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FEDERAL RESERVE

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THE AMAZING DEMAND FOR HOUSING

The housing record defies explanation, but one thing is sure: low down payments and long maturities have stimulated demand. Over the next few years credit terms may become even more important.

CURRENT TRENDS

As the economy pushes to new high levels, more vacation dollars are being spent in Third District resort areas.

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THE AMAZING DEMAND FOR HOUSING

Pick up a business periodical these days and chances are that much space is taken up by a review of the housing situation. Chances are also strong that somewhere the words "over building" will appear—usually preceded by a question. That a majority of those asking themselves, "Are we over-building?" resolutely respond "No" cannot alter the fact that so many feel called upon to ask themselves this question. What causes so much uneasiness in the midst of the present bright housing picture?

An answer to this over-all question lies in the answers to three subordinate questions:

1. Why has housing always been an industry of boom and bust?
2. Does the current spread between the declining number of net new households formed and the rising number of housing units started mean that we are in for trouble?
3. What about mortgage debt? Is the current level too high, or are the terms too liberal?

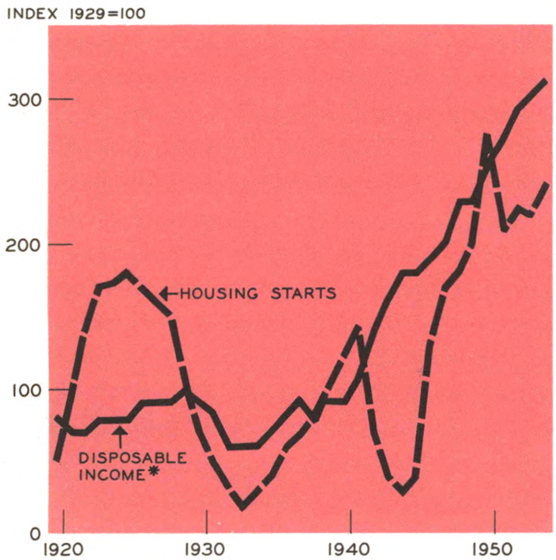
1. HOUSING — FEAST OR FAMINE

The housing industry has been characterized by extreme instability. Just look at an historical record of housing starts. Notice the wide fluctuations in the figures. In 1925, housing starts hit a pre-war peak of 937,000. In each subsequent year the number of starts declined until in 1933 only 93,000 new units were started.

It is to some quite surprising that the demand for housing should be subject to such wide swings. After all, next to food, shelter is the greatest need of consumers. Regardless of climate, people need shelter. People can live comfortably and happily without many of the comforts and luxuries of modern civilization, but without shelter they cannot live at all. Is it any wonder that some are puzzled by the past record of violent changes in housing starts?

Need alone, however, is not enough to make demand effective. Spending power is important too. But the record of instability cannot be explained simply by changes in income—actual or deflated by changes in price. The fact is housing is one of the industries with a good deal

CHANGES IN INCOME AND HOUSING STARTS
(1920-1954)



*1920-28 ESTIMATED
SOURCE: LABOR, COMMERCE

of influence over fluctuations in the level of income. Look at the above chart and you will see this at a glance. From 1925 through 1929 incomes were rising, yet housing starts declined each year. After 1929, incomes started falling too. This chart has caused some to conclude that declining expenditures on housing were not only an important forerunner but perhaps also a cause of the Great Depression.

Durability plus the large volume on hand at any given time, more than anything else, explains the boom-bust aspect of housing history. The dominant characteristic of houses is their durability or longevity. Houses give service over a long period of time. If building volume declines, or if no houses are built in a given year, the services of the existing stock continue to be supplied and used. Since so few units wear out there is hardly a noticeable difference in total housing services. When the production of housing increases, the addition to the total stock of housing is small; so the flow of services from the stock increases by only a fraction of the increase in production. This means that if the demand for the total services of housing declines, the demand for new housing units will decline by a greater percentage. If the demand for the total flow of housing services rises, the demand for new housing units will rise more rapidly.

The fact that small changes in the demand for total housing services bring about large changes in current production centers attention on the factors behind the demand for housing.

