March 15, 1945.

Mr. Herbert U. Nelson,
Executive Vice President,
National Association of
Real Estate Boards,
22 West Monroe Street,
Chicago 3, Illinois.

Posted in Book #8 [illegible]

Dear Mr. Nelson:

On reading your March 12 issue of Headlines, it occurred to me that you probably had not seen an explanatory statement which I issued in regard to the proposal for a special wartime capital gains tax. I am taking the liberty of writing to you because I feel so strongly that there is a heavy public responsibility upon the National Association of Real Estate Boards, of which you are conscious, for leadership and counsel that is both in the national interest and in the interest of the entire real estate industry.

Therefore, I feel that your editorial comment is most unfortunate, for it echoes what to my mind is a superficial objection, namely, that a 90 per cent rate "would naturally freeze assets tightly". The enclosed statement refers briefly to this point, which is put forth as if the market consisted only of sellers and not of buyers, obvious though it is that there must be a buyer for every seller. Clearly the proposed penalty rate would deter the speculative buying, which is exactly what it is intended to do, far more than it would deter the selling for it would not apply to capital assets purchased prior to January 1, 1945, nor would it seriously interfere with the bona fide investor who is not in the market for a comparatively quick speculative profit.

The so-called "free market" argument looks particularly fallacious in the light of experience in the late 20's, when a very low capital gains tax and a heavy volume of buying and selling, particularly in the securities markets, led to higher and higher prices until the bubble burst. If a feverish speculative market in real estate, urban and rural, goes uncurbed through more and more selling, for which there must be a corresponding buying, then, as I am sure you know, it can mean just one thing -- an ever-rising inflated price level. That is what the proposal I have in mind seeks to prevent.

The Wall Street outcry, which was to be expected on this point, is far more understandable than it is coming from the real estate field, where the real investor in a home or a farm is not buying for a turnover in two years, which would be the period during which the 90 per cent rate would apply. Under my proposal that rate would diminish by 10 points or more each year -- not 2 points as your editorial states -- until the present capital gains tax of 25 per cent is reached.

It is, I think, of the greatest public importance that you see this matter in correct focus because, as you know, nothing could be more calamitous, not only to the country but to the real estate industry, than to permit an inflation to get out of hand in real estate values and then to have another ruinous collapse such as demoralized the industry the last time, and which would be infinitely more severe in view of the vastly increased inflationary potential with which we are now confronted.

The real estate industry would be far better off with greater stability over a long period than it would be to have a speculative boom and high income now, much of which would be paid out in wartime taxes, followed, as it inevitably would be, by a collapse and little or no income.

To dismiss rather summarily the capital gains remedy, as you do in your editorial, without offering some constructive suggestion as to how the situation can be met does not strike me as measuring up to your editorial responsibilities in the interest of the industry for which you speak. Yet I know that you wish to measure up in every respect in giving broad-visioned advice and leadership.

Sincerely yours,

M. S. Eccles,
Chairman.

Enclosure

ET:b

HERBERT U. NELSON
EXECUTIVE VICE PRESIDENT
22 WEST MONROE ST.
CHICAGO 3

NATIONAL ASSOCIATION OF REAL ESTATE BOARDS

1737 "K" Street, N. W.
Washington, D. C.
March 29, 1945

Mr. Marriner S. Eccles
Chairman, Board of Governors of the
Federal Reserve System
Federal Reserve Building
Washington 25, D. C.

Dear Mr. Eccles:

Your letter of March 15th was given careful consideration by our policy committee at its meeting last week and I have been asked to write you.

We do recognize our serious responsibility and will try to meet it. We are not unaware of the possible danger of inflation of real estate.

One trouble with the term "real estate" is that it is so broad. It includes so many types of property, so many uses and so much incidental public construction. When people say that real estate prices are going up they are often thinking of only one small part of this big market.

Most types of improved property are not yet selling at the cost of replacement, minus depreciation. This is true of commercial property, and especially true of larger buildings. In the case of very large buildings, such as those in downtown Chicago, recent sales have been at about fifty cents on the dollar of reproduction cost. No doubt you know of the case of the Stevens Hotel, which cost $20,000,000 to build and recently sold at $7,500,000.

When it comes to residential property, the better class of homes cannot be sold at replacement cost. With respect to lower priced homes, there is here and there a bidding for housing facilities for the privilege of immediate occupancy. This is a very different thing from speculation, or for that matter from inflation. The buyer in such cases is quite willing to forget the premium that he has had to pay. Such premiums are due to local scarcities which are not in any way the fault of private owners but are the inevitable result of government war regulation.

