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HOUSING AND FINANCING

Remarks of

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HOUSING AND FINANCING

As an industry trade group, you are vitally interested in the current and prospective status of housing and construction. Consequently, I am somewhat unhappy at having to report on the current outlook for your industry.

The trend of housing starts has been down. The current situation offers little encouragement for a change in this trend. Neither this year nor next can the country hope to meet its basic housing goals. The number of new housing units produced will, for at least four years, have been less than that required by basic demand.

Today I would like briefly to review the forces causing this shortfall. Then I will discuss proposed and current measures aimed at stimulating the construction of new housing and moderating the industry's pronounced fluctuations. You will note that some of my remarks will be critical of certain of the things we are doing today and of some of the steps which have been suggested as remedies.

My view is quite simple, I feel that those concerned with housing policy have put too much stress and faith in financing gimmicks. They have paid too little attention to the need to win for housing a proper national priority in the availability of resources and particularly in the government budget. The result has been greater instability, higher costs, and a low level of accomplishment in the area of greatest needs. This emphasis on gimmickery rather than underlying problems is particularly evident in the so-called "emergency" programs to deal with the existing situation.

Frankly, many of these proposals would do more harm than good. If--in the housing field--action has been delayed until the middle of a crisis, it is usually too late to do much short-run good. It is not, however, too late to learn a lesson. Action must be taken now to minimize the possibilities that other crises will occur in the future.

Why Housing Is Subject to Major Fluctuations

We all recognize, I am certain, that part of the housing shortfall results from the fight against inflation. Governmental policy, including that of the Federal Reserve, continues to aim at limiting the pressure of aggregate demand on available resources. The Vietnam War, rapid increases in business investment in plant and equipment, continued growth in State and local spending, plus a consequent increase in consumption from higher incomes, have combined to overtax our economic

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resources. A shortage of productive capacity--particularly labor--has led to a rapid acceleration of prices. In such a situation, policy has properly aimed at bringing demand more closely in line with available resources.

While higher taxes on consumers have been used to free resources for military expenditures and expanded investment in plant and equipment, restrictive monetary policy--or higher interest rates and tighter credit availability--has also played a significant role in shifting a sizable segment of resources from major users of credit.

Housing is once again at the head of the list of those spheres which have sacrificed resources to fight the war. This fall in housing production has been similar to that of many past periods in which the over-all demand for resources has exceeded supply. Such falls do not, of course, occur only when government policy acts to counter excess demands in the over-all economy. In any case, housing comes under pressure whenever other demands expand. The timing of pressure may be shifted by the Government's programs, but it is certainly possible and many believe probable that without the stabilizing action of Government, the total fall in housing production would be still greater.

An understanding of why housing has followed such an unstable path in the past is vital to a recognition of what needs to be done to achieve more stability in the future. Why is the financing and construction of residential buildings so sensitive to excess demands in the remainder of the economy?

Two incorrect explanations of this sensitivity are frequently advanced:

(1) Government policy-makers are simply indifferent to the fate of the home-building industry.

(2) The industry is viewed as a convenient sacrificial lamb when other economic policies fail to achieve their goals.

While one or the other of these viewpoints may have been valid in the 1950's, this has not been the case in the 1960's. At least in the four years that I have been in Washington, most officials have desired and attempted to ameliorate the downward pressure on housing. The fact that results have not been more successful arises I believe from the extraordinary dependency of the industry on credit and from the fact that most governmental policies have tended to increase rather than decrease this dependency.

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Both builders and ultimate purchasers of houses must be able to finance their positions. Both individual and apartment owners require credit of the longest maturities. Monthly or annual loan payments make up a higher share of housing costs than of almost any other type of spending. Mortgage borrowers take from 30 to 50 per cent of all funds raised in credit markets. As a result it is no surprise that changes in the cost and availability of credit in general have sharp and magnified impacts in the housing sector or that such impacts are greater than in any other segment of the economy.

Furthermore, in the market for credit, housing suffers from some unfortunate institutional handicaps. Most mortgage funds have traditionally been obtained from the thrift institutions. Because of their asset structure, these institutions find it difficult to compete for funds when short-term market rates rise rapidly. In addition, attempts to aid mortgage borrowers have established long-term disabilities such as usury laws, fixed interest ceilings, complexities of loan administration, and problems of foreclosures. As a result, many institutions prefer other types of investment when they are available. When money becomes tighter institutions that have a wide latitude in investment choices put fewer funds into mortgages.

