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HOUSING SUBSIDIES AND HOUSING POLICY

REPORT

OF THE

SUBCOMMITTEE ON PRIORITIES AND ECONOMY IN GOVERNMENT

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

TOGETHER WITH

MINORITY NOTES

MARCH 5, 1973

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LETTERS OF TRANSMITTAL

MARCH 2, 1973.

To the Members of the Joint Economic Committee:

Transmitted herewith for your consideration and use and for the use of other Members of Congress, Federal Government agencies, the business and academic communities, and other interested parties, is a report entitled "Housing Subsidies and Housing Policy" by the Subcommittee on Priorities and Economy in Government.

WRIGHT PATMAN,
Chairman, Joint Economic Committee.

FEBRUARY 27, 1973.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
U.S. Congress, Washington, D.C.

DEAR MR. CHAIRMAN: Transmitted herewith is a report by the Subcommittee on Economy in Government, entitled "Housing Subsidies and Housing Policy."

The report is based on a recent volume of studies prepared for the Joint Economic Committee documenting numerous deficiencies in Federal housing programs, and on hearings held on December 4, 5, and 7, 1972. Through this report the subcommittee has attempted to focus attention on the deficiencies in housing subsidies and housing programs, and to develop a constructive package of reforms. In view of the administration's decision to impose a moratorium on the major housing subsidy programs, I believe that Congress must act promptly to correct the deficiencies in these programs without killing them.

The statement in the minority notes that they were not given sufficient time to comment is not true. They were given 1 week to comment, this was extended to 2 weeks at their request, and they were offered still additional time if necessary. I believe they have not commented because of their inability to reconcile the issues raised by HUD's mismanagement of these programs.

I express the appreciation of the subcommittee to the experts who appeared before the committee as witnesses and contributed papers to the compendium. All have been invaluable in the preparation of this report.

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

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I. INTRODUCTION AND SUMMARY

In the Housing and Urban Development Act of 1968 the Congress reaffirmed the national housing policy that it had adopted in 1949: the realization as soon as possible of the goal of a decent home and suitable living environment for every American family. The Congress also established a numerical national housing goal in 1968, calling for the production of 26 million housing units, including 6 million low- and moderate-income housing units, over the ensuing decade. To help achieve that goal, two new subsidized housing programs were enacted as Sections 235 and 236 of the National Housing Act for homeownership assistance and for privately owned rental housing.

With the growth of these two new programs, plus an acceleration of construction under the older low-rent public housing and Farmers Home Administration programs, there has been a substantial increase in low- and moderate-income housing production. Over the four years 1969–72, about 1.5 million standard housing units have been provided under Federal subsidized housing programs.

Nevertheless, there is still a clear need to produce by 1978 at least the balance of the 6 million low- and moderate-income housing units called for in the 1968 National Housing Goals. First, a substantial part of the 1.5 million new subsidized units were significantly offset through losses of moderate-income units among an estimated total of 2.5 million units lost from the housing supply over the same time period.

Second, the 1970 Census of Housing revealed that there were still 4.7 million year-round housing units lacking some or all plumbing. Third, the 1970 Census also revealed that about 1.9 million mobile homes and trailers were occupied as year-round housing units. Fourth, 4.5 million other units were shown by the 1970 Census to be overcrowded. Fifth, although the condition of housing units was not classified in the Census, past experience tells us that among the 27 million housing units that were more than 30 years old in 1970, a great many units that have all plumbing facilities are in such deteriorated condition that they should not be inhabited for reasons of health and safety.

For all of the foregoing reasons, it appears that, in line with established national housing policies, we should produce at least 4.5 million units under the Federal housing subsidy programs over the next 6 years, or approximately 750,000 units per year. Instead, such housing production seems to have past its peak and to be moving downward. The annual number of Federally-subsidized new and rehabilitated units produced in the last four years has been: 1969—226,000; 1970—471,000; 1971—472,000; and 1972 (estimated)—380,000. After significant growth through 1971, the annual number of subsidized units declined as the administration slowed the development of these programs.

Proposals for cutbacks of the subsidized housing programs, both in government and private circles, have gained support from three circumstances. First and foremost, sales of overpriced and shoddy exist-

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ing homes to low-income homebuyers and subsequent high foreclosure rates, under FHA mortgage insurance programs, had received wide publicity. Second, as more units were completed under the present annual payment subsidy system, the year-to-year rise in housing subsidy expenditures—already at about a $2 billion annual cost level—has created pressures to seek less costly methods. Finally, there has been some question of the continuing need for programs to provide assisted housing, in light of recent high levels of nonsubsidized housing production. The new mortgage market mechanisms that have been created to improve the supply of mortgage funds from the general capital market, when necessary, have added to the sense of euphoria about housing production in the future.

Our recognition of the need for continued high levels of additions to the low- and moderate-income housing supply, and the questions which had arisen concerning the effectiveness of subsidized housing programs, prompted the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee to hold hearings on Housing Subsidies and Housing Policy during the four-day period, December 4–7, 1972. The purpose of the hearings was to assess the extent to which housing subsidy deficiencies were the result of poor program management that could be corrected by improved administration of the Department of Housing and Urban Development, or improperly designed subsidy mechanisms that would require legislative change. To assist in this evaluation, the Subcommittee received testimony from academic experts, home builders, community group leaders, former Federal housing officials, the General Accounting Office, and the Chairman of the Federal Reserve Board. The Subcommittee also invited the Department of Housing and Urban Affairs (HUD) to testify, but Secretary George W. Romney refused to testify himself, or to send any other representative of HUD, saying, "I just do not feel this is the proper time to appear." Mr. Romney was apparently referring to the need to assist the new HUD Secretary in the formulation of administration policies on housing and urban development.

While we certainly understand and support orderly transition in Administration leadership, it appears Mr. Romney's refusal to allow any HUD representatives to participate in the hearings was a political maneuver designed to frustrate Congress' evaluation of these programs. We believe that some HUD representatives, if not Mr. Romney, could have been made available to the Subcommittee. We believe that after four years of stewardship of Federal housing programs—a period during which there has been widespread housing scandals—Mr. Romney, his staff, and the Administration are obligated to give a detailed accounting of what went wrong with these programs and how they can be improved or replaced.[1]

Regrettably, the Administration has instead chosen to abandon Federal housing subsidy programs without justification, and without alternative proposals. Although unwilling to discuss his record with Congress, in a January 8, 1973, speech before the National Association of Homebuilders, Secretary George Romney questioned his own record

[1] Senator Sparkman states: "While recognizing the bad situation with respect to housing, I do not believe Mr. Romney was primarily to blame. I believe he was unable to get sufficient assistance from the Office of Management and Budget and the White House to prevent the scandals."

on housing subsidy programs and terminated any new approvals for these programs for the next 18 months. Mr. Romney's only justification for this drastic action was that:

> It became crystal clear by 1970 that the patchwork, year-by-year, piecemeal addition of programs over a period of more than three decades, had created a statutory and administrative monstrosity that could not possibly yield effective results even with the wisest and most professional management systems.

In a subsequent January 15 letter to Senator John Sparkman, Chairman of the Senate Banking, Housing, and Urban Affairs Committee, Mr. Kenneth R. Cole, Director of the Domestic Council reaffirmed that this was the Administration's justification, saying in the President's name that:

> The bulk of the criticism of the Administration's recent action stresses that the poor will bear the brunt of the action. Most critics hold the misguided view that the poor are actually benefiting from all the programs now. This is the cruelest aspect of the present system; it does not serve the intended beneficiaries, the poor. No one more than they realize that the programs have not improved greatly either their housing or their living environment. Instead, in many cases, the programs have created false expectations, more financial hardship and disappointment.
>
> The program structure we have now cannot possibly yield effective results even with the most professional management. There is mounting evidence that the present programs, for the most part, have proven inequitable, wasteful, and ineffective in meeting housing needs. They have proven inadequate and in most cases counter-productive to the greater solution of our urban and rural problems.