We have had good illustration of the latter fact in recent operations of the G. I. Bill under the Veterans Administration. The veteran, as you know, will not have his credit guaranteed for a home purchase price greater than the appraised value. In the 12,000 loan applications now under process a very large number have been rejected because the appraisal was lower than the purchase price. In fact, the whole act is bogging down on this issue. As far as appraisals are concerned, we have held the line firmly. Our people are responsible for most of these. Of course, the net result is the veteran loses his privilege under the law and cannot buy the home he wants. Whether this is good or bad I don't know, but it is one of the inevitable results created by a demand in excess of supply in certain fields of small houses.

It is difficult for me to see how the legislation you propose would have any particular effect on this situation. Owners of small houses who for one reason or another are compelled to give them up or to move will, of course, sell them at the best price they can. They are not in the business of speculating or buying and selling for a profit. It is, however, the sum total of all their actions that creates some price increases.

We would like to explore with you and with others who are interested in this whole matter some checks that could be employed on inflationary trends in real estate that would be effective but would not have the very bad result of tending to freeze real estate development after the war. The development of real property and building are going to be our biggest job-makers. Costs will no doubt increase in this field but these are the costs of materials and construction. Sooner or later real estate must reflect such costs. If it is not permitted to do so, it cannot be developed. This will be true even if the government undertakes to do all the building.

We suggest that the appraisal approach used so successfully by FHA and by NHA and already approved by Congress might have broader uses. Perhaps in certain areas or types of property the seller might be required to file an appraisal with his recording instruments, such appraisal to be made by an accredited appraiser. The accrediting of such appraisers is not too difficult a task. If the seller receives a purchase price far in excess of the appraisal, some type of credit control might be applied on the excess. This would certainly eliminate shoestring buying. We have good precedents for such procedure already. This approach would have the value of being flexible and reasonably responsive to these increases in value of real property which reflect increased costs. It would at the same time put brakes on purchase speculation.

One thing we fear about the capital gains tax which you suggest is that once it were adopted we would never get rid of it. The capital markets must in our judgment have resiliency and not be flattened out. There is every reason during the war why large profit should be frowned upon. The moment the war is over there is every reason why it should be encouraged. We have no other yeast that can put life into our economic system.

I know Alvin Hansen quite well and greatly admire his capacities. If I could come over one day and discuss this thing informally with you and with him I would greatly appreciate it.

Sincerely,

Herb Nelson

Executive Vice President

March 31, 1945.

Mr. Herbert U. Nelson,
Executive Vice President,
National Association of
Real Estate Boards,
1737 K Street, Northwest,
Washington, D. C.

Dear Mr. Nelson:

As Mr. Eccles is on a visit in the West, I wish to acknowledge your letter of March 29 in regard to inflation dangers as they affect the real estate field. Mr. Eccles has emphasized that the time to act in preventing inflation is before it gets underway and out of control.

He has not undertaken to say that prices of homes, farms, stocks, etc., are either too high or too low. His position is that so long as these capital values reflect underlying economic conditions and prospects, there can be no objection to price adjustments accordingly, but that there is no justification, especially in wartime, for the speculative activity in any of these fields which makes for distortion and instability. It is this activity which the proposed tax would effectively curb.

It seems inconceivable that Congress would not adjust the capital gains tax to peacetime conditions along with other taxes and inflation control measures, which certainly will be dispensed with when the need for them no longer exists. Of course, Mr. Eccles would favor giving the greenlight in every possible way, not to large profits as such, but to encouragement of investment in productive enterprise. In this connection, I would like to quote from a letter he wrote to a Member of Congress on this question of incentives to investment:

> "In the postwar, however, what would really give encouragement to investments that result in production and employment would be to put a tax premium on productive investment and a penalty on mere speculation that furnishes neither production nor employment, but results only in economic instability. In order to induce venture capital to take risks in enterprise that

furnishes production and employment, I would reduce the excess profits tax from the present 95 per cent maximum to, say, 70 per cent, and make the normal corporation tax 25 per cent without the corporate surtax. I would then exempt from the normal 25 per cent tax profits paid out in dividends, since they would be taxed in the hands of the recipients. This would avoid the double taxation that is a real deterrent to the investor in productive enterprise. At the same time, I would grant an exemption of $25,000 to all corporations under the excess profits tax. This would not matter so much so far as the large corporation is concerned, but it would be a tremendous boon to the smaller and medium-sized concerns.

"With such positive inducement to real investment, the capital gains tax would be insignificant and, in fact, there is much to be said for retaining a capital gains tax that would penalize the speculator looking for a quick turnover and hence further encourage the bona fide investor seeking income or longer-range appreciation. The low capital gains tax of the late 20's, far from encouraging venture capital to go into new production, was a positive incentive for luring capital into stock market speculation to make money the easy way."

I will bring your letter to Mr. Eccles' attention upon his return, and particularly your suggestion for an informal discussion.

Sincerely yours,

Elliott Thurston,
Assistant to the Chairman.

ET:b