GENERAL MOTORS CORPORATION

DETROIT, MICHIGAN

December 2
1937

Mr. Marriner S. Eccles, Chairman
Board of Governors of the
Federal Reserve System
Constitution Avenue at 20th St.
Washington, D. C.

Dear Mr. Eccles

I wonder if you will be so kind as to send me a copy of the last Annual Report of the Federal Reserve Board?

I expect to be in Washington December 9th and 10th and if I have some important information which might be of use to you, I will call your office for an appointment, otherwise I will not bother you.

Incidentally, because of your interest in housing, I am attaching a copy of a rather radical approach to the question of housing finance which I started to think about some years ago. I hope you will have time to read it so that I can have a brief discussion on it if you are interested.

Sincerely yours

Stephen DuBrul

Stephen M. DuBrul

SMDuB/F

Encl.

A NEW APPROACH TO THE HOUSING PROBLEM

Background of the Problem

It is conceded by all economists who have delved into the problem carefully that there can be no sustained revival of business from present levels until there is a resumption of a high degree of activity in the building industry. All of the facts of the case indicate that even though there was over-building in the post-war decade in many cities and in some kinds of accommodations, there is today a real shortage of single homes of a modest price.

Furthermore, most people will admit that home building is a backward industry from many points of view. Home construction has made comparatively little technological progress in the machine age. It has remained a disorganized industry consisting of a lot of small contractors building on a speculative basis. Labor has not been organized from a technological point of view. This economic disorganization of home construction precludes it even being classified as an industry. The same is true to a large degree of the manufacturing of building materials. While we have had a number of new materials produced, they are only variations of the old ones and there have not been any basic changes of importance in the art.

As a result, modern housing today offers probably the greatest opportunity for technological progress and the investment of capital. America needs to be rebuilt and can be rebuilt at materially lower costs for more satisfactory dwellings if the problem is approached as a big business enterprise on a national basis.

There is another condition in modern American life which is changing the whole real estate market. For many generations Americans have been urged to buy homes and yet from the point of view of the individual salary or wage earner, the ownership of a home is probably the poorest investment that he can make with his savings. In the first place, he is faced with the difficulty of financing. In the second place, neighborhoods change and thus a home in what may have been a good neighborhood at one time may depreciate seriously. In the purchase of a home the home owner assumes a very serious and rigid debt. A man's salary may be cut or he may be transferred or forced to seek employment in another city; if he dies, his estate is burdened with encumbered property. All of these factors are contributing to making it less and less desirable for any individual person to own any individual house.

Elements of the Problem

The various elements of the problem of housing are -

(1) The traditional methods of financing individual homes are unrealistic and impose a serious and rigid debt burden on the individual home buyer.

(2) The purchase of a home is historically a very risky form of investment of the ordinary person's savings due to -

(a) The hazards of employment in relation to the fixed debt burden and the location of the property in relation to opportunities for employment.

(b) The hazards of capital loss due to the instability of the value of the individual home in an individual city with no way of insuring this risk.

(c) The handicraft nature of building on an individual basis which has prevented the employment of modern mass production technology in this field.

Any improved plan for housing, therefore, must achieve the following results -

(1) It must minimize the capital risk hazard to the individual buyer in the purchase of an individual property, by some sort of pool with others.

(2) It must give greater flexibility in enabling him to cope with changing circumstances, such as his income and his place of employment.

(3) It must enable us to capitalize modern mass production techniques so as to bring down the real cost of housing in terms of the workers' human labor, that is, we must give the ordinary man much more house in exchange for his labor than he can get now.

(4) The plan should contribute toward the stabilization of home building and consequently the stabilization of the entire economic system.

A Proposal

The following plan is offered as conforming to the above specifications -

The type of financing is equity financing through common stock ownership, which eliminates mortgages and long-term fixed debt.

The plan is a modified purchase rental plan whereby the individual rents the property but at the same time is building up an equity in the concern which owns the property, which equity can be converted into a title deed whenever the individual desires and the equity is sufficiently large to enable him to do so.