There are some who view this vulnerable position of the housing industry with considerable satisfaction. "This," they say, "is precisely the type of development we want: a fast and convenient way to take pressure off real resources. A reduction in the demand for building materials, supplies, and labor will help take upward pressure off our price level." However, I, and I believe a growing majority of all policy makers, do not share this view since such a solution to the problem of inflation is both costly, in a sense self-defeating, and inequitable.

Those who are pleased that construction is highly sensitive to monetary and fiscal policies, and that its resources may be transferred elsewhere in the economy, fail to consider the price paid for this instability in terms of construction costs, housing standards, and ultimately on the economy as a whole.

To assume that to fight inflation must first entail a sharp restriction in the construction of new housing is to settle for a costly technique. Such a policy explicitly opts for the traditionally cyclical pattern of ups and downs in the housing industry. I believe that a more stable housing industry would be a far more efficient one. Many of the high cost factors in residential construction--such as wages, land, and productivity--would be reduced if the industry's output were more stable.

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A short-term perverse inflationary effect may also result from housing's instability. To reduce the supply of new housing in the face of steady or growing demand will lead to an increase in the prices of existing houses and rentals, which will naturally spill over into the consumer price index. A stable housing industry is preferable to the present instability. Other more efficient and more equitable ways should be used to lessen pressure on real resources.

What Not to Do about the Problem

Because a real problem exists, it is proper that we seek assiduously for solutions. In reviewing the many proposals currently afloat, however, I judge that many would do more harm than good. This is particularly true of many of the so-called emergency proposals. They seek to plaster over the basic problem by attempting to subsidize directly or indirectly mortgages without making clear the costs of such proposals or who will bear them. As a result, many proposals tend to be either inflationary, discriminatory, or inefficient. Thus they probably are self-defeating or worse.

For example, proposals to fund mortgages by the creation of new money whether through the Federal Reserve or the Treasury are often not recognized as a basic attack upon all financial institutions and as a result upon the entire mortgage market and therefore the housing industry itself. In a short time, funding mortgages through creating new money is likely to lead to less, not more effective funds. Paradoxically, the more total credit expands, the less there may be for housing. Inflation is a direct threat to thrift institutions. How can they exist and invest in mortgages when inflation drives the value of equities up and deposits down?

Other proposals concentrate on the notion that the Government should make up the deficiency in funds. Such direct government aid may be fine under certain circumstances. But if general inflation is the problem, it should be recognized that unless the Government transfers funds and the related resources from another use or gains the funds and resources through additional taxes, the basic problem still remains. You may all believe that housing is more valuable than guns, farm programs, the SST plane, or new ships. If so you should argue that housing be given a higher national priority and that the Government substitute housing for other expenditures. If there is no substitution, you may simply be replacing private non-aided housing by government-aided units rather than increasing total housing production. As long as resources are strained, you cannot have more of everything. You cannot even have more of some things unless the production of others is cut back. Funds for

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housing from the Treasury--whether direct or from the trust funds--must either be saved by lower expenditures elsewhere or they will add to inflationary pressures and not to output.

On another tack, I,personally, find the idea that insurance, trust, pension, and similar funds and institutions be forced to put a certain percentage of their money in mortgages quite objectionable. These proposals are basically inefficient and would give minor results at high costs. If we are to attempt to control the economy by a system of direct controls, I believe far more effective and efficient ones can be devised. The present proposals suffer also because, in effect, they attempt to make a gift of someone's money to someone else. I fear that many such transfers would be in the wrong direction. Financial institutions will buy mortgages if they are currently paying going rates--this is one reason apartment building has been better this year. Attempts to force mortgage purchases upon pension, trust funds, and other groups can be considered as attempts to force investments at less than going rates. To use the old cliché, it is not clear why widows and orphans who depend upon these institutions for their income should subsidize wealthy homeowners, builders, or even members of the National Lumber and Building Material Dealers Association. Most considerations of fairness would point to the reverse type of transfer payment.

What Should Be Done?

I don't want to continue on a negative note. I think more people are gaining an understanding of what the problems of housing are. Significant progress has been made. More is possible. One of the reasons I was pleased to address you today was the hope that industry groups such as yours are now more willing to face up to basic problems in an attempt to solve them. The need, as I see it, is to attempt to correct institutional deficiencies while at the same time devising new methods to cope with the industry's basic problems.