While we agree that there is gross inefficiency in the housing subsidy programs, and billions could be saved, we strongly oppose the Administration's arrogant solution by elimination. There are several reasons we do not believe that such a "meat ax" approach to the complicated problems in the housing area is warranted or wise.

In the first place, the Administration has not justified its drastic decision with a careful documentation of the nature of the difficulties we have experienced in housing subsidies and other housing programs. We are reluctant to accept the Administration's assertions about these programs because, in addition to their lack of analytical substantiation, they reveal a striking duplicity. On the one hand, after managing housing programs for four years, and after knowing that there were serious problems in this area for more than 2 years, the Administration suddenly claims all programs should be suspended for 18 months while they are evaluated. On the other hand, the language used to characterize these subsidy programs, as in Mr. Kenneth Cole's January 15 letter, indicates that the Administration has already condemned these programs as inherently unworkable. Our reluctance to accept the Administration's statements about what it intends, in the face of these conflicting positions, is greatly increased by the findings of the Subcommittee that the primary problem with housing subsidies has been HUD mismanagement.

Secondly, we do not believe the Administration has carefully considered the disastrous effects of their decision on the Nation's housing priorities and the families who need decent housing. The Administration itself had an interagency task force review our housing needs as stated in the Second Annual Report on Housing Goals, and concluded:

> The goals established by Congress in the Housing Act of 1968 still seem to be a reasonable expression of the magnitude of overall needs . . . and it also seems clear that there is no reason at this time to abandon the effort to meet the goals within the prescribed 10-year period.

But the housing moratorium will make it impossible to make even a respectable showing toward the achievement of these housing goals. The Administration is projecting only 250,000 subsidized housing starts in both FY 1973 and FY 1974 under Housing and Urban Development programs and available information suggests about 15,000 a year under the Farmers Home Administration. Since these starts represent approvals already in the pipeline prior to the moratorium, housing starts for FY 1975 will be virtually zero even if it is decided to reactivate the program at the expiration of the 18 month moratorium. Once all the units in the pipeline are constructed, it will take at least another year to reach meaningful housing production levels. As a result, we can expect a total of only about 530,000 subsidized housing starts over the fiscal years 1973, 1974, and 1975, whereas 2,250,000 subsidized units are necessary to achieve our housing goals. Over this three-year period, the housing programs will therefore be operated at a rate which is approximately 77 percent below their intended level. We do not support such a drastic shift away from the valid national priority of assisting those families who badly need improved housing conditions.

Third, we also do not believe the Administration has carefully considered the disastrous effects of their decision on the economy. The 77 percent cut in subsidized housing, during a period of rising interest rates will contribute to reducing total housing starts below the 1972 level by about 20 percent in 1973 and 25 percent or more in 1974. We estimate that a 25-percent decline in housing starts will directly reduce annual GNP by approximately $12 billion, and ultimately reduce annual GNP by as much as $25 billion. Although it is true that these reductions in GNP could be offset by increases in expenditures in other areas, we question whether spending in other areas merits as high a priority. Assuming that there are no offsetting expenditures, the reduction in housing related GNP would probably add to housing price increases and increase unemployment. A considerable increase in the price of housing, which is already rising for new homes at a 5.3 percent annual rate, could occur as the moratorium brings about a significant reduction in the supply of new homes. We would also expect construction industry unemployment to rise to the neighborhood of 10–12 percent in 1974. We view these effects as disastrous because it would mark a return to fighting inflation through policies that increase unemployment.

Fourth, the Administration's declaration of a moratorium on HUD and Farmers Home Administration housing programs have raised questions of far greater import than a freeze on housing and community development programs. Without belittling the importance of these programs, the actions that have been taken, and similar announcements affecting other programs, raise the most serious constitutional issue in many decades regarding our form of government. We recognize the need for some executive discretion in the management of Federal funds. But if the President can ignore the wishes of the Congress to implement programs for which it has authorized and appropriated funds, by the unilateral gutting of programs, the power of Congress to raise funds for designated purposes has been destroyed. The elected representatives of the people will no longer have any power to decide upon priorities in the expenditure of Federal revenues which it alone can raise.

The members of the Congress are just as opposed to inflation as the President. This means that the Congress *must* cut spending for Federal programs that are outmoded or inefficient, and that it *must* establish an overall ceiling that will achieve full employment with stable prices. But Congress has a right to designate the time and the purposes for which expenditures are to be reduced. If the Exective Branch is permitted to arrogate that power unto itself, and disregards the expenditure priorities enacted by the Congress, we cannot exercise our functions. Our form of government has then been changed to one of fiat exercised by the President.

If it is necessary to reestablish government with the division of powers as established by the Constitution, the Congress must take drastic actions. Among actions which the Congress should consider are (1) a refusal by the Senate to confirm Presidential nominees for Federal office; (2) a refusal to appropriate funds for any programs of a Department or an agency whose head has not explained policy changes affecting some of his programs before the appropriate Committees of the Congress; (3) a refusal to appropriate any funds for salaries and expenses of the Executive Branch; (4) formulation of all appropriations bills in terms of specific allocations of funds to which States, localities and identifiable individuals would have a legal entitlement; (5) a refusal to appropriate any funds for any Federal program except where required to fulfill statutory and contractual requirements; and (6) legal actions to obtain court orders compelling Presidents to carry out authorized programs in the volume of activity for which the Congress has provided funds.[2]

For all the foregoing reasons, it is essential that Congress assume the leadership in establishing policies to ensure that both subsidized and non-subsidized Federal housing programs achieve the housing goals more efficiently and fairly. The recommendations below, based on findings from the Subcommittee's hearings, provide a package of major reforms for the Congress to consider and, hopefully to implement during the 93rd session. We believe these reforms provide a superior policy alternative to the Administration's solution through elimination. We say this because the findings and recommendations, taken together, make three major points.

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[2] Senator Sparkman states: "I do not think Congress should be negative in its action. I am eager to restore to the Congress its rightful powers, but I believe this can best be accomplished by positive actions."

First, there is still a continuing need for decent housing for low and moderate income families and this need cannot be met without Federal assistance. The Administration itself has studied and confirmed the housing needs expressed by the 1968 housing goals. The 1970 Census data indicated that the Nation needs approximately 2.4 million units of housing each year just to keep pace with the expected increase in housing needs, and that there remain over 6 million substandard units in the existing housing stock. This is no time to turn our backs on the housing goals set forth in the Housing Act of 1968.

Second, most of the scandals and abuses in our housing programs have been due to faulty administration by the Department of Housing and Urban Development rather than to any inherent defects in the legislation. Shoddy construction, poor inspection procedures, almost no tenant counseling, no careful analysis of the cause of high default rates, excessive land costs, and excessive legal and organizational fees are examples the Subcommittee found where HUD simply did not do its job. While some legislative improvements are needed, our present housing programs are *not* inherently unworkable as some White House spokesmen have charged.

