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FEDERAL HOUSING POLICIES

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THURSDAY, SEPTEMBER 23, 1976

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 10:20 a.m., in room 1202, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey, Proxmire, Javits, and Percy; and Representatives Long and Brown of Michigan.

Also present: Richard Boltuck, G. Thomas Cator, William A. Cox, L. Douglas Lee, and Ralph L. Schlosstein, professional staff members; Michael J. Runde, administrative assistant; and George D. Krumbhaar, Jr., M. Catherine Miller, and Mark R. Policinski, minority professional staff members.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. Madam Secretary, we appreciate your courtesy and cooperation in taking time today to appear for what we might call sort of a roundup session on the developments in the housing field. I say roundup because hopefully the Congress will adjourn within the next week. Considering the pace of events that are underway right now, I would expect that we would be here to ring out the old and ring in the new year. We are showing great statesmanship. They will now start to read the journal in the Senate today, which is of course a matter of very great importance to the public to prove that we can read.

One of the advantages of today's session is that no matter what you may say or what I may say or what will happen, I doubt that it is going to make any headlines. I have a feeling that the headlines will be preempted by events that occur somewhere between now and 11 o'clock this evening. And so we will do the best we can under these circumstances.

Today the Joint Economic Committee holds a hearing on the pace of the current housing recovery and its contribution to economic recovery. We intend to examine recent developments in the housing industry with your cooperation, and analyze the effectiveness of existing Federal Government housing programs and policies.

A quick look at the current situation indicates that the housing industry has experienced a modest recovery in the past year. Housing starts have recovered somewhat, unemployment rates in the construction industry have eased slightly and interest rates have stabilized, admittedly, at unacceptably high levels.

To many of us, however, the pace of the housing recovery has been far from satisfactory, particularly for multifamily housing. We are now 18 months past the low point of the most recent housing depression and housing starts are still 38 percent below the prerecession peak. As the table prepared by the JEC staff indicates, previous housing recoveries have been far more vigorous. By that, of course, we mean from other recessions. In the 1960 and 1966 housing recoveries, we were within 11 percent of the prerecession peak after 18 months. Today, despite the good news last month, we are floundering almost 40 percent below prerecession levels and just as far below our national needs.

As a result, construction unemployment remained at disastrously high levels. I must put a caveat in there that in some area it is more severe than others. It is not uniform. You have to look at the construction employment and unemployment figures pretty much on an area or regional basis. But even at a national level, in August a full 17 percent of all construction workers were unemployed. I might add that we have more reliable statistics on construction workers, because they are more readily identifiable, they are a well known category of workers.

Mortgage interest rates also are a trouble spot. They have remained at or near 9 percent in the last 18 months. Most recently, mortgage interest rates even have edged upward again. These certainly are not what I consider to be signs of a vigorous and widespread housing recovery.

Moreover, the prospects for the future suggest that housing production will remain well below our national needs. High mortgage interest rates, rising prices for both new and existing housing, a sluggish economic recovery and increasing utility costs will slow down or continue to make home ownership a financial impossibility for many American families, thus dampening the pace of the housing expansion. Yesterday we had witnesses with us that had some commentary on this. We had Mr. Hymans of the University of Michigan, we had Mr. Grove of the International Business Machines, vice president and senior economist, and we had Mr. Brimmer, the former member of the Federal Reserve Board and now here in Washington with his own firm.

The most distressing aspect of the weakness of the housing recovery is that at least to some of us, it simply was not necessary. More aggressive Federal Government housing policies could have had a tremendous positive impact. Programs to make housing financially available to moderate and middle income families could have been adopted. The low and moderate income housing programs could have been strengthened. Downward pressure could have been brought to bear on interest rates. Regrettably such actions were not taken. In fact, last year at this time we were told by the President that additional simulus for the housing industry was not necessary because, "there are clear signs of recovery in this vital part of the American economy."

Time after time, policies that might have quickened the housing recovery were rejected. Moratoria, vetoes, and high interest rate economics prevented a significant recovery for housing.

Recently, we have witnessed a most promising new development. In his latest speech, the President told us that his goal is "Home ownership for every American family that wants to own a home and is willing to work for it." I welcome the President's rediscovery of the Nation's housing problems and pledge my full support in working to achieve this important goal. I have always thought that was what our goal was in the first place. I came here in Congress in 1949. The late Senator Robert Taft was then the Republican leader and he was working very closely with the late Senator Ellender of Louisiana. Both of them were men of rather conservative political persuasion. But they were vigorous in their housing efforts. They outlined what was the goal of our Government in housing. It was "a decent home" in a suitable living environment for every American family.

