H O U S I N G

For the $1500 Income Group

Through Private Initiative

* * *

AN ADDRESS

Delivered at the Annual Meeting of the Philadelphia Housing Association

Philadelphia, Pa.

March 30, 1939.

BY

HENRY J. ECKSTEIN

233 Broadway

New York, N. Y.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

I reluctantly follow the overworked custom of opening the discussion of a serious and important subject with a story. That it may explain something of the difficulty of my subject, however, conciliates my prejudice. An important banker having lost his entire fortune and position gladly accepted the opportunity of rehabilitating himself through the operation of a gas filling station which some friends purchased for him. His first customer drove up and said, "Give me fifteen." The banker, reverting to type, responded, "Won't ten do?"

When Mr. Newman asked me to talk on "Housing for the $1500 Income Group Through Private Initiative," I was much tempted to reverse that story and ask, "Won't $2500 do " For that is exactly what the so-called building industry has been doing. We know that the greatest shortage in housing exists for the $1500 income group, but industry has, with exceptions, been building for higher income groups.

In August of 1937, Mr. Robert L. Davison of the John B. Pierce Foundation, the late Dr. Paul M. Pearson and Mr. Alber of the National Housing Committee, Mr. Bernard Newman of the Philadelphia Housing Association, and I spent two days and the best part of one night laying out a long range program for the National Housing Committee. We concluded that our first and most important task was to make a study of what the housing shortage was and in what price range it lay. That survey, dated December 3rd, 1937, has since been recognized as the authoritative answer to these questions. It, in brief, found:

> According to the housing standards of 1930, 2,000,000 new dwelling units were required for the group paying $30 or less per month for rent or rent equivalent.
>
> From 1933 to 1935 the number of families receiving incomes of $3000 or more had not increased proportionately to the national income. Since 1933 the number of families paying $50 or more for rent had decreased, while the number of families receiving incomes of $3000 or more had increased, indicating a positive resistance in the upper income groups to paying the 1929 proportion of income for rent. In 1937, the number of families paying $50 or more was only about one-third of the number paying that amount in 1930.
>
> For the years 1938 and 1939 we needed, each year, approximately 485,000 housing units. Of this number 66%, or 321,000 would be for the income groups paying rents of $30 or less.

In January 1938, following the publication of that report, I held a meeting of about a dozen men interested in various phases of housing. There were present, in addition to three of us who had planned this survey, five leading building material manufacturers, and, as well, Mr. Herbert Nelson of the National Association of Real Estate Boards, Mr. Thomas S. Holden of the F. W. Dodge Corporation, and a leading investment banker. After some general discussion the problem was crystallized by a question put to the group

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

by one of the industrialists present. He asked whether anyone doubted that a house approximately 26' x 26', of good, not "jerry", construction could be built within fifty miles of New York City for $3000. No one dissented. This gentleman then said that the survey from which I have just quoted clearly showed that the one-third top stratum of the lowest income group needed $3000 houses, and what was industry going to do about it? And that if industry did not accept the challenge and prepare to fill the demand, it must realize that Government will.

It then developed that here and there some houses were being built in this price range and the question came up as to what kind of houses they were; and if it was possible to build them in one place, why it could not be done elsewhere.

According to the generally accepted formula, a $1500 income permits a rental of $30 a month (roughly, 25% of income), and a home costing $3000 based on a carrying charge of 12%. This would usually not include heat, light, refrigeration and gas - another estimated $7 per month. In low income families the ideal of 20% of income paid for rent is on the average not attainable. An FHA study shows the average annual rental paid by $1500 income families to range from a low of $220, about 15%, in the southeast to a high of $415, about 28%, in the northeast.

Increasingly, during the last five years or so, small one-family houses have been built by individual owners and by operators for re-sale, at a cost of about $3000. Mostly in the Far-West and South, where land values, methods of construction and wage scales make that cost more easily attainable. But in not negligible instances, this trend is here and there evidenced throughout the Mid-West and East. Reliable data as to this volume, are apparently not available. The FHA shows single family homes insured on a $3000 valuation by it in 1937 at 5.2% of the total insured; the average value of the total was $5384. The percentage of owner-tenants and purchasers with $1500 and under incomes whose mortgages were insured under FHA in 1937 was likewise 5.2% of the total insured.