Third, implementation of the administrative and legislative reforms identified below will save the Federal taxpayer approximately $5 billion on subsidized housing that would be built and financed between now and 1978, while at the same time providing a higher quality of housing to those who need it. We believe these reforms provide a superior alternative to the Administration's moratorium. Accordingly, the specific findings and recommendations of the Subcommittee are as follows:

- **Examination of all available evidence by the Subcommittee indicates a continuing need for the Federal Government to share in the cost of providing decent homes for low- and moderate-income families. In conjunction with improved management and reform, the Congress should authorize and the Executive should implement production targets of 600,000 to 750,000 units of subsidized housing per year.**
- **Errors in program management were responsible for most of the failures in both subsidized and non-subsidized housing programs. The Congress should exercise a more active and firm oversight of the operations of the Department of Housing and Urban Development. In view of the Administration's policy of suspending programs in order to evaluate them, the Congress should insist on annual evaluations of housing programs as part of the Annual Report on National Housing Goals and the Annual Report of the Department of Housing and Urban Development, and it should hold extensive hearings on those evaluations.**
- **There are too many Federal housing programs to be conducive to good management. A consolidation of programs, similar to that proposed by the Administration, was contained in H.R. 16704 and S. 3248 of the 92d Congress. The latter bill was passed by the Senate. The Congress should reconsider enactment of these proposals as part of housing reform.**

- The Section 235 and 502 homeownership subsidies, and the 236 rental subsidy, have not been allocated so that eligible famililes have the same opportunity to participate in these programs regardless of where they lived. Allocations of contractual housing assistance payment among regions and localities by the Departments of Housing and Urban Development and Agriculture should be related to needs more effectively than in the past.
- The Subcommittee found that about 24 percent of the new homes and 39 percent of the existing homes under the Section 235 homeownership program had significant defects, which were primarily the result of HUD's failure to adequately inspect homes before they were sold. Similar quality deficiencies were found in the Farmers Home Administration housing subsidy programs. HUD and the Department of Agriculture should thoroughly inspect homes being purchased under their programs by low- and moderate-income buyers to guard against deficiencies that would shortly require major repairs or replacements.
- A major reason for the high default rates in Federal housing programs has been inadequate screening and counseling on the part of HUD. An expanded program of counseling for low-income homebuyers under subsidized and non-subsidized Federal housing programs should be undertaken. Such a program, to be carried out under contracts from HUD by qualified local agencies, should prepare the purchasers for financial and property maintenance responsibilities.. The Farmers Home Administration should continue to provide directly the sort of individual counseling for homebuyers that has been successful in the past.
- In examining land valuation procedures for section 236 projects in Atlanta, Dallas, and Los Angeles, the General Accounting Office found that in 47 of 68 projects HUD had valued project land above cost, and that on the average land valuation exceeded cost by at least 25 percent in 12 of the 47 cases. HUD should institute a field monitoring system to review the field offices' land valuations practices to prevent windfall profits.
- HUD has not developed a careful analysis of the factors that lead to housing defaults, why the default rates vary among field offices from 2 to 20 percent, and what should be done to prevent these current, high rates of default. HUD should organize its insured mortgage statistics by geographic breakdowns to permit analysis by cities and neighborhoods, and should conduct continuing analyses of the causes of defaults under different programs. HUD should have an adequate and trained staff to handle its housing business volume. Government-underwritten financing in the sale of any home by

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a speculator should be prohibited. HUD should also adopt procedures for accepting a deed in lieu of foreclosure from a homeowner who is in default and finding another buyer to avoid the high costs of property acquisition.

- The General Accounting Office's study of the Code Enforcement Grant Program found it to be almost a complete failure because HUD did not correctly administer the program. HUD should develop adequate criteria to determine where local code enforcement projects will lead to meaningful housing rehabilitation, and then insist that local authorities meet these criteria before they provide code enforcement funds.
- HUD has not adequately monitored operating and maintenance costs for federally assisted multifamily rental projects. HUD should obtain adequate data for evaluation of operating expenses estimates prior to housing project approvals, and should exercise surveillance to prevent field office allowances for legal, organizational and other fees above those permitted by central office guidelines. It should also arrange for adequate audits of Section 236 project operations to guard against improper rent charges and retention of collected rents that should be returned to the Government.
- The high interest costs associated with Federal housing subsidy projects is a matter of concern. The Congress should establish a subsidized Housing Loan Fund from which direct loans could be made to finance Section 235 and 236 housing in order to save between $2 and 4 billion in interest costs over the next six years. It should be stipulated that such loans shall be recorded in government accounts in a separate budgetary capital account, excluding them from regular budgetary outlays. Such a procedure would be adopted in recognition of the fact that they are repayable loans and that it is no more inflationary to finance a given number of units, as determined by authorizations for housing assistance payments, through direct loans than through private mortgage loans.
- Congress should revise the residential rental property tax provisions, particularly those associated with the Section 236 credit subsidy, to moderate excessive rates of return, reduce Treasury costs, and create better motivations for improved operation and management. Items to be considered are revision of the accelerated depreciation schedule, to include a reduction and some stretch-out of investor benefits, and a modification of the capital gains provision.
- HUD should substitute for its 10 percent builder and sponsor profit and risk allowance a reduced straight profit allowance which should not be calculated as part of the replacement costs of a subsidized housing project. It should also reduce processing and inspection

fees and exclude them from replacement costs. The Congress should authorize and HUD should adopt a waiver of mortgage insurance premiums for Section 236 projects, which are then paid back to mortgagees via subsidy payments, resulting in a government interest cost while the funds are out of Government possession. All of these measures would lower rents and housing assistance payments.

- The Congress should not authorize and HUD should not initiate a broader housing allowances program than the presently authorized experimental program, nor should any other proposed new national housing subsidy mechanism be authorized without a thorough test. Action with respect to a housing allowance program should await the availability and evaluation of housing allowance experiments now being conducted by HUD, which should proceed as rapidly as feasible.
- There is a need for an effective mechanism to counteract the basic causes of cyclical credit crunches, which give rise to very sizable and costly fluctuations in homebuilding, and have an adverse effect upon small business and State and local government credit availability, when the economy approaches full employment and tight money conditions prevail. The Congress, after consideration of alternatives, should authorize the exercise of regulatory powers over the allocation of credit so that housing, small business and State and local governments will not bear an undue share of the burden of credit shortages.

II. HOUSING POLICY OBJECTIVES

There is a need for a continued high level of residential construction during the decade of the seventies. Census projections indicate an increase of over 1.3 million households per year. An estimated 700,000 housing units per year are being lost each year, compared with 600,000 during the sixties. In addition, there will be a loss of about 200,000 mobile homes and trailers per year from the over 2 million now occupied as year-round residences. There are also at least 100,000 vacation and other second homes being built each year. At least another 100,000 a year is needed to provide for vacancies so people can continue to move about. This all adds up to a requirement of approximately 2.4 million units just to keep pace with the annual housing requirements.

If the national goal of a decent home in a suitable living environment for every American family is to be achieved, it will also be necessary to replace the substandard units in housing stock and eliminate the overcrowding. The 1970 census showed that there were still some 4.7 million housing units in the country lacking some or all plumbing. There were also 4.5 million households living in overcrowded conditions, that is more than 1 person per room in the housing units. Thus, at least 6 million units will be needed to eliminate these substandard living conditions. And most of these will have to be subsidized because the occupants of substandard and overcrowded housing generally have inadequate incomes to pay the full cost of standard housing.

These housing needs were carefully studied by an administration interagency task force as a part of the Second Annual Report on Housing Goals in 1970. At that time, in addition to adopting a production schedule that called for approximately 600,000 subsidized low- and moderate-income housing units in each year from 1973 through 1978, the Administration concluded:

> This administration has carefully reexamined the Nation's housing needs and the production schedule originally established for meeting the housing goals. . . . In brief, the goals established by Congress in the Housing Act of 1968 still seem to be a reasonable expression of the magnitude of overall needs. Although the call for 26 million units in 10 years, including 6 million subsidized units for families of low and moderate income, should not be regarded as a specific and prescriptive statement of requirements in exact numbers, it does serve as a useful guideline for measuring progress. It also seems clear that there is no reason at this time to abandon the effort to meet the goals within the prescribed 10-year period.