This means making certain that (1) mortgage borrowers are enabled to compete freely in the markets for funds and are not rationed out for arbitrary institutional reasons; (2) the government housing subsidies are altered so that instead of taking the form of tax benefits and slightly cheaper mortgage interest and going mainly to those who can best afford housing, as is now the case, they be used to supplement the funds of those most in need. At the same time, the governmental programs should be established so as to furnish a stable demand base. And (3) if greater stability is introduced into the mortgage market and government programs, the industry should seize this opportunity to improve its own stability and efficiency.

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Improving the Competition for Funds

I think more and more people are coming to realize that the attempts through all types of laws and regulations to place mortgage borrowing in a special market with slightly lower rates may have done more harm than good. It has magnified normal instability. It has not attempted to separate markets by need. Great improvements might be possible if we allowed those who can afford housing to bid freely for funds in the market. At the same time, those who are rationed out by high prices they cannot really afford should be offered direct government aid to enable them to enter the market for funds also.

One method of allowing mortgages a fair crack at the general supply of credit has been through the establishment of the lending agencies such as FNMA (Federal National Mortgage Association) and FHLB (Federal Home Loan Banks). Changes along this line have paid off well this year. These institutions are lending at over a $10 billion annual rate. They are currently supporting over one-quarter of the housing market.

These agencies form part of a general program of developing money and capital market instruments to integrate mortgage finance more closely into our financial markets. Such a development will continue to lessen the dependence of mortgage lending on the more traditional sources of funds, such as savings and loans and insurance companies. Other steps along this path include the issuance of longer term bonds by the FHLBB, FNMA, and now GNMA. These have taken time to work out, but such issues are coming into existence. They hold out considerable additional promise for the future.

Variable interest rate mortgages offer another way of making mortgage investments considerably more attractive for lending institutions. The fact that lenders' income would move more closely with current market rates would insure the ability of financial institutions to compete more effectively for funds as rates change. They also would make mortgages a less risky and, therefore, more valuable investment. Variable interest rates need not alter the borrower's monthly payments but rather could increase or decrease the amount of repayment on principal made each month and therefore would change the ultimate term of the mortgage.

Finally, I have advocated for several years, and believe the need is even more crucial now, that deposit institutions issue longer term certificates. At the present three-year and five-year certificates paying 6 or 6-1/2 per cent interest if held to maturity would appear to provide an efficient basis for primary mortgage lenders to compete with the money market. Such improved competition is necessary to expand mortgage flows and to halt the major instabilities in the flow of mortgage funds and of housebuilding which now exist.

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Government Programs

I believe that now is also the time to re-examine many of the basic concepts related to government subsidies for housing. The size of the assisted programs approved by Congress as part of the National Housing Goals is such that if Congress could be convinced to assure the priority and a stable flow of these funds, it could guarantee for the industry as a whole at least one stable market. The size of this market plus the improvements brought about from a better flow of mortgage funds should insure greater future stability and, therefore, should stimulate more progress in industry organization and construction techniques.

I recognize that the industry has preferred to press for indirect subsidies through tax credits and lower interest rates rather than for direct ones. I have never been convinced of the logic of this approach. A large share of the subsidies are probably wasted in higher costs and inefficiencies. Under existing programs, the moderate-income and well-to-do have been housed. This has not been true, however, for those with less than normal incomes or those in central cities. More important, while from the standpoint of public appearance, indirect subsidies may have their advantages, they have not brought about stability.

New Techniques

With a more stable demand from the government program and a more constant access to credit, a greater stress on efficient construction methods, the quicker introduction of new materials, and the rationalization of labor practices should make it possible to achieve lower cost housing for all families.

We don't know how much of the industry's problems are related to its past history of instability, but I believe the share is great. Our national goal, through 1978, as you will recall, has been laid down in the Housing Act of 1968 and calls for ". . . the construction or rehabilitation of 26 million housing units, 6 million of these for low and moderate income families." Progress toward meeting this goal will be immeasurably helped if we can improve the efficiency of our entire housing-construction industry. I have pointed out possible improvements in the manner in which financial resources are raised and allocated. This should help to dampen the traditional cyclical building pattern, as well as to improve the productive efficiency of management and labor. To the extent that progress is made in these areas, great strides will have been made toward providing solutions to problems of great public interest, as well as to meeting the needs of those such as you directly concerned in the housing-construction industry.

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