2. HOUSEHOLDS AND HOUSING STARTS

The demand for housing may be divided conveniently into two parts. One might be called quantitative or basic demand, and the other qualitative. Basically, the demand for more housing services depends on population factors. With population increasing rapidly, mainly as the result of a large number of births, this would seem to lead to rosy conclusions about present and prospective demand for housing—not to apprehension about over-building. But children don't buy houses. A more important source of demand for housing is the number of net new households formed each year.

What is net new household formation?

Assuming you know the number of occupied housing units, it is easy to estimate the number of net new households formed each year. The number of households is equal to the number of occupied housing units. So the number of net new households formed each year merely represents the difference between the number of occupied houses in succeeding years. It is influenced by the number of marriages and divorces, which in turn are influenced by the number of people reaching marriageable age and the effects of social and economic influences on marriage and divorce rates. The net household formation figure also includes those who have "undoubled" —moved away from the in-laws and set up a household of their own. Of course, single persons of all ages who maintain their own households are a part of this figure too. It is an all-inclusive figure and means that when housing starts exceed net new household formation the difference has to represent vacancies, demolitions, or dwelling units otherwise removed from the housing market.

Projecting into the future the number of new households that will be formed each year is tricky business. Fortunately, the Department of Commerce and the Bureau of the Census do all of this figuring for us.

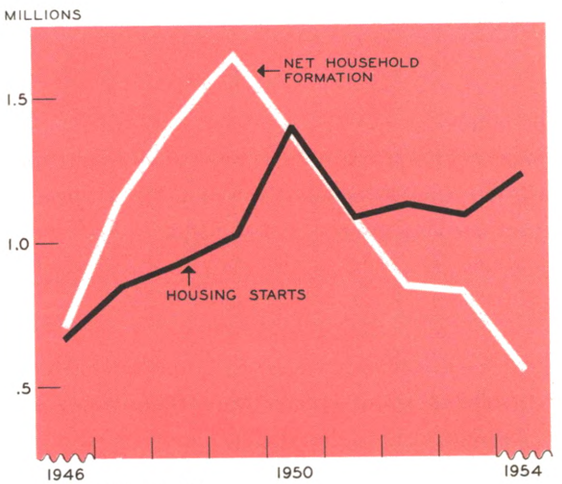
Housing starts exceed net new households

As you can see from the solid white line on the chart, net new households have been declining since 1949. The Census Bureau projects an average level of household formation only slightly above that of 1954 over the next five years. The lower levels of household formation reflect in large part the low birth rates of the depression-ridden 1930's. The infants of the depression era are now reaching marriageable age and there just aren't too many of them. The result: fewer marriages, fewer families being formed, and fewer net new households. Little further change in the size of the group reaching marriageable age will occur in the next few years. During the 1960's, however, a substantial rise is expected.

It is important to remember that the figures for net new household formation in this chart are all-inclusive. To repeat, the figures measure the difference in the number of occupied housing units in succeeding years. This is emphasized because frequently it is said, "Oh, yes, marriages are down but more older people and young, single people are able to set up and maintain their own homes, and there is less doubling up." This is all true; it is also true that older people and young single people maintaining their own households are included in the figures, past and projected, for net household formation; and the figures are still low.

The black line in the chart indicates the number of new housing units started each year. Since 1950, housing starts have been exceeding net new households being formed. From March 1950 to April 1954, units started totaled about

HOUSEHOLD FORMATION AND HOUSING STARTS



SOURCE: LABOR, COMMERCE

4.9 million as compared with about 3.3 million households. Recently, the gap between household formation and housing starts has been widening. This suggests an excess of supply over the primary source of demand—one reason for viewing the future of housing with foreboding.

Obsolescence—basic to housing demand

While net new household formation is a measure of the basic demand for housing, it is not the only one. Obsolescence is another basic factor in housing demand. Obsolescence, however, is an extremely difficult thing to measure. As a matter of fact, it is an extremely difficult thing to define, particularly with respect to shelter.

There is a lot of talk about what the passage of time does to houses. Some say houses have a 40-year life or a 60-year life or even a 200-year life. The impression given is that houses are like the "one-horse shay." Actually, with adequate care, houses can last almost indefinitely. What usually happens is that neighborhoods change gradually or houses get very expensive to keep up. Plumbing wears out; termites get in beams; the roof needs replacing; the heating plant stops working. While houses are running down in value, rents decline. That is how lower-income families get homes they can afford. It is a filtration process.