Some progress has been made in providing improved housing to needy low- and moderate-income families. The annual number of Federally-subsidized new and rehabilitated units produced in the last four years has been 1969—226,000; 1970—471,000; 1971—472,000; and 1972 (estimated)—380,000. In view of this 1.5 million increase in subsidized units it appears that, in line with established national housing policies, we should produce at least 4.5 million units over the next 6 years, or approximately 750,000 units per year. The annual requirement adopted earlier has increased because housing production between 1969 and 1972 fell short of the original goals. As indicated above, after significant growth through 1971, the annual number of subsidized units declined as the Administration slowed the development of these programs in 1972.

The Administration's recently announced 18-month housing approval moratorium will now make it impossible to even make a respectable showing toward the achievement of our housing goals. The Administration is projecting only 250,000 subsidized housing starts in both FY 1973 and FY 1974 under Housing and Urban Development programs and about 15,000 a year are indicated under the Farmers Home Administration. Since these starts represent approvals already in the pipeline prior to the moratorium, housing starts for FY 1975 will be virtually zero even if it is decided to reactivate the program at the expiration of the 18-month moratorium. Once all the units in the pipeline are constructed, it will take at least another year to reach meaningful housing production levels. As a result, we can expect only about 530,000 subsidized housing starts over the fiscal years 1973, 1974, and 1975, whereas 2,250,000 subsidized units are necessary to achieve our housing goals. Over this three-year period, the housing programs will therefore be operated at a rate which is approximately 77 percent below their intended level. We do not support such a drastic shift away from the valid national priority of assisting those families who badly need improved housing conditions.

Examination of all available evidence by the Subcommittee indicates a continuing need for the Federal Government to share in the cost of providing decent homes for low- and moderate-income families. In conjunction with improved management and reform, the Congress should authorize and the Executive should implement production targets of 600,000 to 750,000 units of subsidized housing per year.

III. HOUSING PROGRAM MANAGEMENT

Congress Should Strengthen Oversight Review of the Department of Housing and Urban Development

During the past two years, hearings by a number of Congressional Committees, ably assisted by the General Accounting Office and newspaper investigations, revealed the countenance of blockbusting and real estate speculative activity under FHA home mortgage insurance programs. The non-subsidized Section 221(d)2 and Section 203 programs as well as Section 235 were utilized in Detroit, Boston, New York, Philadelphia, Washington, Chicago, Newark and St. Louis to sell deficient homes to moderate-income persons. Subsequent indictments of FHA employees and private real estate and mortgage company officials pointed out the existence of fraud and bribery, as well as a laxity in FHA operations. In contrast, there were examples of some carefully administered, successful FHA operations under the same programs (e.g., Milwaukee).

There have also been instances brought to light of poor sites and shoddy construction in both new and rehabilitated Section 221, 235, and 236 housing developments in a number of metropolitan areas, such as the Baltimore, Boston, San Antonio, Spokane and Columbia, S.C. There apparently was a great emphasis on production, to meet production targets, and insufficient emphasis on quality control.

The Congress had no organized system for detecting such program management inadequacies until widespread citizen complaints led to investigations. Now the Administration asserts that programs are so inherently defective that they must be suspended for 18 months.

Errors in program management were responsible for most of the failures in both subsidized and non-subsidized housing programs. The Congress should exercise a more active and firm oversight of the operations of the Department of Housing and Urban Development. In view of the Administration's policy of suspending programs in order to evaluate them, the Congress should insist on annual evaluations of housing programs as part of the Annual Report on National Housing Goals and the Annual Report of the Department of Housing and Urban Development, and it should hold extensive hearings on those evaluations.

Housing Programs Should Be Consolidated and Simplified

It has been charged that there are too many Federal housing programs, several of which conflict with each other or duplicate activities, and that this situation unnecessarily complicates the housing assistance system and impedes good management. This is true. The Congress has recognized this deficiency in the system, however, and has made significant consolidation and simplification proposals.

The Housing and Urban Development Bill passed by the Senate in 1972 (S-3248), for example, created a new statutory framework—the Revised National Housing Act. The revised act would consolidate the numerous narrow and overlapping existing programs into several basic programs, and have eight basic insuring authorities. Home mortgage provisions are divided into two sections, subsidized and unsubsidized, as are multifamily mortgage provisions. These four authorities would replace a very large number of existing programs. One supplemental loan program consolidates three existing programs, as does one mortgage insurance program for health facilities. Requirements under the consolidated programs are set out in relatively simple and understandable terms.

There are too many Federal housing programs to be conducive to good management. A consolidation of programs, similar to that proposed by the Administration, was contained in H.R. 16704 and S. 3248 of the 92d Congress. The latter bill was passed by the Senate. The Congress should reconsider enactment of these proposals as part of housing reform.

Allocation of Housing Subsidies Should Be Related to Needs

Allocation of contractual authority for housing assistance payments, by region and locality, by HUD under the Section 235 homeownership and Section 236 rental housing programs, and by the Farmers Home Administration under its home loan programs, have not been in relation to needs. Industry production capacity and past performance have been significant factors in the allocation of housing assistance payments authorizations. In addition, distribution of housing assistance at the local level has often been simply on a first-come, first-served basis. Consequently, there has been a disproportionate regional, State and local distribution of federally assisted housing in relation to population and needs among the various geographic areas. The Department of Agriculture has not developed estimates of rural subsidized housing needs as a basis for allocating resources.

To illustrate the results of the above allocation processes, about 11 percent of the housing units provided by HUD through December 1971 were located in the Northeastern States, which would have received about 32 percent of the housing units had they been allocated on the basis of HUD-estimated needs. Similarly for Agriculture, about 10 percent of its housing units were located in the Northeastern section of the Nation, which had about 18 percent of the Nation's rural population. About 58 percent of the Agriculture housing units were located in the South with about 41 percent of the total rural population.

The Section 235 and 502 homeownership subsidies, and the 236 rental subsidy, have not been allocated so that eligible families have the same opportunity to participate in these programs regardless of where they

lived. Allocations of contractual housing assistance payments among regions and localities by the Departments of Housing and Urban Development and Agriculture should be related to needs more effectively than in the past.

Improved Housing Inspections Should Be Made by HUD and the Department of Agriculture

Homebuyers purchasing a home that has been approved for FHA-insured mortgage financing and for housing payments support are prone to assume that it is in good condition. Many are too much in need of housing to raise questions. Yet the responsible Federal agencies have not afforded the expected consumer protection.

A nationwide sample survey in 1971 by the HUD Office of Audit of 1,281 properties financed under Section 235 found that about 24 percent of the new homes and 39 percent of the existing homes had significant defects. A review and verification of the findings of the HUD Office of Audit by the General Accounting Office, including reinspection of some of the same houses, led the GAO to conclude that:

Appraisers had not been adequately trained to make inspections;

The emphasis on providing houses had placed an unusually heavy workload on appraisers;

Appraisers were not adequately supervised; and

Field office personnel did not adjust their thinking and attitudes to encompass the consumer-oriented needs of the new program.

Among purchases financed under administration of the Farmers Home Administration of the Department of Agriculture, pursuant to the Section 235 program and its own Section 502 program, over 50 percent had defects similar to those found under the HUD administered Section 235 program. This was because the homes were inspected by Farmers Home Administration county supervisors who were not qualified as housing inspectors.

Such defects have been found not only in homes purchased under the subsidized homes, but also in existing homes sold to moderate-income home buyers with low down-payments, financed with FHA insured Section 221(d)(2) and 203 mortgages. The latter are non-subsidized housing programs, which means that defective housing is not an intrinsic feature of the subsidized housing programs.