The problem of purchasing land, designing the residential area, purchasing materials, construction, insurance and maintenance are all on a large-scale mutual insurance corporation basis, essentially cooperative but with all corporate advantages. This would provide a basis for all of the advantages of large-scale management in production and operation while at the same time preserving the principle of individual proprietorship and occupation of the home which is absent on a strictly rental basis.

The prospective home builder would apply to the corporation for assistance in building his home. The first step would be to examine his budget and to make sure that he is a responsible party and, furthermore, that he is not undertaking to build a house the cost of which would really be beyond his income. The rough rule in this respect is that no one should have a home the cost of which is in excess of twice his current and prospective annual income. The corporation would refuse to finance a house beyond this limit for any individual.

The individual would then consult with the architect and real estate agents of the company to select a lot and the designs for his home. The company would purchase the property and build the house, retaining clear title to it. The home builder would purchase common stock in the home-owning corporation equal to ten per cent or more of the current value of the property. (This would be the down payment.) The stock would be purchased in the open market at current market price. This stock would be placed in escrow and would not be transferable so long as the home builder occupied the house. The home builder would sign a lease with the company for a two or three-year term at the current rental value of the property. This lease would include an option to purchase the property at current market price as determined by appraisal or competitive bidding at any time he may choose. He would also enter into a contract with the company to invest a certain portion of his savings each month in the stock of the company at current market price, that is, instead of applying savings against the principal of a mortgage on a monthly payment plan he would apply the equivalent on the purchase of common stock in the corporation. This stock would be added to the other shares which he had purchased in lieu of a down payment and also would not be transferable so long as he remained in one of the company's houses. At the end of any lease period the home builder would have the first option on the renewal of a lease for another period so that his occupancy would not be interrupted. However, the renewal rental is not guaranteed in advance. It may be either higher or lower than the rental during the previous period, depending upon the current circumstances and conditions determining rents in his particular community. In other words, if they have fallen, he would pay a lower rent in the succeeding periods -- if they have risen, he will pay a higher rent. This, of course, is the same chance that any present lessor assumes.

Whenever the home builder has accumulated shares which at the current market price are equivalent to the current market price of the property, he may exchange his shares for a deed to the property if he desires.

If, at the end of any lease period, the occupant should desire a more expensive house, the process may be repeated and he either could be built a new home or could lease another already owned by the company. The reverse is also true. If he met with reverses which required that he reduce his living costs, he may move into less expensive quarters and continue on the same plan. If, at the end of a lease period he wished to withdraw, he would not be compelled to continue his lease but could move out and would receive all of his shares which are in escrow which, in turn, could be sold in the open market or retained by him as a new investment as he may desire.

If he were moved to another city the company would assume the lease (possibly with some charge) and in the city to which he moves he could arrange with the company for another house providing, of course, that they are operating in that city.

The company would maintain its own architectural staff and its own maintenance crews. While in the beginning it probably would not engage in construction directly, it could purchase its materials on a long-term volume contract basis, thus obtaining the same advantages in material costs savings as automobile companies and the large mail order houses obtain by such contracts. The economies in construction along these lines would be enormous, thus making the plan more attractive both to the home builder and to the investor.

The corporation would have an agent in each of the cities where it has purchased property and the agent would have complete charge of all property in that area. The agent in each city would look after the maintenance and the accounting of local property, the payment of taxes, etc.

With proper distribution of holdings by cities and within the cities, it would not be necessary to carry fire insurance, that is, the company would be self-insured.

The cash carrying costs of such a corporation would be quite low, consisting only of supervision costs, taxes and current maintenance costs. It would be self-sustained from the very beginning, since rentals would be coming in every month.

By this plan, therefore,

(1) We would make housing a modern, large-scale national enterprise with all of the possibilities that go with it.

(2) The home builder can build his own home which to all intents and purposes is his but with no mortgages to concern him, and with the liquidity that goes with the ownership of common stock. He would benefit in the profits and losses of the corporation exactly in proportion to his stock equity. In this way, he would be pooling his risks as an individual property owner with thousands of other individual property owners and thus would eliminate the hazards of individual ownership.