Mr. Henry N. Wright, editor of the Architectural Forum, has courteously and helpfully made available to me the results of a most exhaustive and illuminating survey of low cost homes the Forum has just completed for publication in its April issue. It shows a considerable and encouraging activity in the construction of fairly well built, adequate low-cost homes and their increasing availability in various sections nationwide. The cost of construction ranges from about $2600 to $4000. The lowest price house, built in any quantity, sells for about $3300, and its full maintenance cost, based on a 10% down payment and 25 year amortization, works out to an average of $35 per month including services. The Forum's breakdown shows that the greatest geographic variability in costs exists in the factors of taxes and climatic requirements for heating, insulation, etc. Next in variability are the costs of land and land improvement, labor and builders' volume. More constant are building materials, finance and other cost factors.

In the $3000 price group (and we are compelled to use this approximate figure rather optimistically and even euphemistically) are a number of industrial homes built by or sponsored by large industrial corporations for employees, usually for sale. There is a strong and justifiable protest at the practice of selling homes to employees, a practice often combined with commissary stores, methods of operation and the sale of other

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

services, which tend to bind employees to the job, thus often creating labor difficulties, even though it is rationalized that these are thereby avoided. In this way, and through the difficulty of resale if the buyer wishes to change his employment, his personal freedom and the mobility of work location is restricted. Industry-owned homes are rightly frowned upon by labor leaders and those interested in the social welfare and freedom of the worker.

The only project designed by building materials manufacturers and dealers themselves to reach the low cost market is that of the National Small Homes Demonstration sponsored by lumber manufacturers and dealers in cooperation with manufacturers and distributors of home building materials and equipment. After earlier experiment at higher costs, this group is demonstrating the possibility of building adequate one-story houses at about $2000, and two-story houses at $2500 to $3000. These figures, however, do not include land, landscaping and sales commission, which additions, it is estimated by the Demonstration, should still bring most of these homes into the $3000 area. They are however, again, single home projects, built by prospective owners, or by others for resale.

Two interesting projects, both Government sponsored and subsidized, and hence not applicable to our subject, may be mentioned for the promise they hold of showing what can be done to bring construction costs down by the use of newer methods. In each case phenol resin bonded plywood was used under a pre-fabrication and pre-cutting system. In the instance of the project of the Housing Authority of Fort Wayne, Indiana, the cost for overhead, construction materials and land (the latter at $40 per house) is $900 per house. WPA labor is used and its cost is not included. Thus owners can acquire these homes, after twenty years, at a cost of $2.50 per week.

The second project is that of the Federal Security Administration. Most of the 11,800 houses built by it are in rural areas, and have no plumbing, although some such houses are in urban centres. In Missouri a cost of about $1100 was achieved.

But all these are single family units. Multiple unit construction, especially in rental projects and urban housing, shows no such progress. Nor have the operations of the USHA as yet given evidence that it may show the way to private enterprise to build for low income groups on a non-subsidized basis. Contrariwise, so far private industry has led public housing in reducing costs. Indeed, most public housing has not started to approach the cost levels we are discussing, although some success has been achieved in certain localities, such as New York, through intelligent planning and aggressive action towards reducing costs at least to a basis lower than was at first anticipated. The latest USHA report, you will recall, estimates median shelter rent for all seventy-six approved Southern projects at about $13.80 per month per dwelling, and for the sixty-four Northern projects at about $16.80. The report comments: "These rents will be the lowest approached in recent time for decent housing, public or private...... The program will serve only the lowest income group and will supply decent housing to families having only about half the income that they would need to rent or purchase modern homes supplied by private enterprise."

The report, however, fails to point out that the USHA accomplishment is based upon charging for rent only about half the rental cost and that the construction costs are not as low as those of comparable private endeavor.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Whatever resistance private industry may at first have had, or still has, towards accepting the undeniable evidence that the large home shortage and market is in the price range the National Housing Committee survey disclosed, there is, here and there, an evident effort to approach that market. Through devices of one kind or another some progress is being made. But that progress, it must be reiterated, is restricted on the whole to individual houses built separately or in small groups. It has not reached large and planned community housing nor apartment houses in urban centers. Nor do I know of any devices or experiments worth speaking of, planned to reach those fields.

It may be possible that this goal may only be achieved bit by bit as finance, business and Government, each in their own way and turn, find the initiative and the method of chipping away at the problem. In a measure, and not entirely a negligible measure, this has happened these last six years or so. Through the public housing program, through those private endeavors described, through the National Housing Act and FHA, through some realization of business and pressure on the part of the public and market demand, headway has been made and we might, without over-optimism, feel that sooner or later the end may so be achieved. But is that enough? Why wait for an all too slow evolutionary development when time and need call for aggression, initiative and action?