But let's take a brief look at the administration's record:

Last year, the President vetoed legislation that would have reduced mortgage interest rates to 7 percent for 400,000 families. In his veto message, the President told us that these interest rates were "too low."

Funds for section 235 and section 236 were impounded.

The section 8 program began at much too slow a pace.

In fiscal year 1974, this administration promised 60,000 subsidized housing starts; we got 31,000.

In fiscal year 1975, the HUD budget promised 200,000 subsidized housing starts; we got 24,000.

The President now tells us that housing is one of his highest priorities. Suddenly, he has specific proposals to help American families buy their first home. I have reviewed these proposals and I must say, while they appear to be a step in the right direction, they in my opinion, are far too limited in scope. We will discuss these proposals later in the hearing.

Our first witness today is Hon. Carla Hills, Secretary of the Department of Housing and Urban Development. Secretary Hills, I want to say that you have done a good deal to increase the responsiveness and the effectiveness of HUD. We are grateful for the leadership that you have provided and the cooperation that you have extended to this committee and the Congress.

You will be followed by two witnesses: Prof. Kenneth Rosen of the Woodrow Wilson School at Princeton University, and Mr. Henry Schechter, director of the Department of Urban Affairs of the AFL–CIO.

Secretary Hills, we appreciate your willingness to appear before us today and we look forward to your comments.

Secretary HILLS. Thank you very much, Mr. Chairman.

Chairman HUMPHREY. Senator Percy, do you have a comment you would like to make?

Senator PERCY. Very briefly, Mr. Chairman.

OPENING STATEMENT OF SENATOR PERCY

Senator PERCY. We are at a pause in the recovery period now, and I was concerned about it until the figures came out. Traditionally it has lagged in the upturn. The figures that you released, Secretary Hills, were, I think, tremendously encouraging. When I discussed those figures with 5,000 members of the AFL–CIO at their convention in Springfield, Ill., on Monday there was tremendous encouragement there. I think a part of the downturn has been very heavy Government spending which caused an increase in interest rates, squeezing out many, many people from home purchases and mortgage opportunities. Now that interest rates are coming down, the stock market is responding to that, and housing is responding to it. This is a good time for people to buy a house. In fact, we are moving at a rate now of about a million and half, with a strong upturn of 22½ percent, as I recall your figures, over last year. I think this is very encouraging; encouraging to the workers and encouraging to the entire economy. I certainly would also like to commend the administration for the emphasis placed on homeownership during the first major address following the Labor Day recess by the President. Homeownership was the subject of the first speech I gave 10 years ago in the Senate, the first piece of legislation I introduced, the only piece in the history of the Senate, I guess, that every single Republican cosponsored, and 100 in the House—and bipartisan. We did pass a bill which looked like it was written by a committee; it had a lot of holes in it, but the emphasis to keep moving toward homeownership is very, very good indeed.

I would like to join the chairman in commending you on what I consider to be an outstanding job in administering a huge bureaucracy in a way I think we are all very proud of.

Secretary HILLS. Thank you, Senator.

Chairman HUMPHREY. Senator Javits.

OPENING STATEMENT OF SENATOR JAVITS

Senator JAVITS. Mr. Chairman, while I agree with everything you have said and everything Senator Percy has said, I think it must be noted that we are in a very bad way in housing, even with a million and a half housing starts. I commend Secretary Hills. I appreciate everything you have done. But the American housing stock is really obsolescent. The neglect of the multifamily housing, the unbelievable acres, belonging to my own big city of New York and most of the other big cities, of not only obsolescent housing, but disgraceful, horrible housing—shells of buildings, abandoned buildings, bombed out buildings, burned buildings—is shocking for a country of our size and consequence. I would like to say that I believe that this situation is made more serious because of crime and a general breakdown in the social sense, than unemployment, because it affects many more people.

And I hope very much, Madam Secretary, that we are not going to go to sleep on the proposition. I know we are just doing fine. But coming back to a million and a half housing units, the previous goal—and I was the sponsor of the Taft-Ellender-Wagner legislation in the Congress many years ago—was 2 million units started. This goal is completely out of date and it is thrown out of balance with an unbelieveable weighting in favor of single-family homes, which are worthwhile, but only serve, roughly speaking, two-thirds of the population, assuming the housing is in good shape.