The White House is an example of what age can do to a house. During President Truman's term, the floors sagged and ceilings fell. The President and his family moved out lest the place collapse. Experts estimated the cost of repairing the White House and admitted that a brand new building would cost only about half as much. Due to the historical significance of the White House, sentiment overruled pocketbooks and it was repaired. Most people with a private home in a similar situation would rebuild.

There is no easy way to tell how many houses would become obsolete between now and 1960, or for that matter how many have been demolished because of obsolescence over the past few years. Some articles remind us that if we build as many as 300,000 units a year for replacement only, we would replace our present stock of housing only once in about 150 years. This type statement may seem to imply that we have 300,000 housing units that are 150 years old each year; this is not the case. Very few analysts assume more than 150,000 housing units become so obsolete as to require replacement each year. This is the number where obsolescence is a physical fact; the house is worn out.

Upgrading ups replacement demand

But obsolescence is a relative concept. How soon a house becomes obsolete depends on a host of things like income levels, technological changes, and changing tastes. Thus a house that seemed livable at one income level may seem obsolete or at least in need of replacement if incomes rise. This type of change in demand might be thought of as qualitative, and differentiated from rock-bottom or basic demand flowing from household formation and physical obsolescence.

Recently, this qualitative replacement demand has become more and more important. If we are to continue building housing at present rates over the next few years, this type of replacement demand will become even more important. What are the forces behind this demand?

The factors commonly expected to sustain the demand for housing are a revision of consumer preferences in favor of housing, rising incomes, a high birth rate, migration, and the availability of mortgage money. Since these factors may play a more important role in the future demand for housing, we shall examine each of them.

Little chance consumers will devote larger part of income to housing

Incomes in the post-war period have been high and are still rising. Against this background, some analysts seem to doubt that we are having any housing boom at all. They point out that residential construction expenditures in constant dollars averaged $10 billion in the 1950-1954 period and $10 billion in 1925-1929. In other words, no increase in real spending on housing has occurred despite a 40 per cent rise in real income. (Income corrected for change in prices.) Likewise, it is pointed out that residential construction expenditures accounted for only about 3½ per cent of gross national product from 1950 to 1954, as compared with 7 per cent of G.N.P. from 1925-1929. These studies provide a comforting conclusion to the question, are we over-building? But statistics — as shown on pages 8 and 9—can be made to prove almost anything. Here are a few observations that raise doubts as to the interpretations attached to studies relating housing expenditures to total spending.

Consumers may not be spending as much of their incomes on shelter but they probably spend much more on many kinds of consumer capital related to the house. Statistical measures of residential construction expenditures depend on an arbitrary definition of items to be included or excluded. This definition falls increasingly short of the full cost of a housing unit as the consumer sees it. For example, while certain consumer durables such as oil burners are in the housing figures, others like refrigerators, washing machines, dryers, automatic dish washers, garden equipment, storm windows, and venetian blinds are not. If the definition of residential construction expenditures included these items, spending on housing would be relatively stronger than present measuring methods indicate.

The housing boom has featured a movement to the suburbs. Suburbanization makes the automobile a nearly necessary part of home ownership. Many families could return to their 1929 standard of housing only if the costs of the car were removed from the family budget.

Finally, casual observation seems to indicate that at least the lower-income classes have greatly bettered their housing standard since the 1925-1929 period. It is probably among the upper-income groups that housing has suffered a decline. This is understandable in view of the housekeeping problems created by a large house. Domestic servants are much harder to find than formerly.

These observations warn us that it is unsafe to sit back and expect a revision of consumer preference in favor of housing. Times have changed and so have consumers' conceptions of a house.

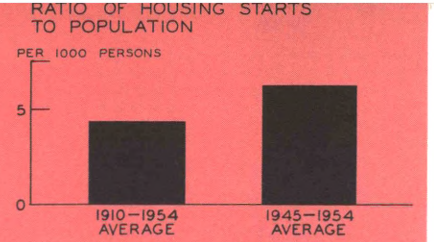
But rising incomes may speed replacement

On the other hand, it is possible that as incomes increase, families will at least devote a proportional share to bettering their housing. This is likely especially if builders succeed in imparting to their product some of the characteristics of other consumer durables. For some time now the housing industry has been talking about how nice it would be if people would change old houses for new at a more rapid clip. There is some evidence of headway in this direction.

