Research Department
Federal Reserve
Bank of
San Francisco

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Landlords' Plight

The home-building industry is really two distinct industries, and the difference has never been so evident as it is today. While single-family housing has shown signs of recovery from its earlier slump, multi-family housing has continued in a state of near-collapse. The demographics are right for high-density multiple-unit construction, true enough, but the economic factors are all wrong. In particular, the level of rents apparently is not high enough to offset the costs of building and operating apartments, including the substantial costs of dealing with tenants, environmentalists and zoning commissions.

New multi-family starts in 1975 have averaged an annual rate of 246,000 units—a whopping 78-percent decline from the boom peak of fourth-quarter 1972. (Single-family starts, at an 814,000-unit annual rate, are off 40 percent from the early-1973 peak.) In certain months this year, some major metropolitan centers reported not a single permit issued for new multi-unit construction. The dollar volume of multi-family building reached a $5.6-billion annual rate in the May-July period—61 percent below even the depressed levels of a year ago, compared to only a 6-percent decline for single-family housing.

Reaction to boom

The unprecedented slump is in part a reaction to the preceding boom. Almost 3 million units of multi-family construction were started during the 1971-73 period, or more than during the five preceding years put together. And even after demand began to dry up, 755,000 completed units poured out of the pipeline last year, reflecting the lengthy building time required for high-rise construction. (Normally nine months or more are involved from start to completion of a multi-unit structure, compared with five months' time for a single-family unit.) But one result of the boom was a sharp reduction in the age of the nation's stock of multi-family housing; while the single-family stock was gradually aging between 1960 and 1973, the proportion of the multi-family stock below ten years in age jumped from 21 to 55 percent.

The boom was completely understandable; a housing shortage had developed during the 1960's, and present population trends suggested a significant increase in demand for apartments and condominiums throughout the 1970's. Net household formations were about 50 percent higher in the late 1960's than in the earlier part of the decade, but housing production was weak because of the 1966 and 1969 periods of credit stringency. As for present demand, adults in the apartment-hunting age categories—between 20 and 34, or over 65—are expected to account for the entire 19.3-million increase in the nation's population between 1970 and 1980, while the number of children should decline by 5.1 million.

(continued on page 2)

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Condo crisis

The overbuilding to meet this expected demand was most evident in the market for condominiums (and related cooperative housing). Condominium units generally are in multi-unit apartment buildings, and each tenant owns rather than rents his own unit, thus providing him with all the tax advantages of ownership. The number of condos has increased 15-fold since 1970 to almost 1.3 million units, with about half of the total located in Florida, California and New York. In the 1973-74 period, condos accounted for 25 percent of all starts in the for-sale market.

With inflation and recession hitting consumers' pocketbooks, and with financing expensive or even unavailable, the market for condos began to dry up last year, especially in resort areas. Many potential buyers became disenchanted with reports of shoddy construction and deceptive "low ball" estimates of the costs of maintenance and recreational facilities. Builders meanwhile were plagued with severe cost overruns because of lengthening construction times and sharp increases in the cost of land, labor and materials. Many condominium builders defaulted on their loans, thereby weakening the financial position of real-estate investment trusts, which had previously been providing about one-fifth of all mortgage lending for multi-unit housing.

Rental squeeze

The rental sector—still the vast bulk of the multi-unit housing market—has suffered from all these difficulties plus some unique problems of its own. Overbuilding has been part but not all of the problem. The rental vacancy rate has averaged 6.2 percent for the past year and a half—somewhat above the rate prevailing in the early 1970's but considerably below the 8-percent-plus rates that prevailed throughout the first half of the 1960's. Effective demand of course has weakened with the recession, however.

Costs meanwhile have continued their inexorable rise. Construction costs for apartments and office buildings were 11 percent higher this spring than a year ago, on the basis of higher costs—some substantial—for labor and many construction materials. Financing costs also have remained high—aggravated of course by the severe problems of the REITs, who had contributed so much to the strength of the earlier apartment-building boom. Mortgage carrying charges for income properties (on principal and interest) rose from about 10 percent to 12 percent between mid-1973 and early 1975, and still remained near peak levels this spring.