Since fixed charges would be low, including only minimum maintenance and administration costs and taxes, it would be possible for the company to reduce rentals if rentals fell and at the same time not have to sacrifice its property on a demoralized market. All capital losses would be pooled on a mutual basis. All profits would be pooled likewise. By accumulating sufficient surplus the company would be in a position to carry through almost any depression and not concern itself seriously with capital value fluctuations of a short-term nature due to demoralization of the real estate market.

Whenever the company had a vacancy it would have the choice of releasing or selling, depending upon the profit calculations.

The company would maintain a crew of inspectors which would inspect its property periodically and arrange to make all necessary repairs to prevent undue deterioration. By keeping the property in the pink of condition, it should be possible to obtain better rents than the ordinary landlord can obtain.

The savings in maintenance cost alone, by virtue of a trained crew of maintenance men working steadily throughout the year would be substantial and should be reflected in lower rentals (or higher profits) as compared to other property.

By this plan a home builder today could obtain finances to build a home when he cannot obtain mortgage money because of the hazards to mortgage holders which now exist. The person purchasing stock as an investment need not fear the expropriation of his equity to the same degree that it exists in so many ordinary operating corporation investments today.

In a sense this is a building and loan association without the mortgage feature and without the necessity of the individual obtaining title to an individual piece of property.

It may be classed as a mutual home owners society for that is exactly what it is. The shares of such a company should be most attractive investments to a tremendous number of individuals and institutions.

It would be noted that by a plan of this kind the interest rates currently being paid for financial aid in the ownership of a home would automatically be adjusted to the current long-term interest rate. This would come about as a result of the fact that if interest rates fall, the yield on the stock remaining fairly constant (which it should) would automatically increase the price of the stock. If interest rates rose, on the other hand, with no increase in dividend rates, the price of the stock would tend to fall. In other words, all of the economic factors governing the price of capital and the risk factor would automatically be equated out in the long run, both for the investors and for the home owners securing their aid in the purchase of their homes. ?

The development of such a corporation should make it possible to revive building on a sound basis and contribute to the stabilization of this key industry by checking unsound building expansion by maintaining a staff of expert land and building economists and statisticians whose sole job would be to study the trends which would guide the corporation in its operations. This in itself is almost a virgin field and therefore should pay tremendous returns for the expense involved. ?

Eventually corporations of this kind would probably largely displace the present type of building and loan associations and mortgages, with all of their attendant evils.

S. M. DuBrul

9/27/34
Revised 4/19/35
Revised 11/30/37

December 14, 1937.

Mr. Stephen DeBrul,
General Motors Corporation,
Detroit, Michigan.

Dear Mr. DeBrul:

Mr. Eccles has asked me to acknowledge and reply to your letter of December 2d with which you enclosed a paper entitled "A New Approach to the Housing Problem".

In view of the fact that Mr. Eccles' activity in the housing program must necessarily be limited owing to his official duties, he is not attempting to follow the details of the administration of the legislation. However, he will retain keen interest in the matter and for that reason will expect to have analyzed for him any new ideas which appear to suggest practical means for stimulating the program. I have read through your paper and find it very interesting and at Mr. Eccles' direction I shall turn it over to an expert in the field for his consideration.

As requested, I am enclosing herewith a copy of the Board's Annual Report for the year 1936.

Yours very truly,

Lawrence Clayton,
Assistant to the Chairman.

enclosure

Received in
Chairman's Office
DEC 4 - 1937
Board of Governors
of the
Federal Reserve System

Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date January 4, 1938

To Mr. Clayton

Subject: Mr. Stephen DuBrul's "New Approach to the Housing Problem"

From A. B. Hersey

ABH

Mr. DuBrul's paper embodies "a rather radical approach to the question of housing finance", as he says in his letter. The original elements of the plan, which are discussed below, will require the test of experimentation before they can be generally accepted. Not all the elements of the plan, however, are novel; the idea of large corporations building and owning large numbers of properties to rent and sell is not new and is in fact one of the key ideas of the present F.H.A. program. This idea is relied on both by Mr. DuBrul and by the administration in part as a method of achieving the results of (1) cheaper housing through mass production techniques and (2) introducing greater stability into home building through more careful planning.