Certainly, the fact that low-income families are becoming fewer and families earning $5,000 or more annual income are increasing must at least help shape a more rapid replacement market. A good part of the building that has taken place in the post-war period has been to service families in the $3,000 to $5,000 income group. As many of these families move into the $5,000 and over income group, there is good chance that they will want to upgrade their housing.

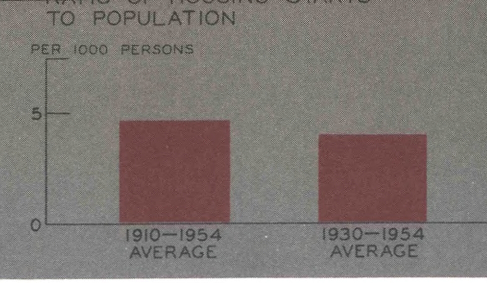
(continued on page 10)

1. Over the past 45 years home building has averaged about 4.5 new dwelling units annually for each 1,000 persons. Since the end of the war it has averaged 6.3 units.



YES NO

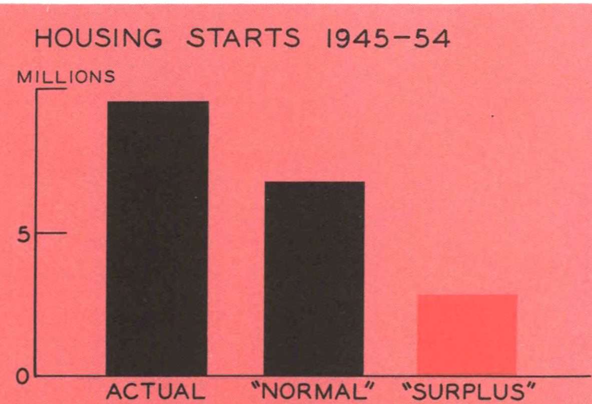
5. From 1930 to 1954, the actual rate of building annually has been only 4.0 dwelling units per 1,000 population as against a "normal" of 4.5 units.



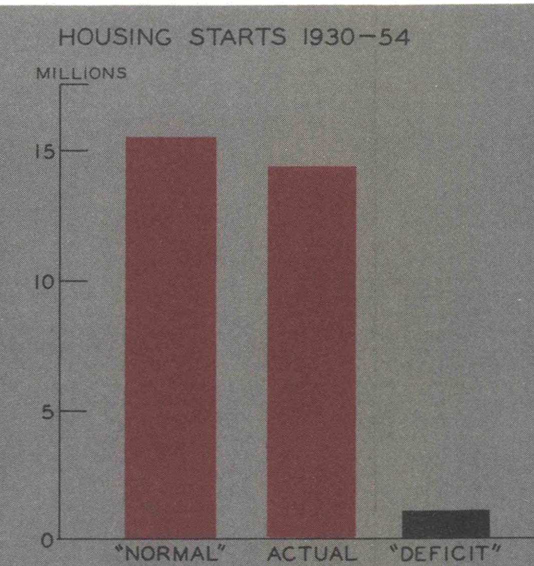
ARE WE OVER-BUILT?

Statistics can support either answer

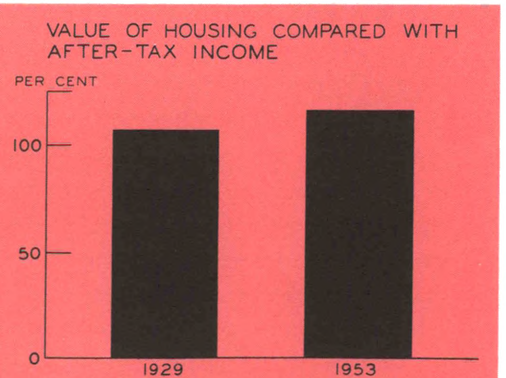
2. About 9,600,000 dwelling units have been built in the post-war period. On the basis of the 45-year average, we would "normally" have built only 6,800,000 units; so that means about 2,800,000 "surplus" units have been built.

