of them the point is quickly reached where increased costs react against someone's business and someone's employment. The problem of the construction industry and its workers, then, is to find a reasonable way, through continuity of production and employment, to adjust the costs of housing to the consumer's means.

Toward this end, it is my intention shortly to initiate a series of conferences with representatives of industry, labor, and finance, with a view to giving housing construction a fresh start in the coming building year and averting a recurrence of the conditions that brought about the reverses of the present year. If these groups will cooperate in this effort, as I believe they will, the result cannot but work to the advantage of our whole national economy.