So, Mr. Chairman, I would like to add the caveat that we are not doing the job of housing in this country that begins to fight this battle—even through recovery from the low levels of 1974 and 1975 is fine. We need a new Taft-Ellender-Wagner differently oriented act, recognizing that cooperatives are also homeowners, and so are condominium owners, and the poor are also entitled to own their own homes if they can do it, and we can get them geared up to it. We need to fix our attention to a much higher plateau than will be represented by "the recovery from the recession."

I thank you.

Chairman HUMPHREY. Congressman Brown.

Representative BROWN of Michigan. No thank you, Mr. Chairman.

Chairman HUMPHREY. I just want the record clear. I commend the Secretary for her cooperation. I certainly do not commend what I consider to be the housing program.

May I say to my friend from Illinois, what did you eat for breakfast that gave you that optimism?

Senator PERCY. I always get my optimism from sitting next to the distinguished Senator from Minnesota.

Chairman HUMPHREY. You have drained all mine out.

Senator PERCY. I always choose to interpret your comments with the best in mind.

Chairman HUMPHREY. I appreciate that very much.

Now, what we would like to know is what is ahead. We know where we have been. We know what the facts are in terms of housing starts and housing construction. What is the prospect for the future?

Please proceed, Secretary Hills.

STATEMENT OF HON. CARLA A. HILLS, SECRETARY OF HOUSING AND URBAN DEVELOPMENT

Secretary HILLS. Thank you, Mr. Chairman. And good morning to the other members of the committee.

It is a pleasure to appear before you once again to discuss the current outlook for the housing sector of our economy. If I may, Mr. Chairman, I will summarize my prepared testimony in the interest of time, and submit my full statement for the record.

Since my last appearance just over a year ago, the housing recovery which had then begun has strengthened and accelerated. We are now in the 20th month of a recovery phase which has seen the annual rate of housing starts increase by 602,000 units above the low point in December 1974, to the current level of 1.542 million through August 1976. There is every reason to expect this recovery to continue. Savings flows are now and have been at record levels for much of this year, except for a period of slower growth during the spring; mortgage interest rates have been gradually declining since late last summer; and personal income has continued to grow at a steady rate.

Based on all available data and indicators, the Department forecasts 1.5 to 1.7 million starts in the mid-1976 to mid-1977 period. This forecast represents an extension of our forecast transmitted to Senator Humphrey last January, which has proven accurate in the first half of 1976.

In many ways, this recovery is fairly typical of the recoveries from our three most recent previous housing slumps—those of 1960, 1966, and 1970. After 20 months, the current rate of improvement is proceeding at about the average rate of the three previous cycles, with the starts rates now up 64 percent from the trough in December 1974, compared to an average increase of 66 percent at the comparable stage in the three previous recoveries.

The brightest spot in the current recovery involves the single-family sector—both starts and sales of newly constructed single-family homes. For the first 8 months of 1976, sales are up 17 percent over the same period last year, and starts are up 34 percent—averaging 1.118 million on a seasonally adjusted annual basis. If this pace continues, 1976 would be the fifth best year on record for single-family starts. Despite all the difficulties and burdens associated with the soaring costs of buying a new home (new house prices increased 17 percent in the past year, even as sales increased by the same proportion), homeownership is increasing in America; more and more families are being added to the 65 percent of American families who already own their own homes.

Why is the single-family market doing so well, despite rising costs. The answer, I believe, is that incomes have been increasing at the same time and in roughly equal proportions, along with costs. Our figures indicate that over the long run, the ratio of median house price to median family income has remained fairly constant at a ratio of 2.8 or 2.9 to 1—as far back as the mid-1950's, and as recently as 1975. In 1965, for example, the median priced new home sold for $21,500, but median family income was only $7,000; in 1975, the median home cost $42,600, almost double, but the median income also doubled to $14,000.

Another mitigating factor regarding home price increases is that so many Americans—65 percent of our families—already own a home. As the price increases, so does the value of their home, and their equity in it. The rise in existing home prices enables them to afford better homes when they decide to move; they can finance the downpayment on their new homes from the increased value of their old one.

This means that the rapid price increases strike most seriously at those families which now rent and want to own. In many cases, these are young families, who have not had a chance to accumulate the downpayment for a home, and who must work harder to save more as home prices rise.