The novel feature of Mr. DuBrul's outline is a "purchase rental plan whereby the individual rents the property but at the same time is building up an equity in the concern which owns the property" (through instalment purchases of its stock at market values), "which equity can be converted into a title deed whenever the individual desires and the equity is sufficiently large" (as measured by market value) "to enable him to do so." Under such a plan the buyer would be in less danger of losing a part of his equity if he should have to cease making his payments than under a mortgage purchase plan, since the market price of the stock would be expected to be more stable than the value of any single house might be. Or if the individual desired to more into another house owned by the same company he would not have to sell but could transfer his lease, retain his stock equity and continue his instalment purchases of stock. Through this novel feature of Mr. DuBrul's plan it would be hoped to achieve the results of (3) minimizing "the capital risk hazard to the individual buyer in the purchase" of property and (4) giving greater flexibility in enabling the buyer "to cope with changing circumstances, such as his income and his place of employment."

The occupant's problems of risk and flexibility can largely be avoided in rental housing. Rental housing, however, will presumably never satisfy everybody and it is therefore importantto consider how these problems can be met in the field of owner-occupied housing. It seems worthwhile to point out, nevertheless, that there are probably greater opportunities for low-cost construction in the field of rental housing than in the field of owner-occupied housing, to which Mr. DuBrul devotes his attention. Some of the specific details of Mr. DuBrul's plan are also suited particularly to construction in the upper price ranges, such as the spreading of operations of a single company over single properties scattered through a city and the opportunity for prospective purchasers to pick out their own sites and plans. Leaving these objections aside, what is to be said of Mr. DuBrul's main suggestion as a contribution in the field of owner-occupied housing?

The plan has one definite advantage as compared with other schemes in which the individual could cash in on his equity without the hazards of selling an individual home property. In such schemes--in that of Mr. Ivan Tarnowski, for example--the property-owning company would hold the buyer's payments in cash or liquid investments in order to repay them to him at any time. The company would in effect be in the banking business, and serious problems of supervision would consequently arise. In Mr. DuBrul's plan, on the other hand, the buyer can reimburse himself by selling out his equity to other investors.

Some of the principal difficulties of the plan that can be foreseen are the following. (1) Assuming successful operation, it would nevertheless take some time to establish a market for the corporation's stock. (2) The corporation might itself become one of the principal buyers and sellers of its own stock, so that there might arise questions of the fairness of the market value of the stock. (3) If the corporation were not successful, the hazards of ownership of an equity in the corporation might be even greater than the hazards of home-ownership with an ordinary mortgage. (4) Due to variations in market prices at which the buyer would make his instalment purchases and at which he would convert his equity into a title to a house, an element of uncertainty as to the eventual cost of acquiring ownership would enter the picture. Mr. DuBrul disposes of this difficulty by asserting that the burden on the purchaser "would automatically be adjusted to the current long-term interest rate. This would come about as a result of the fact that if interest rates fall, the yield on the stock remaining fairly constant (which it should) would automatically increase the price of the stock." Consequently the purchaser would profit in making his exchange of equity for title if interest rates had fallen, and would lose if interest rates had risen. Two comments may be made. First, there may be no particular advantage in an automatic adjustment of burden according to interest rates since other factors such as employment and income affect the purchaser's ability to pay. Second, Mr. DuBrul's analysis refers only to a period of continuous change in interest rates. If interest rates should first fall and then rise before the purchase was consummated, the consequence according to the same reasoning would be that the purchaser would pay a high price for his equity and then find that it had a low turn-in value. The final cost would thus have been high despite the fact that interest rates had been below normal during the purchase period. However, if the scheme were to work out successfully, this disadvantage of uncertainty as to final cost might be offset by the smaller hazards in disposing of the equity if that were necessary.

The general conclusion is that there is nothing fundamentally wrong in the idea of home acquisition through instalment purchases of a stock equity. It is the sort of idea, however, which ought to be tested by some experience if it is to be offered as a plan for general use. The plan relates solely to housing built for eventual if not immediate sale and certain of its goals can be easily met by building housing only for rent. Other goals of the plan will be reached by large-scale construction and management, with or without F.H.A. assistance, and the peculiar features of this plan are not essential for these purposes.