The General Accounting Office found that about 24 percent of the new homes and 39 percent of the existing homes under the Section 235 homeownership program had significant defects, which were primarily the result of HUD's failure to adequately inspect homes before they were sold. Similar quality deficiencies were found in the Farmers Home Administration housing subsidy programs. HUD and the Department of Agriculture should thoroughly inspect homes being purchased under their programs by low-and moderate-income buyers to guard against deficiencies that would shortly require major repairs or replacements.

Adequate Counseling Should Be Provided for Low- and Moderate-Income Homebuyers

Low- and moderate-income homebuyers need counseling on family budgeting, financial responsibilities of home ownership and home maintenance, yet the General Accounting Office found "inadequate counseling on the part of HUD." Authorization for appropriations to support counseling was provided by Section 235 and 237 of the National Housing Act, which were enacted in 1968. HUD never requested an authorization for this purpose, but the Congress appropriated \$3, 250,000 for counseling in fiscal year 1972. The funds are being used for contracts to local counseling agencies to train staff and volunteers and to evaluate the counseling program. HUD has inaugurated a limited program in 15 field office jurisdictions, whereby \$100 of the house sales proceeds is paid to a qualified local counseling agency to provide counseling to those low-income homebuyers that the FHA insuring office determines are in need of counseling.

The effectiveness of counseling was demonstrated through the conduct of a comprehensive counseling and maintenance training program for Section 235 homebuyers by the Milwaukee FHA office. A substantial number of the homebuyers were welfare mother heads of families. Nevertheless, there were very few loan defaults.

A demonstration on a much larger scale has been provided under the Farmers Home Administration Office. Every homebuyer under that program has had his financial situation reviewed and received family budget counseling in one of the more than 1,700 offices of the Farmers Home Administration before receiving a loan. This procedure has contributed to a very low default rate under the program.

A major reason for the high default rates in Federal housing programs has been inadequate screening and counseling on the part of HUD. An expanded program of counseling for low-income homebuyers under subsidized and non-subsidized Federal housing programs should be undertaken. Such a program, to be carried out under contracts from HUD by qualified local agencies, should prepare the purchasers for financial and property maintenance responsibilities. The Farmers Home Administration should continue to provide directly the sort of individual counseling for homebuyers that has been successful in the past.

Land Valuation for Multifamily Projects Should Be Monitored to Prevent Windfall Profits

Based on an examination of land valuation assigned to 68 recently completed Section 236 projects in three HUD field office jurisdictions, the General Accounting Office concluded that, "HUD procedures in valuing land for mortgage loan purposes generally had not considered the actual cost to the owner as one of the valuation criteria." In 47 of the 68 projects land was valued above the cost of the land to the owner. For 12 of the 47 projects, in which the valuations were made within 24 months of acquisition by the owner, the valuation assigned by HUD ranged between 126 and 137 percent of the owner's cost in 5 cases, between 145 and 192 percent in 3 cases, between 208 and 256 percent in 3 cases, and was 333 percent of the owner's cost in one case. GAO estimated that the difference between HUD's valuation for the land and the owner's costs of land for the 12 projects would increase HUD's interest reduction payments by about $2 million over the life of the 12 mortgage loans.

In April 1972 HUD issued revised guidelines to its field offices which state that land values are not to be based solely on the sale price of comparable sites, and that variances between the HUD appraisal and the owner's cost must be fully justified. At this time, we have no assurance that these guidelines are being implemented.

The General Accounting Office, in examining land valuation procedures for section 236 projects in Atlanta, Dallas, and Los Angeles, found that in 47 of 68 projects HUD had valued project land above cost, and that on the average land valuation exceeded cost by at least 25 percent in 12 of the 47 cases. HUD should institute a field monitoring system to review the field offices' land valuations practices to prevent windfall profits.

PROCEDURES FOR ADEQUATE ANALYSIS OF DEFAULTS AND REGULATION TO REDUCE THEM SHOULD BE ADOPTED

HUD does not have adequate procedures to obtain a useful analysis of the factors leading to defaults. There are no HUD data as to the amount and location of mortgages insured on a city-by-city or neighborhood-by-neighborhood basis, hampering an assessment of potential losses, or of successes or failures under various programs in specific geographic areas. Initial default experience at 10 HUD field offices under the Section 235 program showed variations in default rates ranging from a low of 2.2 percent in one office to about 20.1 percent in another. As a result of high default rates, as of June 30, 1972, HUD had incurred an average loss of about $3,835 to manage and dispose of acquired Section 235 properties for a total loss of over $15 million. Projected estimates of eventual losses for the entire program indicated that losses might total as much as $532 million on homes to be insured through fiscal 1978.

High default rates and property acquisitions were also experienced under non-subsidy FHA-insured mortgage programs which supported financing of purchases of existing homes with low down payments by limited-income families. As brought out in Congressional hearings, there were abuses of mortgage financing which led to high rates of default and foreclosure under the FHA Section 221(d)(2), Section 203, Section 237 and Section 223(e) insuring programs, which do not involve subsidies, in Detroit, Philadelphia, New York, Boston and other cities. Block busting, inadequate repairs and sales at exorbitant profits by real estate speculators characterized the market activities leading to the high foreclosures. Related to these activities there was a good deal of fraud and corruption. From 1968 through November 24, 1972 there have been 31 indictments, 13 dismissals, 28 suspensions, 4 demotions and 22 reprimands of HUD employees for improper activities in connection with housing program business. A number of private real estate business people involved in the illegal activities have also been indicted.

The administration of HUD programs has also suffered from a lack of staff increase to match the greatly expanded program workloads and from an almost continuous series of reorganizations in the past few years.

In contrast the Farmers Home Administration has had a low home loan default rate under its subsidized and non-subsidized home mortgage programs. The favorable record of the Farmers Home Administration in this respect is due in part to a procedure employed to avoid foreclosures. When an owner-occupant cannot meet his mortgage obligations and is likely to lose his home, the Farmers Home Administration often finds another qualified buyer to purchase the home.

HUD has not developed a careful analysis of the factors that lead to housing defaults, why the default rates vary among field offices from 2 to 20 percent, and what should be done to prevent these current, high rates of default. HUD should organize its insured mortgage statistics by geographic breakdowns to permit analysis by cities and neighborhoods, and should conduct continuing analyses of the causes of defaults under different programs. HUD should have an adequate and trained staff to handle its housing business volume. Government-underwritten financing in the sale of any home by a speculator should be prohibited. HUD should also adopt procedures for accepting a deed in lieu of foreclosure from a homeowner who is in default and finding another buyer to avoid the high costs of property acquisition.

Code Enforcement Program Should Be Enforced

The Congress has recognized that an important component of a strategy to improve the Nation's housing was preventive action to save houses before they could deteriorate into a slum condition and promote neighborhood flight. Thus, under the Housing Act of 1954, the Congress directed that Federal housing programs include rehabilitation of basically sound houses, and authorized Federal financial assistance to assist communities in enforcing housing codes under the Code Enforcement Grant Program. Unfortunately, the General Accounting Office has found numerous deficiencies in HUD's management of this program.

The GAO found that housing deterioration has not been prevented because most communities have not carried out effective code enforcement. Contrary to the intent of Federal legislation, HUD has continued to approve programs without ensuring that the cities have effective code enforcement. Cities were certified as eligible for Federal assistance when they were ineligible. In a GAO review of 29 communities that had received HUD approval, for example, 28 did not have effective citywide code enforcement.