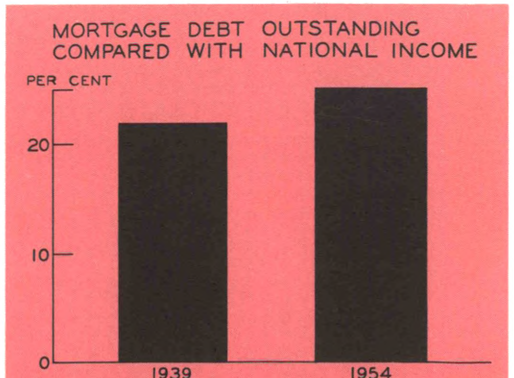


6. Those who argue that we are not over-built use the 1930-1954 period to prove their point. Although we "normally" would have constructed 15,530,000 units, actually only 14,360,000 units were built. According to this argument, we seriously under-built in the 1930-1944 period, and even with the large volume of building since 1944 we have not caught up. (Of course, since 1910 wide fluctuations have taken place, from about 8 houses per 1,000 population in 1925 and 1950 to less than one per 1,000 during the great depression.)

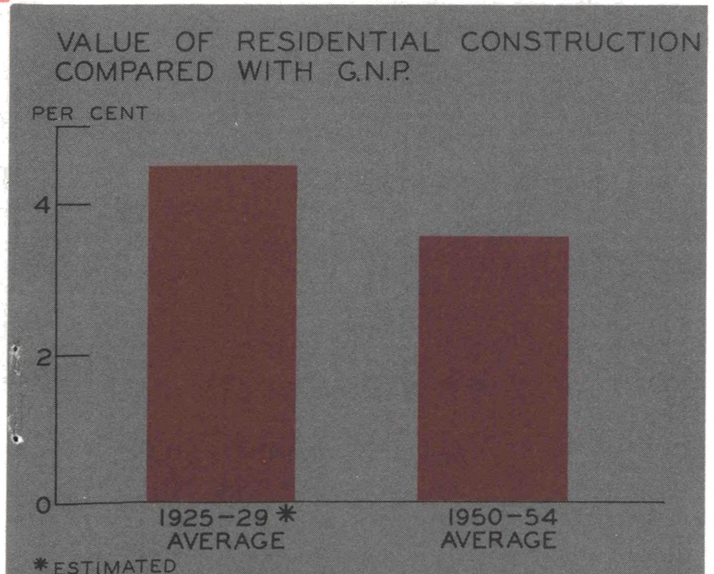


3. In 1953, the value of non-farm housing was 117 per cent of income. In 1929, when many feel we had adequate housing relative to income, it was 109 per cent of income.

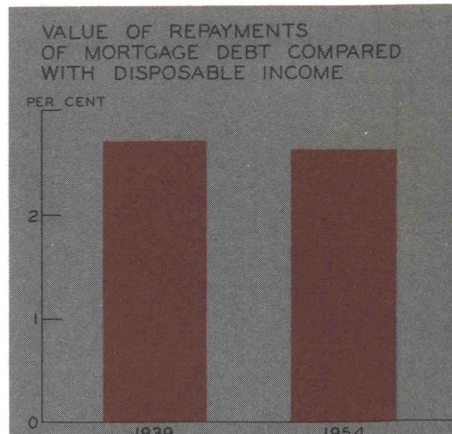




4. Mortgage debt in relation to income is larger now. In 1954, mortgage debt was 25.3 per cent of income. In 1939 it was 22.4 per cent.



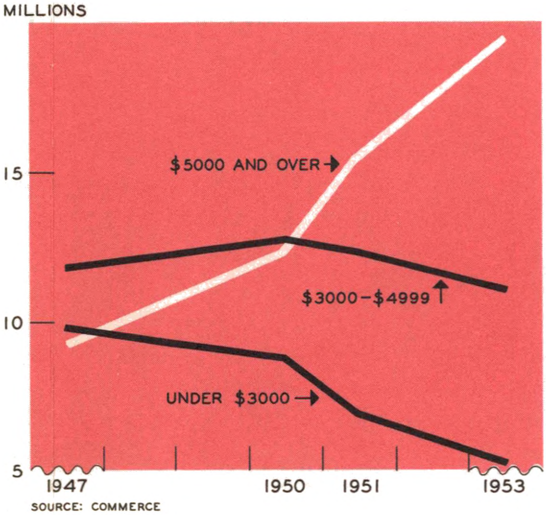
7. Further, residential construction expenditures as a proportion of G.N.P. are still below the late 1920's.



8. If the best measure of debt is the claim it makes on income, mortgage debt is no more

The chart below shows that families earning less than $3,000 and between $3,000 and $5,000 are declining, while families earning in excess of $5,000 are increasing.

NUMBER OF NON-FARM FAMILIES BY INCOME GROUPS
(*Selected Years*)



As people move from one income class to another and presumably buy more expensive houses, they must sell the place from which they move or if rented, their landlord has to find a new tenant. Thus there is no real increase in demand for new houses unless this process filters down and someone moves from a house or an apartment, which then stands vacant, is demolished, or otherwise removed from the housing market. As this process takes place, the tendency is for vacancies to rise. Historically, few units seem ever to be torn down unless it is to make way for more intensive use. (Tear down a single-family house to make room for an apartment.)

More rapid replacement as a result of increasing incomes would involve, in the long run, a sharper decline in prices of old houses relative to new. Ultimately, of course, it involves displacing the poorer part of the housing stock long before present standards of physical obsolescence set in. This would be a revolutionary change in the character of the housing market. On a long-run basis, the housing market seems to have been primarily a growth market with additions to stock equalling growth in the number of households. Perhaps with substantial changes in style, design, and quality, builders will be able to generate a replacement market.

Children need room to grow

Previously in this article it was mentioned that children don't buy houses; that is true, but they certainly yell loudly and long for more living space. Many homes built right after the war had just two bedrooms. As the number of families with a second, third, and fourth child increases, these homes become inadequate. This tends to create a new market for larger houses by these second-time buyers and to enhance the possibility of a more rapid replacement market.

Migration feeds demand

It is a fact that about 5 million people a year move from one state to another. Another 5 million move from one place to another within the same state. Net migration from farm to city has added measurably to housing demand. Over the decade to 1950, the number of occupied farm dwelling units declined by about 1 million. Since nearly a million farm houses were built over this period, the number vacated was greater than a million. As a result, in 1950 the Census found about 10 per cent of all farm dwellings vacant. Most of the vacant farm houses were dilapidated and otherwise unavailable for rent or sale. Since 1950, the net migration from farms to the city has continued, leaving an increasing number of vacancies. Many of the vacant dwellings again are unavailable for occupancy and not a part of the total housing supply.

There is much said about net migration from the center city to suburbs. This kind of migration probably has added to housing demand in the short run, but the effect on available housing units is not the same as when there is a net movement from remote farm areas to metropolitan areas. When the net migration is from city areas, the housing units left behind are likely to be available for rent or sale to others.

Availability of mortgage money

The influence of the availability of mortgage money on housing demand would seem to become greater as replacement demand rises in importance. Replacement demand arising from higher incomes, more children, and migration appears more likely to be postponable than basic demand from household formation and physical obsolescence; hence credit terms become a larger consideration to more customers.

The importance of terms is apparent in recent experience. Small down payments and long maturities were major forces behind the enormous housing demand in 1954.

It is not too difficult to understand why housing demand generated by a desire for upgrading would be responsive to liberalized terms. The house-buying power of a given income can be changed considerably by the nature of the terms of purchase. The Housing Act of 1954 changed FHA down-payment requirements so that, for example, about $2,000 was sufficient on a $15,000 home. Prior to the change, in excess of $2,000 down was required to buy an $11,000 home. This sort of change exerts particular pressure on families who already own a home. Chances are the equity they had in their homes can be used on a more expensive place. With the lengthened maturities permissible under the housing act, the same monthly payment would enable a family to buy a somewhat more expensive home. For example, the monthly payments on a $12,500 mortgage amortized over 20 years is about the same as for a $15,000 mortgage over a 30-year period.

3. THE MORTGAGE DEBT LOAD

There is some reason to wonder how much longer replacement demand for housing can or should be stimulated by easier credit terms. Much of the current apprehension about the housing situation and the alleged over-building stems from a feeling that the mortgage-debt load is already too heavy for the economy to carry. No analysis of the housing situation is complete without attempting to appraise the soundness of the present mortgage-debt structure.

Most observers recognize the naivete of merely comparing the size of mortgage debt today with some year in the past, whether or not "normality" is implied. Our economy has grown tremendously, incomes have risen, substantial changes in the purchasing power of the dollar have taken place, and our population and number of households have greatly increased.

It is not so well recognized but it is probably equally unsound merely to compare mortgage debt as a proportion of personal disposable income with some other year. Mortgage contracts have changed considerably over the years. For example, in the 1920's the typical mortgage contract was of short maturity, did not provide for full amortization, and very frequently carried interest charges of 6 to 8 per cent. Today, mortgages typically run for 20 years, provide for monthly amortization, carry interest charges of 4½ to 5½ per cent, are first mortgages, and are frequently underwritten by Government insurance and guarantee programs.

Perhaps the best way to test the soundness of mortgage debt is to measure the actual or potential claim it makes on current or prospective income. The size of the claim mortgage debt makes on income depends principally on interest rates, mortgage maturities, and the level of income. Generally, longer maturities prevail now than in any pre-war year, and interest rates are as low or lower. Thus although mortgage debt today is equivalent to 30 per cent of disposable income as compared with 23 per cent in 1939, regular payments on mortgage principal and interest absorb about the same proportion of spendable income. Compared with 1929, the methods of repaying home-mortgage debt today are so different as to preclude comparison. It seems certain, however, that mortgage-debt repayment is considerably less burdensome today. By this test, the present level of mortgage debt does not appear too high, at current income levels.

On the other hand, it should be emphasized that mortgages written on easy terms are jeopardized by the slightest downturn in the value of existing houses. For example, on a 30-year no-down-payment loan, after five years just 8 per cent of the unpaid balance has been paid off. Any significant decline in real-estate values would leave some mortgages exposed—unpaid mortgage balances exceeding market values. So that even though the present level of mortgage debt is probably not too burdensome, the composition of the debt is such that a small part of it would probably not withstand downward pressures on real-estate values. It would be dangerous for this small part to grow significant in the future.

Conclusions

Historically, the housing industry has been subject to violent ups and downs. It is important, therefore, to examine causes of change in the demand for housing. In the long run, the housing market has been a growth market with additions to stock roughly the same as growth in the number of households plus replacement of physically obsolete houses. In the recent past, the number of housing starts has been running well beyond the rate of household formation plus physical obsolescence. The difference has been made up by more rapid replacement or a general upgrading. The factors such as rising incomes, high birth rates, migration, and ready availability of mortgage money have propelled this rapid replacement demand. In order to maintain present levels of housing starts over the next few years, replacement demand will have to become even more important. A broader replacement market involves a faster decline in the prices of old houses relative to new. Since this type demand is probably more readily postponable it is more sensitive to changes in mortgage terms. Mortgage debt at present does not appear too burdensome, but the composition of the debt is such that a small part of it would be left exposed by almost any significant decline in real-estate values. This makes it somewhat dangerous to stimulate a more rapid replacement market by further liberalization of mortgage terms.

CURRENT TRENDS

Those Busy Vacation Dollars

Business so far this year has been a succession of pleasant surprises. Late last year, when it became obvious that we were on the road to recovery, most observers expected business to increase further this year. But "recovery" has been an obsolete term for several months now. The economy seems to be pushing on to new and unexplored territory.

The new boom has been supported by unexpectedly large amounts of spending for automobiles and houses. Businessmen, revising earlier plans, now also expect to spend more for plant and equipment. The most recent of pleasant surprises has been the ease with which labor and management reached agreements in the automobile and steel industries.

The most pleasant surprise of all would be if the economy continues the recent rate of expansion in the face of almost certain adjustments in spending for cars and houses. Sentiment seems to be swinging toward the optimistic view that other types of spending, particularly capital expenditures by business, will step in to take over. On the other hand, it might be well not to expect too much. It should not be too serious for the economy to slow down for a breath—unless we make it too serious. Perhaps it is a good thing that the transition comes at this time of year. This is vacation time—a time to take things less seriously.

It looks like a good season for the vacation business

In some parts of this district, however, vacation time is a time for serious business. And from a brief check-up of the seashore and mountain resorts within our borders, we are impressed by the optimistic predictions concerning the 1955 vacation season. A brightening employment picture, which means more "take-home" pay, appears to be creating the kind of atmosphere in which people really enjoy making plans for their annual period of relaxation. As this is written, even "Old Man Weather" seems to have been doing his part to speed up preparations and bring into focus the finer details of another summertime vacation.