From this point of view let us consider the various individual factors that compose the cost element and the problem, and some things that might be done.

Land costs can, of course, not be controlled, except for large scale projects, and then only if control is established by legislation, based on the concept of housing as a public utility with power of condemnation given to investors who will accept rent controls and income limitations as compensation therefor. The National Association of Real Estate Boards and at least one other group have suggested legislation towards this end. These proposals are a sound, essential step forward towards providing housing for those groups who fall between the very lowest and the higher income brackets.

Tax exemption leads, in my opinion, only more deeply into a vicious circle. However valid the theory may be that tax exemptions encourage projects that save governments social, sanitary and public improvement costs, such subsidies in the long run, if not sooner, check and impede private initiative through the increase in tax rates on other private properties. Mr. Ernest Fisher's study of housing in Europe shows that tax exemptions are in the end absorbed in increased costs.

Labor costs in some large centers are unquestionably disproportionately high, not, as I view it, so much in the wage scale itself, as in union practices, such as refusing to handle semi-prefabricated materials and jurisdictional conflicts. Here, however, I believe no effective dealing can be hoped for until material and other construction costs have made their contribution. Once these elements are brought to bear on the cost structure through efficiency and simplification of methods and through the elimination of waste in distribution and other practices, there would be a basis for a forceful and, yet, equitable attack on unreasonable labor costs and wasteful labor practices.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Private industry must be willing to make sacrifices in the cost of materials delivered to the job. Not, however, as a social or public-spirited measure, but on the principle that it is good business to increase volume by reduction in costs to meet the demand of the market. This can be done through research and the development of new materials; through the extended production and use of prefabricated materials; through packaging methods, and, above all, through savings in distribution costs. I cannot here enter into detailed discussion of this delicate and involved subject, but from my own knowledge of the industry I am certain that without disrupting the present distribution channels, but through organizing and modernizing them, through cooperation of the manufacturers of various materials with retail dealers on a volume-expense reduction basis, a great reduction in distribution costs without impairing profits could be accomplished. It requires a willingness to cast off outworn methods and root out reactionary individualistic hold-outers and traditions.

Industry, despite the objectives it professes, is not really getting at the lowest possible cost results because it still clings to certain old protective methods and practices. We need a competent, continuing research body to study economies obtainable through the introduction of new methods of using and combining materials already, or easily made, available. Such an organization should as well explore entirely new methods of construction, pre-fabrication proposals, lower finance plans, in effect, every element that might reduce costs. It should act as an information center and clearing house for all interested in the construction of and purchase of homes. Towards this end, Mr. Robert Davison suggests the establishment by the Government of a "research project under an advisory committee set up similar to that of the National Advisory Committee for Aeronautics."

Great strides towards the facility of securing mortgage money, the reduction in its cost and the assurance of security, has been made in recent years through the FHA. The results, however, are largely seen in three directions. 1. Making mortgage money available and at lower rates for construction projects beyond the price range of our subject. 2. Individual homes built by owners or by speculative builders for resale. 3. Limited dividend projects that provide a better type of home at slightly lower rentals than formerly available for tenants in an income range beyond that of our subject. However, only a few of these have been developed. During 1937 the FHA commitments to insure this type of home were only 45 mortgages amounting to $38,325,250, out of a total of 390 applications which totalled $514,674,582 in amount. Of that total only 4.2% of the dwelling units covered thereby were scheduled for rent at under $30.

That free capital, interested in this last type of investment, will continue to build for higher rental groups rather than the group under discussion, is but natural. There is no inducement to build such projects for the lowest rental ranks so long as tenants can be found for homes at more than lowest rentals. Furthermore, the more the objective approaches the lowest range, the more difficult it is, under present conditions, to reach the comparative cost range that building for the lower income groups involves, even after the elimination of certain facilities and refinements. Nor is there reason or incentive for such investors to try to reach that range.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The problem is how to finance and how to secure capital for large scale, lowest rental housing. One student of this subject, himself in charge of real estate investments for one of the country's large lending institutions, writing me on this subject, says, "For this very low income group my experiments and my testing, if it can be called such, has been on the basis of an interest rate as low as 3%. This would, of course, not be particularly attractive to institutional investors and not at all attractive to private investors. My firm conviction is that this problem is never going to be solved until private enterprise takes it in tow and is willing to make sacrifices to change the present course of its development."