The GAO also found that HUD frequently approved projects in areas where housing was too deteriorated for code enforcement to work. Although HUD had evidence that extensive deterioration existed in proposed project areas, it approved projects for inappropriate areas because its criteria for selecting areas were inadequate. GAO's review of 10 projects showed that three were in areas appropriate for code enforcement and seven were in areas obviously more appropriate for complete rehabilitation or redevelopment. These seven inappropriately selected projects represented a cost to the Federal Government of $13.5 million. The extent of deterioration in some projects approved by HUD and the low incomes of the property owners precluded successful completion of the projects, and therefore were a waste of the taxpayers' money.

Although the emphasis of the code enforcement program was to be on improvement of housing, as of June 30, 1970, the GAO found that HUD had approved over $131 million—of which $91.2 was the Federal share, or 54 percent of all code enforcement funds—for public improvements. By spending over 50 percent of all code enforcement funds for public improvements, HUD has not complied with the intent of Congress and has diverted resources from the more critical need of improving housing. Public improvements, such as repairing streets, alleys and sidewalks, do not significantly contribute toward preventing housing deterioration. The GAO concluded that HUD's overemphasis of such projects was due to a lack of criteria for determining what would contribute to code enforcement and improved housing.

The General Accounting Office's study of the Code Enforcement Grant Program found it to be almost a complete failure because HUD has failed to correctly administer the program. HUD should develop adequate criteria to determine where local code enforcement projects will rehabilitate basically sound housing, and then insist that local authorities meet these criteria before they are provided code enforcement funds.

Rental Program Management Oversight Should Be Improved

Before a multifamily housing project is approved for mortgage insurance, the HUD-FHA office must ascertain whether the contemplated market rents (i.e. before subsidy) to be established will be adequate to meet the debt service and projected operating expenses.

HUD has not had adequate data to make accurate estimates of operating and maintenance costs. Projects have been approved on the basis of underestimated future operating expenses. Later, as costs mounted, rents have had to be increased to levels that made the units too expensive for the contemplated occupancy group. There are also possibilities that projects have been approved with unnecessarily high operating costs, causing rents to be higher than needed.

Instances have been uncovered of incorrect rent charges against occupants in Section 236 housing projects. In some instances owners have failed to remit to HUD rent charges in excess of base rent which rightfully belong to the Government.

The amounts allowed by the Dallas field office of HUD for legal and organizational fees during the development of Section 236 projects were about 82 percent higher than the amounts suggested by HUD guidelines.

- **HUD has not adequately monitored operating and maintenance costs for federally assisted multifamily rental projects. HUD should obtain adequate data for evaluation of operating expense estimates prior to**

housing project approvals, and should exercise surveillance to prevent field office allowances for legal, organizational and other fees above those permitted by central office guidelines. It should also arrange for adequate audits of Section 236 project operations to guard against improper rent charges and retention of collected rents that should be returned to the Government.

IV. HOUSING PROGRAM DESIGN

A Capital Budget Account and Direct Loans for Subsidized Housing Should Be Authorized

Under the economic design of the Section 235 and 236 programs as interest subsidy programs, the higher the interest rate paid on the long-term capital funds borrowed to finance the housing, the greater will be the subsidy. The interest rates on private, FHA-insured mortgages which are used to finance housing under these programs, are generally 1 to 2 percentage points higher than interest rates on Treasury securities. There could be substantial savings if the Treasury borrowed the necessary funds for direct loans, to be made by HUD, to finance the housing projects. It has been estimated that on Section 235 and 236 units to be built in 1973 through 1978 in accordance with the national housing goals plan, cumulative savings with an aggregate present worth of $2 to $4 billion could be achieved.

It should be noted that a necessary complementary procedure to direct loans would be the establishment of a capital housing loan account, for repayable housing loans, to be kept out of the regular budget total outlays figure. Otherwise, there would be opposition to the direct loans because they would be included in the regular budgetary outlays total and would be labeled as inflationary. As a practical matter, it is no more inflationary to build a given number of subsidized housing units with direct government loans than with private loans. The number of subsidized units to be built is very largely determined by the contractual authority for housing payments enacted by the Congress. Regardless of the method of financing the same requirements will ensue for land, labor, materials and financial capital. There would be no more inflation as a result of the direct loan financing.

In fact, direct loans would be less inflationary because of the lower annual housing payments, which would produce cumulative savings of Federal and taxpayer's funds with a present worth of $2 to $4 billion. The savings would be achieved by using the superior credit rating of the U.S. Treasury to borrow the funds for a public purpose. Since there would be an offsetting decrease in capital market demands for private mortgage financing, there would be little if any effect upon the general structure of interest rates that would affect government borrowing costs in general.

Another issue concerns the departure from reliance on private enterprise to the maximum extent possible. Considering the fact that the entire matter of subsidized housing provision is not one which is within the confines of a competitive free enterprise market system, and the fact that any additional interest costs are to be paid by the taxpayers, the direct loan would seem to be entirely consonant with the objectives of our economic and political system.

The high interest costs associated with Federal housing subsidy projects is a matter of concern. The Congress should establish a subsidized housing loan fund from which direct loans could be made to finance Section 235 and 236 housing in order to save between $2 and $4 billion in interest costs absorbed by housing assistance payments over the life of the mortgages to finance such housing over the next six years. It should be stipulated that such loans shall be recorded in government accounts in a separate budgetary capital account, excluding them from regular budgetary outlays. Such a procedure would be adopted in recognition of the fact that they are repayable loans and that it is no more inflationary to finance a given number of units, as determined by authorizations for housing assistance payments, through direct loans than through private mortgage loans.

Multifamily Tax Incentives Should Be Modified to Improve Management

There are certain tax subsidies used in conjunction with multifamily subsidized housing projects, including accelerated depreciation, more liberal provisions for recapture of accelerated depreciation in event of sale (i.e. all proceeds treated as capital gains after ten years, instead of 16⅔ years for non-subsidized projects), and deferment of taxable gain payment when the project is sold to a tenant organization and reinvested in other subsidized housing.

The principal tax advantages lie in the allowance for payment of tax at capital gain rates on the gain realized at the sale of a project. The large losses which can be claimed for tax purposes as a result of the depreciation allowances have value to taxpayers in high tax brackets because the losses can shelter some of their taxable income. When the project is sold, typically at a price comparable to the initial price, the "losses" are found not to be losses at all and income tax must be paid—but now at capital gain rates. Income tax payments are thus not only deferred but converted to lesser amount upon sale.

Although the purpose of these tax subsidies is to encourage the development and operation of housing for low- and moderate-income families, one of the primary effects has been to draw in parties who are more interested in lucrative tax shelters than in the provision of housing. In a typical Section 236 subsidy, for example, the developer of the project forms a limited partnership with passive investors who have high incomes and a desire to obtain tax losses in order to reduce their tax payments. The advantage to the developer is that this allows him to raise much more money from the limited partner investors than is required to develop the project. The developer can usually raise 15 to 25 percent of the mortgage amount, make a cash outlay of about 3 percent of the mortgage amount to construct the project, and thus at the outset receive 12 to 22 percent of the mortgage amount as a developer's fee. The developer usually must share some of this fee with a tax shelter broker, who will market the tax shelter by locating investors for the project. The windfall to the high income investors will of course vary according to his tax bracket:

a 50 percent bracket investor will receive an after-tax return of 15 percent for new construction and 25 percent for rehabilitation. A 70 percent bracket investor will receive 25 to 40 percent in similar circumstances.

In a typical 236 housing project an investor in the 50 percent income tax bracket can expect an average annual after-tax-return equal to 15 percent of the mortgage amount for new construction project and 25 percent for a rehabilitation project. These returns are so attractive to investors that the developer/builder can sell the equity shares having a nominal value equal to 11 percent of the mortgage amount for prices equal to 15 to 25 percent of the mortgage amount. About 3 percent of the equity share sales proceeds would be retained by a broker.