Advance reservations have been heavy

At resort areas along the Delaware and New Jersey coasts and vacation spots in the Pennsylvania mountains, local bankers and businessmen tell us that the hotels have received many more inquiries this season than last. Actual reservations seemed a little disappointing at first, as is usually the case when there are periods of cool, wet weather. But as summertime temperatures became the rule, bookings for July and August came in with a rush. Cottages also were taken up slowly until Memorial Day, although here too vacationers started looking quite early in the season. Housekeeping apartments in some of the larger shore resorts have not been renting as fast as their owners might wish, but the demand for these accommodations is improving steadily. Summer camps in the Poconos are said to be filling up rapidly and some of those catering to children closed their books long before school was out. Other resort areas like Boiling Springs in southern Pennsylvania and Eaglesmere in the north are looking for one of the best seasons ever.

New roads and bridges attract guests from greater distances

In New Jersey, the opening of the Garden State Parkway has brought places like Cape May, Wildwood, and Ocean City within three hours' driving time of New York City. Some New Jersey coast resorts always were popular vacation spots with New Yorkers. The New Jersey Turnpike with its convenient interchanges to shore points increased this popularity. But the Garden State Parkway, running nearer the coast, provides an even more direct, high-speed route to virtually all the famous bathing beaches. This year, hotels, guest houses, and cottage owners report inquiries and many reservations from people living in a wider area of New York State and even in southern New England.

Rehoboth Beach in Delaware counts the Chesapeake Bay Bridge among its many blessings because it draws a lot of vacationers from the Washington and Baltimore areas. In the Poconos of Pennsylvania, new bridges and improved highways have made this whole mountain resort area more accessible to visitors from both New York and northern New Jersey. And to various vacation spots in the Blue Ridge Mountains near the Maryland border, the Pennsylvania Turnpike offers quick transportation from the east and west.

Motels are increasing in popularity everywhere

From every major resort area in this Federal Reserve District comes word that many more motels have been built this year. Some of them are much larger and offer far better accommodations than those built earlier. Current reports indicate that occupancy in these establishments has been exceeding expectations and that their up-to-date appointments are creating stiff competition for less modernized rooming houses and even some of the older hotels.

To be sure, motels cater primarily to shorter-staying guests in all the resort areas. But the weekends at both seashore and mountains have become an increasingly important part of vacation business. Most resort people will tell you the "weekenders" are good spenders; only a few say they simply add to the crowds. This year, Memorial Day weekend at the shore was an early-season record breaker and in some parts of the Poconos accommodations of every sort were filled to capacity. The July Fourth holiday period seems to have given a repeat performance —only on a somewhat grander scale. In the period between these holidays many vacation spots reported the largest crowds and some of the heaviest spending ever seen at that time of the year.

Retail sales are climbing seasonally

Merchants in the shore resorts, where retail volume is such an important part of the summer's business, appear well satisfied with the rate of improvement that has taken place in recent weeks. In many instances, sales ran somewhat behind last year's level until mid-June. The weather was cool, there were rainy weekends, so summer merchandise moved slowly. But in the past several weeks, dollar volume has picked up sharply in nearly all lines. In some of the more popular vacation spots, retailers say business in the past two weeks has exceeded last year's level by as much as 10 per cent. Restaurants also report a marked improvement through the week, with their establishments operating at capacity over weekends. Amusements and other boardwalk concessions are said to be well patronized, and expressions of opinion all seem to point to one of the best vacation seasons in recent years.

Parking problems and the weather are the only question marks

What to do with the automobiles that bring vacationers to the New Jersey beaches seems to be the number-one problem this year. Every resort from Cape May to Toms River is making concerted efforts to ease the situation that has grown with the new superhighways and so many more people owning automobiles. Parking space becomes really critical over weekends and there is growing concern over the possibility that any aggravation of this situation may discourage a significant number of visitors who come more or less regularly in these periods throughout the season.

When businessmen or bankers in any of our resort areas venture a forecast for the current season they always do so with one reservation—that is, the weather. This season our first two holiday weekends left nothing to be desired, so a lot of earlier records went by the board. In fact, there have been some fine weekends and longer stretches of good vacation weather since the middle of June. A somewhat better-than-seasonal volume of early vacation business has been the result. Hotel managers, restaurant owners, and retail merchants are never too concerned about the first three weeks of July because so many plants close down for vacation in that period. But thereafter comes the question mark. August is often a "tricky" month at the seashore because of "northeasters," and in the mountains it can be much too cool as well.

THIRD FEDERAL RESERVE DISTRICT