It is my own opinion that our economy has for some time been approaching a permanent low interest rate era. Insurance companies and banks have taken large mortgages on large apartment houses, office buildings, etc., at 4% and often lower. This trend is evidenced by the recent reduction in rates on small home mortgages by some savings banks to 4½%. The increasing difficulty of insurance companies and banks in finding mortgage investments has reached a point where there is keen competition for the better class of loans. But 1% on an 80% mortgage on a $3000 unit reduces the rent only $2 per month. A more important factor is the need to entice capital on an investment basis. However much mortgage money may be available, and however cheaply, it can only help the situation in a small, even though important, degree if all the other cost factors make no contribution. Most essential is the availability of reasonably priced equity money. To secure it for this purpose on any basis other than speculative and large quick profit turnover motives requires some indispensable compensations. These are: 1. Projects must be large scale to insure economy of construction and operation, and to protect them against neighborhood deterioration. 2. Low costs must promise the maintenance of value, after normal depreciation. 3. The speculative factors in original land acquisition and subsequent profitable resale anticipation must be eliminated. That is, we require permanent investors who are looking for reasonable security and continuation of return, and only these things. There is no reason to hope that strictly private, in the sense of individual, capital will enter this field. Such capital must by nature be profit-seeking, and there is no incentive for it to assume the burden and risk of conception, development and operation merely for income.

An ideal solution would be if housing were to become a typical large business enterprise. That solution calls for the following specifications. An individual or group with ample capital resources, initiative and progressiveness. The approach should be that of all large business undertaking; that of reaching mass markets through mass production and distribution methods after initial research into and planning of methods of construction, development, purchasing and management that would achieve these results.

Such a project need not be limited to rental, but could include, in part or whole, resale housing. I am certain that such a conception and undertaking, similar, of course, to the principle that has operated in other industrial enterprise, would, through the power of mass purchasing and production and its own resources, find the way to improve construction methods, reduce costs and show the way to smaller projects of similar type, and so establish housing through private initiative in a large way.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

I fear, however, that we cannot hope for such a solution. First, because changes in the limited dividend features of present Section 207 of Title 2 of the National Housing Act would be needed if it were expected that such projects would utilize the insured mortgage provisions of the FHA. For such capital demands free play for profit and the opportunity of working under the law of averages as to capital risk and profit incentive. Furthermore, capital is these days inhibited by many fears, resistances and objections to profit taxes.

Accordingly, we must look to the purely investment field as a way out. In insurance companies, savings banks and other trusteed funds we do have tremendous pools of capital seeking secured investment that are at present restricted to the mortgage field. Such capital must be provided the free and safe opportunity to enter the field of rental housing ownership as an investment on a more or less assured income basis. The forward-looking thinking in this direction of certain persons, such as The Twentieth Century Fund, Mr. Jerome Frank of the SEC, certain Government officials and, indeed, even some insurance executives, is that a percentage of such funds should be released for investment in ownership instruments. This has already been accomplished in New York State, where the Metropolitan Life Insurance Company has availed itself of the opportunity and principle. Even if that project may not entirely meet the price range and volume under consideration, there is prospect of a furtherance of this movement. In a study of "The Construction Industry" recently published by the Tri-Continental Corporation, Mr. E. Everett Ashley III, its author, says, apropos the Metropolitan project, "With the low prevailing interest rate, the unpromising outlook for railroad bonds and the growing difficulty of investing large funds at an adequate return, the opening of the rental housing field to insurance companies should prove to be a welcome solution to a difficult problem."

Something more is needed than the passage by other States of legislation similar to that already adopted by New York to entice and compensate such capital. It is assurance of return and security. Toward this end I am able to present two suggestions. Both are predicated on the above objectives and the belief that the mortgages trustee investors are at present buying are purchased almost entirely because of the Government insurance feature. At 80% they are often for more than the realistic value of the properties, due to the machinations of land owners and builders, and, apart from the Government guarantee feature, not always soundly secured.

A plan devised by Mr. Frederick M. Babcock, Assistant Administrator of the FHA, is called "Yield Insurance". Mr. Babcock proposes that the National Housing Act be amended to provide an FHA guarantee of a minimum income on large scale projects, on the basis of the establishment of original cost by audit thereof, depreciated at the rate of 2% per annum. One form of yield insurance is for projects where the cost of production and the rentals available bear a reasonable relationship. Here, for an insurance rate of 1/8% per annum the plan provides that if a project in any of the first twenty years of its existence earns less than 2½%, the FHA will pay the difference between 2½% and the amount actually earned. Such insurance is limited to a total of 10% during the first twenty years. Where the return in any one year is over 5%, the excess earnings shall be used to

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

reduce the original established investment.