Recognizing the problems facing these families, President Ford proposed, on September 15, a housing program which would reduce the barriers of downpayment and monthly cost which have kept many younger families from entering the housing market in recent years.

Specifically, the President has proposed to reduce the downpayment required on homes whose mortgages are insured by FHA—downpayments which now range as high as 20 percent—down to a maximum of 5 percent. In addition, the President has proposed an increase in the maximum FHA mortgage loan from $45,000 to $60.000. This new limit would cover 87 percent of home sales. By simultaneously lowering downpayment requirements and covering a larger segment of the housing market, this plan should go a long way towards easing the downpayment barriers to homeownership.

In order to lower the monthly payment burden, we will utilize the experimental finance plan authorized by the Community Development Act the President signed into law in 1974. This plan would allow FHA to insure graduated payment mortgages, which would enable young families to pay less for their homes initially, when they are just beginning their employment, and pay for increasing mortgage payments in later years out of their increasing income. We expect to have regulations concerning five different types of such mortgages published within 3 weeks.

The graduated payment mortgage is a means of addressing what I consider to be a key housing cost problem. The cost and supply of mortgage credit. Mortgage interest rates are high by historical standards and have been high during this recovery, although they are below the peak levels reached in late 1974. A basic problem of housing finance is that the total supply of funds to the financial markets is limited, and housing tends to get its share only after the appetites of other borrowers have been satisfied.

Even in the face of record and near record levels of savings inflows, thrift institutions continue to cast a wary eye on mortgage lending, after suffering three waves of disintermediation in the past 10 years, with habitual Federal deficits still threatening to bring on severe future inflation. In this context, reducing still further the rate of inflation—and lenders' fear of inflation—remains one of the most important ways in which the Federal Government can help housing.

Chairman HUMPHREY. I must go to vote. Congressman Long will preside. I will be right back. Please proceed.

Secretary HILLS. In addition to the longrun problems caused by chronic Federal deficits and inflation, the mortgage market suffers from severe cyclicality, which we believe can and should be addressed by reforming the structure of our financial system. To achieve this, the administration has supported the Financial Institutions Act proposal to obtain financial reform by removing deposit rate ceilings and smoothing the flow of credit to thrifts.

The state of the multifamily housing sector remains as a source of considerable concern. When compared to other cycles, even to the relatively weak recovery of 1960–62, the performance of the multifamily sector has been lagging, although our most recent indicators are more promising. Currently, multifamily housing starts are 22 percent above the level of August 1975, and have increased by 57 percent from the cycle trough of December 1974. But the multifamily rate is still well below the peak rates of 3½ years ago.

In considerable measure, this weakness is the residue of the exceptional overbuilding in the early seventies, which quickly became unsold inventory when the optimistic projections of demand failed to materialize. As a result, vacancy rates rose to a peak of 6.3 percent in the second quarter of 1975, the highest level since 1967—so high that multifamily owners were unable to secure rents sufficient to cover rising costs, and investors tended to avoid new multifamily construction.

Recently, we have noted some hopeful signs in the multifamily sector. Vacancy rates have come down this year, and the rental absorption rates on new apartments have risen to record levels, indicating that the multifamily sector is clearly on the road to recovery—a road, however, which necessarily involves a longer and more complex process than for single family homes. In order to stimulate this process, the administration has taken and continues to take action, authorizing the release of $3 billion in tandem funds for multifamily mortgages in January of this year, and an additional $2 billion on September 9. These funds are earmarked for FHA insured multifamily units, and will finance the construction of 200,000 apartments.

Our fundamental national goal is decent, safe, and sanitary housing for all Americans. As the members of this committee are by now well aware, I have long supported increased use of our existing housing stock for this purpose. The total cost, and therefore the demand made on the mortgage market for financing, is much less for restoring existing housing than for construction of new public housing. The community development block grants have been used by local officials in large measure to improve local housing conditions and to preserve and improve local neighborhoods with sound existing housing stock. In addition, the section 8 rental assistance program provides substantial incentives for landlords to rehabilitate existing units and revitalize older residential neighborhoods. Under the section 8 existing program alone, we already have 219,000 contract reservations, of which 166,000 have come in fiscal year 1976 and the transition quarter. This exceeds our goal of 165,000 for this period. The families who occupy these units will be living in existing private housing which meets strict HUD housing quality standards. The taxpayers benefit because assisting families to live in sound existing housing is far less expensive than building new public housing, and landlords benefit because it increases the effective demand for units, rather than creating vacancies as public housing does. Section 8 participants have expressed a strong preference for the program over public housing because it allows them a choice of neighborhoods and buildings, rather than requiring them to live exclusively in Government-built concentrations of low-income families.

In our concern with rising costs, the housing of low-income families, and the economic health of the housing sector, we should not lose sight of the fact that the housing of the American people continues to improve. We are closer today to meeting the national goal of a "decent, safe and sanitary" home for all American families than we have ever been. There are many problems in housing, but I believe that we have made progress in resolving those problems in the past year and that, with the help of Congress, we can continue to make progress.

That concludes my statement, Mr. Chairman. I will be happy to answer your questions.

[The prepared statement of Secretary Hills follows:]

Prepared Statement of Hon. Carla A. Hills

Mr. Chairman and members of the committee, it is a pleasure to appear before you once again to discuss the current state of the housing sector of the economy and our projections for the future. Since my last appearance, just over a year ago, the housing recovery which had then begun has significantly strengthened and accelerated. We are now in the 20th month of a recovery phase which has seen the annual rate of housing starts increase by 602,000 units above the trough of the cycle in December of 1974 to the current level of 1.542 million through August of 1976. There is every reason to expect this recovery to continue. Savings flows are now and have been at record levels for much of this year, except for a period of slower growth during the spring; mortgage interest rates have been gradually declining since late last summer; and personal income has continued to grow at a steady rate.

Based on all available data and indicators, the Department forecasts 1.5 to 1.7 million starts in the mid-1976 to mid-1977 period. This forecast represents an extension of our forecast transmitted to Senator Humphrey last January, which has proven accurate in the first half of 1976.

In many ways, this recovery is fairly typical of the recoveries from our three most recent previous housing slumps—those of 1960, 1966 and 1970. After 20 months, the current rate of improvement is proceeding at about the average rate of the three previous cycles, with the starts rate now up 64 percent from the trough level in December 1974, compared to an average increase of 66 percent at the comparable stage in the three previous recoveries.

Unlike the previous recoveries, however, the current recovery has been concentrated to an unusual degree in the single family sector. The August 1976 single family starts level was 66 percent above the trough and 22 percent above a year ago. For the first eight months of 1976, single family starts averaged 1.118 million units on an annual basis. This can be contrasted with the first eight months of 1975, when single family starts averaged 837,000 units annually. The difference represents a 34 percent increase over last year. This is a faster single family rate of recovery than has been typical in recent cycles; only that of 1970 rebounded more quickly.

This improvement in single family starts has been accompanied by a marked increase in sales of new single family homes. The sales figure for July, the most recent available, was up almost 5 percent from the June figure, and the sales for the first seven months of the year were about 17 percent above the first seven months of 1975. Sales in 1976 to date are running at an annual rate, which if continued, would be the fourth best year among the 14 for which we have data, behind only the boom years of the early 1970's.

The excellent levels of new single family housing starts and sales have occurred despite rapidly rising new home prices. Even with the 2.5 percent price decline in July, the prices of new homes are still 17 percent above the corresponding figures of last year. The record of rising prices has generated concern among homebuilders, buyers, the Congress and the Administration. Rising prices are often cited as the cause of the decline in housing market activity.

Without minimizing this problem, I would like to place it in perspective. The price increases have occurred at the same time and in roughly equal proportions as increases in sales and starts; coincidentally, both new home prices and new home sales have risen by 17 percent over last year. Starts of new homes so far this year have occurred at a rate of 1.118 million units per year, the fifth best year on record, and just slightly below the levels of 1971 (1.151 million) and 1973 (1.132 million); if starts continue for the rest of the year at the August seasonally adjusted rate, they will top 1973. This is a strong record. If multifamily starts were doing as well as single family, we would be experiencing an excellent year in housing production. At the same time, sales of existing housing are occurring at an alltime record rate. Clearly, homeownership is increasing in America; more and more families are being added to the 65 percent of American families who already own their own home.

Why is the single family market doing so well, despite rising costs? The answer, I believe, is that incomes generally have been increasing at the same time. We often talk as if housing price increases were the only change in the housing market, ignoring the income increases which enable buyers to purchase homes in record and near-record numbers. Both incomes and sales prices have increased in equal proportions for over two decades. Our figures indicate that, over the long run, the ratio of median house prices to median family income has remained fairly constant at a ratio of 2.8 or 2.9 to 1, as far back as the mid-1950's, and as recently as 1975. In 1965, for example, the median priced new home sold for only $21,500, but median family income was only $7,000; in 1975, the median home cost $42,600, almost double, but the median income doubled also to $14,000.