Apartment owners have been squeezed by a market situation which won't permit them to recover double-digit construction and operating costs by raising rents. In the first half of 1975, rents increased at a 7.4-percent annual rate—roughly half the increase considered necessary to stimulate new rental construction. One factor involved here was the lag in rent increases caused by fixed-rent leases and rent-control laws. New York City, with its Temporary Rent Control Act of 1943, now finds its restrictive legislation being matched by other communities across the country.

Another subsidy program

To many, the solution is yet another subsidy program, with Section 8 of last year's housing legislation playing the role previously assigned to the unlamented Section 236 of Great Society days. Under the 236 mortgage-subsidy program, the Federal government would subsidize the interest on a multi-family mortgage, down to 1 percent, and the tenant in that project would pay a rent equivalent to his share of the (very low) debt service plus his share of operating costs. But when operating costs soared under the impact of inflation, those costs had to come out of the tenant's pocket because the Federal subsidy covered only the debt service. Many tenants couldn't pay, many apartment owners defaulted on their mortgages, and so HUD is now the unwilling landlord for over 100,000 units of 236 property worth about $2.5 billion.

Under the new Section 8, HUD pays the landlord a direct subsidy covering the difference between the fair-market rent and an amount equal to 15-25 percent of the tenant's family income. Fiscal 1976 appropriations call for about 400,000 families to be subsidized under this program, although according to some calculations, roughly one-third of the nation's total population could qualify for such subsidies. The program subsidizes both existing housing and new construction, but there's been little progress to date on the 200,000 new multi-family units which HUD originally had expected would be built in 1975 under this program.

With or without Section 8 assistance, multi-family construction seems bound to register some recovery from its deeply-depressed state simply because of favorable demographic factors. The fast-growing numbers of retirees, empty nesters and swinging singles—with their strong demand for condos and small apartments—seem bound to dominate the housing market for some time to come. (The favorable demand situation is accentuated by the well-publicized problems of single-family housing, such as higher per-unit land, fuel and commuting costs, and the financial risks involved in big-ticket purchases during recession periods.) But a significant recovery in the multi-family sector must await the solution of its underlying economic problems.

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

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 8/27/75	Change from 8/20/75	Change from year ago Dollar	Change from year ago Percent
Loans (gross, adjusted) and investments*	84,592	– 333	+ 432	+ 0.51
Loans (gross, adjusted)—total	63,836	– 225	– 2,959	– 4.43
Security loans	995	– 95	– 757	– 43.21
Commercial and industrial	22,664	– 190	– 1,102	– 4.64
Real estate	19,569	+ 7	– 251	– 1.27
Consumer instalment	9,934	+ 23	+ 326	+ 3.39
U.S. Treasury securities	8,089	+ 31	+ 3,634	+ 81.57
Other securities	12,667	– 139	– 243	– 1.88
Deposits (less cash items)—total*	84,836	+ 246	+ 4,698	+ 5.86
Demand deposits (adjusted)	23,485	+ 286	+ 1,349	+ 6.09
U.S. Government deposits	302	– 162	– 42	– 12.21
Time deposits—total*	59,592	+ 118	+ 3,291	+ 5.85
States and political subdivisions	5,927	– 62	– 38	– 0.64
Savings deposits	20,684	– 14	+ 2,929	+ 16.50
Other time deposits‡	29,252	+ 44	+ 219	+ 0.75
Large negotiable CD's	15,403	+ 226	– 551	– 3.45

Weekly Averages of Daily Figures	Week ended 8/27/75	Week ended 8/20/75	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves	77	48	21
Borrowings	2	26	352
Net free (+) / Net borrowed (–)	+ 75	+ 22	– 331
Federal Funds—Seven Large Banks			
Interbank Federal fund transactions			
Net purchases (+) / Net sales (–)	+ 1,495	+ 1,794	+ 821
Transactions of U.S. security dealers			
Net loans (+) / Net borrowings (–)	+ 279	+ 544	+ 580

*Includes items not shown separately. ‡Individuals, partnerships and corporations.

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