The second plan designed for low rental housing in slum and blighted areas uses the same basis of established cost. The insurance cost is 1/4% per annum. The minimum guarantee is 3½% for the first twenty years, with a total of 14% during that period. "Earnings in excess of 4½% shall be devoted, in the order named, to (1) Expenditures for needed or desirable improvements, repairs, maintenance, and alterations, (2) Accumulations in a reserve for the foregoing purposes, the total of such reserve not to be allowed to accumulate to more than 7½% of the original established investment, (3) Payments to the FHA as additional premiums (really a penalty for failure to reduce rents).

"There will be no direct regulation of rents by the FHA but management supervision is contemplated.......Under defined conditions, powers of condemnation are given."

This plan, it will be noted, includes the features of the public utility housing conception advanced by the NAREB and, in addition thereto, it substitutes opportunity for ownership investment in place of mortgages and insures return rather than principal. It is not a subsidy, since the insurance feature should be self sustaining. Resale under appropriate conditions is provided for. No direct regulation of rental is included, but the limitation of profit withdrawals in cash would operate to keep rentals down. The need for the Yield Insurance feature is that "Policy holders, savings depositors and stockholders will find little or no criticism to bring when ownership of real estate is introduced, if the guarantee of yield is used." It also tends to assure to insurance companies, etc., the income returns required for their reserve provisions.

The second suggestion is one that has recently occurred to me as further encouragement and assurance to investors to enter this field once it has been made legally possible. I am convinced that if we disregard the shifts in values due to speculation and changes of ownership in the lowest class, older and most depreciated dwellings, whether in urban or semi-urban centers, in fact those that are today the very localities slated for ultimate slum clearance, we should find that low rental housing, freed from speculative interferences, has not only been a good investment, but profitable. If one were to charge against the original cost of such properties, the net return after depreciation, maintenance, etc., through the range of years, including all depression periods, the total net income received would be seen to have paid the owner a handsome average annual return, cleared off all the original cost and probably have left a good principal profit as well. "The experience of the Metropolitan in its venture at Woodside, Long Island, shows that after a fifteen year period, which included some of the worst depression years in history, the average return was close to 5%." (Tri-Continental Corporation.)

I suggest that a study of a few properties of this nature in several typical localities be made. I am sure it will show that through all vicissitudes of time, fortune and neighborhood, housing of the lowest rental type, freed from speculative interchange of ownership, is good business. On this point Mr. Ashley says, "With proper selection of sites,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the risk involved in taking the equity position in real estate should be little, if any, greater than it has been in the past on many of the mortgage loans placed during the last boom period."

To sum up. It is certain that there is no immediate prospect for large scale low cost non-subsidized housing, excepting on a strictly investment basis, and that individual capital cannot be lured into this field. The focal points of attack on our problem must be:
1. To reduce the cost of producing houses by (a) facilitating the acquisition of land at fair values by various devices including power of condemnation; (b) by reducing construction costs to meet the market demand for lower cost, adequate, modern homes. The building material industries can help accomplish this end by scrapping out-moded, wasteful, costly distribution methods without loss of profit and by participation in research efforts in design, and economies in function, mechanics and technique. (c) By a continuous research towards this end by some competent, authoritative organization not connected with any branch of the industry, preferably a Government agency; (d) by the elimination of wasteful labor practices.
2. To reduce the cost of housing to the occupant by establishment of sound investment possibilities on an ownership basis and by reducing the hazards which arise from division of interests in senior and junior positions. For these purposes reasonable guarantees of income return should be offered in compensation for the above mentioned lower cost advantages and for the elimination of the attractiveness of speculative opportunities.

Or else - and here I see but one possible ultimate - housing, by and large, will become a government function. Not by volition or planned State monopoly, but through a continuous increase in subsidized public housing coupled with an ultimate taking over by the Government of over-valued non-paying mortgages through HOLC and other agencies, and through the demand by a large percentage of the nation that something be done for it. Here I mean just this. We are talking of and doing something about low cost subsidized housing for one-third of the nation, the underprivileged. The upper stratum can take care of itself, and rather handsomely does. But what of the large predominant middle group, estimated at 65 to 70%, who can afford to pay for adequate housing of the type that the very poor are today getting at half its cost from government landlords? How long will this group remain content with antiquated, inadequate homes for which it pays twice the price at which up-to-date housing is becoming available to others? Surely, sooner or later this group will become articulate and demand that if private industry will not provide this as a commercial, or at least investment, venture, Government shall.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis