Research Department
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Going Through the Roof?

Against a backdrop of rising mortgage rates, most observers were ready to conclude this summer that a decline in the nation's protracted housing boom was imminent, if not already underway. To be sure, the volume of housing completions was still rising at mid-year, as the number of units under construction reached 1.73 million—21 percent above a year ago. On the other hand, housing starts fell 8 percent below last winter's near-record level during the spring quarter, while permit activity dropped to its lowest level of the past two years. At the same time, the pace of home sales slackened, with the result that the inventory of unsold single-family units reached 435,000 at mid-year—30 percent above the year-ago figure and equal to a 7½ months' supply at current sales rates.

The decline in both sales and housing starts thus preceded this summer's run-up in mortgage rates. When rates began to climb, however, they climbed sharply. The average rate on a conventional, new-home loan rose only 18 basis points between June 1972 and June 1973, but by late July lending rates were as much as 91 basis points higher, reaching 8.50 percent and more in some sections of the country.

This increase stemmed in part from the midyear rise in ceiling rates on bank and thrift-institution deposits, which was initiated to forestall a major disintermediation triggered by the continued rise in rates on competing market instruments. Ceiling rates on passbook savings were lifted to 5 percent for banks and to 5.25 percent for savings-and-loan associations; even at that, however, investors by late July could obtain 8.32 percent on 3-month Treasury bills, a major competing instrument. Consequently, on financial grounds alone, many mortgage lenders and homebuilders believe that a sharp decline in both home sales and homebuilding can be expected by year-end, as funds that would normally be allocated to mortgages flow out of the thrift institutions despite higher rates on savings and mortgage loans.

Unrelenting rise

An even larger cloud than rising financing costs has cast an increasingly large shadow over the housing industry—namely, the unrelenting rise in the costs of both home construction and ownership. Indeed, it is possible that a potentially large segment of the home-buying public—the low- and moderate-income segment—may be priced out of the market.

Between the spring of 1972 and the comparable period of 1973, the median sales price of a new, single-family home rose by 20 percent, from $26,800 to $32,400. While part of the increase in costs represents a continuing trend towards more amenities (such as air conditioning and installed appliances) the average size of a new home apparently has increased only slightly over the period, so that most of the rise in home prices represents a proportional increase in cost per square foot. In terms of the value of

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all new single-family units, about 70 percent of the over-the-year dollar rise in construction spending represents a rise in price rather than in "real" product.

The price upsurge, although recently accelerating, has continued for the better part of a decade. Median new-home prices jumped 80 percent between 1963 and 1973, with only a partial offset in the form of increased floorspace and more amenities. The rise in prices has outpaced the gain in median family income over the period, especially in the last several years. Over 60 percent of all new homes marketed in 1963 sold for less than $20,000, but the proportion dropped to 19 percent in 1972 and to only 13 percent so far in 1973. This development, of course, largely explains the increasing popularity of mobile homes. Whereas in 1963 mobiles accounted for 21 percent of all home sales, the proportion has since increased to 45 percent, including 88 percent of all units priced under $20,000.

Heavy demand pressures have played a major role in the upward tilt of home prices. Domographics explain a large part of this phenomenon; in 1972 there were 2.3 million marriages, while in 1960 only 1.5 million couples took the plunge. These household formations have then been translated into high levels of effective demand by a rising tide of incomes. But in addition, a major long-run stimulus has been the government subsidization of home-ownership costs, through such means as income-tax deductions for mortgage interest payments and property taxes.

Labor, land, lumber

The past year's increase in home prices reflects the combined influence of rising costs of labor, materials and land. Hourly wage rates (including fringe benefits) in the building trades rose by about 7 percent over the past year, while materials rose by about 10 percent. Lumber, which by itself accounts for about one-third of construction costs, rose by 35 percent between mid-'72 and the May peak.

Land prices in particular have soared. According to a National Association of Homebuilders survey, the average cost per acre of finished lot increased by 30 percent in the last year alone. Moreover, the price of the average lot has more than doubled in the last 10 years despite a decline in average size. (In the past three years alone, the average lot size has declined 18 percent.) Consequently, the cost of land has contributed even more than the cost of labor or materials to the 80-percent jump in home prices of the past decade.

The problem of materials costs has eased recently because of the downturn in lumber prices. From their spring peak, lumber prices in some cases have declined almost back to levels of late 1971. This decline reflects not only the downturn in housing starts, but also such factors as the increased availability of timber from national forests and

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Japan's self-imposed reduction in log purchases.

Longer-run prospects for lumber are more uncertain. Over the last decade, the total amount of available commercial forest has declined by several hundred million acres, but industry sources claim that timber supplies could be increased by improved forest management (including fertilization and salvage), better utilization of logging residues, and improved technology in wood processing (such as computerized processing controls in sawmills). However, a number of uncertainties may act as a damper on increased investments aimed at achieving increased and more efficient production. Even now, lumber production costs may have to rise because of the heavy investment expenditures being undertaken for purposes of pollution control.

Labor costs may continue to rise at the 7-percent annual pace of the *past year. Admittedly, that is a* much lower rate than was recorded before the advent of the Construction Industry Stabilization Committee in April 1971. On the other hand, hourly earnings of construction workers currently exceed the average for all manufacturing workers by about 60 percent, despite a poorer productivity performance than other industries in recent years. Part of the problem lies with restrictive labor practices, but also with building codes and protective legislation (including environmental measures) which reduce productivity gains by increasing costs of production.

Land costs may continue to be the *major cost problem, however, especially* when influenced by the expanding network of environmental controls—such as those involving sewer moratoria, wetland restrictions, noise control, waste disposal and open-space requirements. Much of the support for environmental constraints comes about because of the disappointed expectations of homeowners who find that "broadening the tax base" through economic growth does not automatically bring about a lowering of property taxes.

Money costs

Finally, there remains the question of the cost and availability of mortgage funds. The fact that the median price of a new home has increased by 80 percent over the last decade also means that 80 percent more funds are now necessary to finance the same number of *homes, assuming that there were* no change in interest rates and nonprice terms of lending over the decade. However, at the interest rates prevailing this spring, $184 in monthly payments (principal plus interest) would be required to carry a 25-percent-down loan on this year's $32,000 median-priced home, compared with $85 for the $18,000 median-priced home of 10 years ago. Over the entire 25 years of the loan's life, total payments on this year's home would amount to roughly $52,000, compared with the $25,000 in total payments required for the 1963-model home.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT
(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 7/25/73	Change from 7/18/73	Change from year ago Dollar	Change from year ago Percent
Loans adjusted and investments *	73,734	+ 117	+ 10,186	+ 16.03
Loans adjusted—total*	56,769	+ 312	+ 10,351	+ 22.30
Commercial and industrial	20,145	+ 121	+ 3,407	+ 20.35
Real estate	16,770	+ 73	+ 2,876	+ 20.70
Consumer instalment	8,444	+ 23	+ 1,314	+ 18.43
U.S. Treasury securities	5,278	− 339	− 1,024	− 16.25
Other securities	11,687	+ 144	+ 859	+ 7.93
Deposits (less cash items)—total*	71,454	+ 88	+ 8,636	+ 13.75
Demand deposits adjusted	21,295	− 344	+ 1,679	+ 8.56
U.S. Government deposits	828	+ 199	− 178	− 17.69
Time deposits—total*	48,170	+ 299	+ 7,048	+ 17.14
Savings	17,877	− 78	− 359	− 1.97
Other time I.P.C.	21,326	+ 429	+ 5,634	+ 35.90
State and political subdivisions	6,299	− 66	+ 951	+ 17.78
(Large negotiable CD's)	10,601	+ 304	+ 5,136	+ 93.98

Weekly Averages of Daily Figures	Week ended 7/25/73	Week ended 7/18/73	Comparable year-ago period
Member Bank Reserve Position			
Excess reserves	23	37	− 6
Borrowings	189	135	15
Net free (+) / Net borrowed (−)	− 166	− 154	− 21
Federal Funds—Seven Large Banks			
Interbank Federal funds transactions			
Net purchases (+) / Net sales (−)	− 151	+ 355	− 1,383
Transactions: U.S. securities dealers			
Net loans (+) / Net borrowings (−)	− 11	+ 53	− 184

*Includes items not shown separately.

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