And the high rates of return for Section 236 also mean higher costs to the U.S. Treasury. The implications of the above analysis is that the tax benefits will cause Section 236 rental housing to have a higher per-unit subsidy cost than the Section 235 homeowner program. At $200 per unit, the extra cost will amount to about $40 million in fiscal year 1973 alone.

Another problem is that these tax shelters diminish rapidly after the tenth year of new project ownership because deductions for accelerated depreciation and mortgage interest are greatly reduced. At the same time, the required holding period for favorable tax treatment of all sales proceeds has been met after ten years. There appears to be little incentive to continue ownership after 10 years. With that outlook, the profit-motivated investor has little incentive to pour funds into good management, maintenance and replacements. It would be more profitable for him to use funds either for payments to a subsidiary management firm or for reduction of the outstanding mortgage loan balance prior to sale. The latter outlook is even more likely to prevail if a roll-over short-term sale to a tenant organization and reinvestment of sales proceeds in another project is contemplated in order to defer payment of taxes on capital gain realized in sales proceeds.

Congress should revise the residential rental property tax provisions, particularly those associated with the Section 236 credit subsidy, to moderate excessive rates of return, reduce Treasury costs, and create better motivations for improved operation and management. Items to be considered are revision of the accelerated depreciation schedule, to include a reduction and some stretchout of investor benefits, and a modification of the capital gains provision.

Certain 236 Fees Should Be Reduced or Eliminated

A limited distribution (or for-profit) sponsor of a Section 236 multifamily project receives an insured mortgage equal to 90 percent of replacement cost. Generally, no cash is invested, however, since there is included in the replacement cost a builder's and sponsor's profit and risk allowance of 10 percent of the total cost of the project except land. There is also a 2 percent allowance for general builder's overhead. There may also be some margin for non-cash credits to the builder-sponsor in the 4 percent allowed for architect's fees and 1 percent for organizational expenses. The builder-sponsor can thus accumulate his 10 percent equity, and sell his equity as shares in the limited distribution corporation to high-income persons who are interested in the tax shelter benefits, so that he is left with little or no cash investment in the property.

A cash investment by the sponsor could be encouraged by eliminating the builder's and sponsor's 10 percent profit and risk allowance and substituting a builder's profit similar to that allowed under the Section 207 nonsubsidized program, of approximately 5 percent. A 5 percent cash investment then would be required. The consequence would be to reduce the replacement cost and mortgage amount by 5 percent.

Since the subsidy payments include the cost of mortgage insurance premium payments, which are subsequently collected from the mortgagees, HUD pays out funds which it later collects. As a result, the GAO has calculated that the Government loses the use of such funds for an average of 6 months, at an estimated interest cost to the government of $1.6 million for the current fiscal year. This amount could be saved by waiving the mortgage insurance premium. Such a waiver would also eliminate the ½ percent premium paid during the construction period, which is included in the replacement costs. There had been such a waiver for the predecessor Section 221(d)(3) rental housing program.

Another reduction of a fraction of 1 percent in replacement costs could be affected by a reduction of FHA processing and inspection fees, insofar as possible, and the exclusion of such fees from replacement costs. There would be some small cash investment required to cover these costs in addition to the 5 percent requirement previously mentioned.

A total reduction of replacement costs of perhaps 6 percent would reduce the mortgage amount and monthly debt service proportionately. Rents and subsidy payments would also be lower. As one expert witness suggested, builders and investors would probably still find it attractive to participate in the program because of the allowable returns and tax incentives.

HUD should substitute for its 10 percent builder and sponsor profit and risk allowance a reduced straight profit allowance which should not be calculated as part of the replacement costs of a subsidized housing project. It should also reduce processing and inspection fees and exclude them from replacement costs. The Congress should authorize and HUD should adopt a waiver of mortgage insurance premiums for section 236 projects, which are then paid back to mortgagees via subsidy payments, resulting in a Government interest cost while the funds are out of Government possession. All of these measures would lower rents and housing assistance payments.

Alternative Housing Subsidy Proposals Should Be Thoroughly Tested Before Full-Fledged Adoption

Experience with current housing subsidy programs has demonstrated that unforeseen abuses and "bugs" can lead to failures and high costs. Any proposed radical changes in the provision of subsidized housing should be thoroughly tested. New proposals for housing allowances, the equivalent of cash pavments to households to rent the housing of their choice, has received a great deal of attention.

The proponents of housing allowances claim that the present programs are more costly than housing allowances would be because the present programs emphasize the construction of new housing which costs more than existing standard housing. One of the witnesses who testified before this Committee, Henry Aaron, estimated that a "modest universal housing allowance—would have cost from $4.9 to $6.2 billion in 1967." These estimates are based on assumptions of either stable housing costs or housing costs rising 10 percent as a result of housing allowances, respectively, and that the number of beneficiaries under these assumptions would be 12.3 million and 14.1 million respectively. Another witness, Anthony Downs, expressed the belief that "the housing allowance might be far more expensive than existing programs." He also pointed out that a housing allowance might cause rapid inflation in housing prices.

Thus, two noted housing economists, although on opposite sides of the issue, both foresaw house price and rent inflation if a housing allowance program is instituted. One assumed a rise of up to 10 percent in rents and prices. The other apparently feared something more drastic.

Other witnesses also saw the dangers of inflation in a rent allowance program and agreed that more knowledge should be obtained about housing market conditions under which housing allowances can be used effectively without inflation. These views reflect a recognition of the elementary laws of economics that if there is an increase in demand without an adequate supply or matching increase in supply, a rise in market prices or rents will occur. Such increases in rents and prices would affect other units, as well as those that are occupied by allowance recipients. Housing market conditions differ from one locality to the next and there is a need to discover what will happen under different supply/demand relationships as the demand is increased by housing allowances.

It was to answer such questions that an experimental housing allowance program, to be conducted by HUD, was authorized by the Housing and Urban Development Act of 1970. During the two years since the program was authorized HUD was engaged in the design of the experiments. The experiments, to be conducted in a number of cities, are divided into three groups: (1) demand, to test the demand reactions of the allowance recipients; (2) administration, to test the effectiveness of different methods of housing program allowance administration by different types of agencies; and (3) supply, to test the reactions of suppliers of housing services in the market with respect to rents, prices, and services. The field experiments are just getting underway, and it will probably be about two years before reliable measures of the impact of housing allowances can be obtained.

There are other arguments, pro and con, concerning housing allowances, such as whether greater freedom of housing choice could be exercised by housing allowance recipients, or the effects upon housing production and services. Practically all of these questions are interrelated with that of the price effect under different market conditions, however, and can only be tested together.

The Congress should not authorize and HUD should not initiate a broader housing allowances program than the presently authorized experimental program, nor should any other proposed new national housing subsidy mechanism be authorized without a thorough test. Action with respect to a housing allowance program should await the availability and evaluation of housing allowance experiments now being conducted by HUD which should proceed as rapidly as feasible.

V. MORTGAGE CREDIT AND BUSINESS CYCLES

In 1971 and 1972, the latent demand for improved housing became effective at higher levels than ever before, in an economic environment that provided conducive mortgage financing support. High savings inflows to mortgage lending institutions and a decline in long-term credit demands from non-housing sectors helped to loosen the mortgage credit situation. In late 1970, early 1971, mortgage interest rates were reduced from an 8½–9 percent range to a 7–7½ percent range where they generally have been over the past two years.

These rates are still at a high level in the perspective of the last half century. The availability of funds at these rates, however, following a five year period dominated by two credit crunches and tight money, when housing production was below population growth and replacement requirements and mortgage interest rates rose to 8½–9 percent, sparked the residential construction boom of the past two years. This has been the feast which homebuilding has enjoyed periodically. When will the famine period begin?

Our economic and financial history is replete with recurring credit cycles in which housing, small business and State and local governments have borne the brunt of restrictive monetary policies when we approach the peak of a busines cycle and the economy overheats.

There has been one school of thought, reflected by at least one of the witnesses before this Subcommittee, that the mechanisms which have been created since 1966 will ameliorate the affects of a credit crunch upon housing when it comes up again. The adherents to this view apparently have in mind the privatized Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Government National Mortgage Association, the Federal Home Loan Banks and the Farmers Home Administration. All of these institutions have developed methods of tapping the general capital market to provide funds for mortgage financing.

They carried on extensive operations during the 1969–70 credit crunch, and total housing starts declined much less than in 1966. This effect was a result of rapid growth of subsidized housing production under the impetus of 1968 legislation, however, which largely offset the drastic decline in non-subsidized housing production. Demand for subsidized housing is not as sensitive to higher interest rates because, under the subsidy formulas, the higher interest costs are absorbed by higher subsidy payments. On the other hand, non-subsidized housing demand is quite sensitive to higher interest rates, and declined to about the same significant degree in the 1969–70 credit crunch as in 1966.

There was a great deal of money borrowed in the general capital market and channeled into mortgages by FNMA, the Federal Home Loan Banks and the Farmers Home Administration during 1969–70. These organizations had to pay high interest rates (8 to 9 percent) on borrowed funds, however, and could only make their funds available for high interest rate mortgages. As previously indicated, the net effect was to finance the growth in the interest rate-insensitive subsidized housing segment of the housing market, while a significant decline in the non-subsidized segment took place.

A recurrence of the 1969–70 growth of subsidized housing to save the situation during the next credit crunch is unlikely. Out of a total of 2.4 million new housing starts in 1972, subsidized units will have accounted for roughly 14 percent. Even a 50 percent increase in subsidized production could not avert a significant total decline if a 25 percent decrease in nonsubsidized production were to occur as might be expected in a 1973 or 1974 credit crunch with the moratorium on new subsidized housing instituted by the Administration, there will also be a substantial decline in subsidized housing production.

There is a need, therefore to create an effective mechanism that will ameliorate the cyclical credit crunch effect upon housing construction. The Board of Governors of the Federal Reserve Board recognized the need for a more effective means of countering the wide variations in homebuilding activity in a report to the Congress, dated March 3, 1972, entitled, "Ways to Moderate Fluctuations in the Construction of Housing." That report, based on a series of studies by the staff of the Board, noted that the housing cycles have been in an inverse relationship to the general business cycles, that the housing downturns relate to effects on the cost and availability of credit which come from the demands for loanable funds, and that the strongest competition usually comes from the business sector. There were of course other elements in the report, but the foregoing was the basis for the proposal which the Federal Reserve Board recommended to the Congress for priority consideration and which Chairman Burns discussed when he testified before the Subcommittee.

Specifically, the recommendation was for "flexible use of the investment tax credit as a means of achieving greater stability in outlays by business firms for machinery and equipment." As Dr. Burns said, "These expenditures are large, cyclically volatile, and relatively insensitive to monetary policy. During periods of credit restraint, expenditures for machinery and equipment have repeatedly drawn on resources that otherwise would have been available for housing."

The impact of corporate borrowing on our credit markets can be seen in the table below. During the period from 1965 to 1971, corporations claimed 40% of the total supply of credit; the Federal government claimed 7%; homebuyers claimed 20%; and all other sectors claimed 33%. However, during the relatively tight money years of 1966–67, and 1969–70, the corporate share of the credit market increased to 45% while the Federal share dropped to 2% and the share going into home mortgages dropped to 18%. These figures indicate that it is corporate rather than Federal deficit spending which is the primary source of instability in our credit markets.

NET FUNDS RAISED IN CREDIT MARKET; 1965–71

Sector	Percentage share: Easy money years, 1965, 1968, 1971	Percentage share: Tight money years, 1966–67; 1969–70	Percentage share: All years, 1965–71
Federal Government	13	2	7
Corporate business	33	45	40
Home mortgages	23	18	20
All other	31	35	33
Total credit market	100	100	100

Source: Federal Reserve Flow of Funds Accounts, November 1972 (figures on net borrowing are net of funds supplied to credit markets.)

Based on the Federal Reserve Board analysis, which has been confirmed by a number of studies of residential construction cycles, the Federal Reserve Board's reasoning and recommendations, as presented by Dr. Burns were as follows: "If the investment tax credit were lowered in boom times and raised in slack periods, we would experience more stability in business demand for external financing, and therefore also in market interest rates and in the flow of funds for housing. This tax flexibility could be achieved by authorizing the President to vary the investment tax credit within prescribed limits, perhaps from zero to 10 or 15 percent. Before a change in rate could become effective, a 60-day waiting period would be allowed for disapproval by either House of Congress, analogous to the procedure for reorganization plans."

Several questions regarding the efficacy and acceptability of this proposal have been raised by Senator Proxmire and others. First, it is doubtful whether the Congress would delegate the authority to vary investment tax credit rates to the President. Second, the suggested 60-day waiting period, modeled after the reorganization plan legislation, would greatly reduce any effectiveness that the flexible investment tax credit might have. One can foresee tremendous acceleration in business loan demands and commitments during the 60-day waiting period which would acerbate an existing housing credit shortage. Third, since business loan demands during a boom period are insensitive to rising interest rates, how much more sensitive would they be to about a 10 percent investment tax credit loss during such periods.

As an alternative to the Federal Reserve Board recommendation, Chairman Proxmire put forth a proposal that the Federal Reserve Board be given the authority to limit borrowing by corporations with annual sales over $100 million, in order that the burden of the credit crunch should not be imposed unduly upon housing, small business and state and local governments.

There are, no doubt, other alternatives that could and should be considered in order to find an effective means of obtaining a more balanced allocation of credit when the economy heats up.

There is a need for an effective mechanism to counterattack the basic causes of cyclical credit crunches, which give rise to very sizable and costly fluctuations in homebuilding, and have an adverse effect upon small business and State and local government credit availability, when the economy approaches full employment and tight money conditions prevail. The Congress, after consideration of alternatives, should authorize the exercise of regulatory powers over the allocation of credit so that housing, small business and State and local governments will not bear an undue share of the burden of credit shortages.

MINORITY NOTES

The Minority Members have not prepared views to accompany this Report. However, we would like to repeat our opinion, recently expressed in the full Committee Report on Price and Wage Control, regarding the increasingly common and unfortunate practice of scheduling many Committee hearings on important matters at times when Congress is adjourned or in recess. Such scheduling makes it extremely difficult for the Committee Members to participate in hearings and obtain the complete background necessary to come to well-thought-out conclusions and recommendations on these matters.

The hearings upon which this Report is based were held approximately 2 months ago, at a time when the Congress was in adjournment and when few Members on either the Majority or Minority side were able to participate. Additionally, the Minority Members of the Subcommittee were given little notice that a report based upon these hearings was scheduled for issuance by the Subcommittee. The short period of time between circulation of the Majority Report and the time by which comments on the Majority Report were requested, combined with the fact that the full Committee is now in the midst of its annual hearings on the Economic Report of the President and the Council of Economic Advisers, made it virtually impossible for the Minority to prepare comprehensive views regarding the recommendations and conclusions contained in the Majority Report, We do hope to submit such views at a later date.

Procedures of the type described above with regard to both hearings and reports do not permit any of the Committee members to give the consideration to the issues raised before this Committee which those issues merit.

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