Another factor mitigating the effect of home price increases is the fact that so many Americans already own a home. As prices increase, so does the value of their home, and their equity in it. The rise in existing home prices, from the standpoint of the 46 million families which already own homes, enables them to afford better homes when they decide to move; they can finance the downpayment on their new homes from the increased value of their old one.

This means that the rapid increases in home prices are primarily a problem for those families which now rent and want to own. In many cases, these are young families, who have not had a chance to accumulate the downpayment for a home, and who must work harder to save more as home prices rise. Many young families now manage to buy homes: among those families in the under-25 age bracket, about 300,000 each year now buy their first home, while among those in the 25-to-34 bracket, some 900,000 families do the same. But there are many more young families who continue to rent, and who want to own.

Recognizing the problems facing these families, President Ford proposed, on September 15, a housing program which would reduce the barriers of downpayment and monthly cost which have kept many younger families from entering the housing market. This plan would enable a significant number of families in the middle income range to join the 65 percent of American families which currently own homes.

Specifically, the President has proposed the enactment of legislation to reduce to a maximum of 5 percent the downpayment required on homes whose mortgages are insured by FHA. These required downpayments now range as high as 20 percent. On the average priced FHA insured home, the President's proposal would reduce the downpayment required by more than 50 percent. In addition, the President will ask for authority to increase the maximum mortgage loan which FHA can insure, from $45,000 to $60,000. This new limit would cover 87 percent of home sales today. By simultaneously lowering downpayment requirements and extending those lower requirements to a larger segment of the housing market, this plan should go a long way toward easing the downpayment barrier to homeownership.

In order to lower the monthly payment burden, we will utilize the experimental finance plan authorized by the community development act he signed into law in 1974. This plan would allow FHA to insure graduated payment mortgages, mortgages under which a borrower could lower his initial monthly payments and increase monthly payments later in the life of the mortgage. To enable as many families as possible to avail themselves of this mortgage, this Department will offer any one of five types of graduated payment mortgages. All of them would enable young families to pay less for their homes initially when they are just beginning their employment, and pay for increasing mortgage payments out of their increasing income. Since under our plan, in no case would the amount of the borrower's outstanding debt exceed the original purchase price of the home, these mortgages would allow the borrower to reap the full benefit of any appreciation in the value of his or her home. We expect to have regulations concerning these mortgages published within three weeks.

The full value of this plan can best be illustrated by looking at the example of a family which uses both the downpayment reduction and the graduated payment mortgage to purchase a home. On a $38,000 home, the necessary downpayment would be $1,400, a reduction of 40 percent from the current requirement. The remaining $36,600 of the purchase price would be financed by a graduated payment mortgage under which payments would rise by 3 percent per year for ten years and then remain level for the remainder of the mortgage term. The new mortgage would require a payment of $233 per month in the first year and $240 per month in the second year. These represent reductions of 15 percent and 13 percent, respectively, from the required payment on today's standard mortgage. We feel that this plan represents a pace setting innovation and a strong stimulus to the housing market.

The graduated payment mortgage is a means of addressing what I consider to be the key housing cost problem: the cost and supply of mortgage credit. Mortgage interest rates are high by historical standards and have been high during this recovery, although they are below the peak levels reached in late 1974. A basic problem of housing finance is that the total supply of funds to the financial markets is limited, and housing tends to get its share only after the appetites of other borrowers have been sated.

Habitually, large federal deficits have absorbed an increasing share of our savings, an average of about 14 percent over the past five years (and about 30 percent in fiscal 1976) which has increased the competition for funds, driven interest rates up, and pulled funds out of the mortgage market. Potential homeowners are the least able to compete for funds in this environment. The inflationary expectations generated by large deficits push mortgage rates still higher, and many would-be homebuyers who do not have sufficient current income to pay these inflation premiums withdraw from the market.

In the present recovery, mortgage rates have been particularly affected by continuing lender concern over inflation. For example, although new savings inflows during the past year have approached—and in several cases exceeded—record levels, thrift institutions have channelled them only partly into mortgage lending. Thrifts have also used them to reduce the level of their outstanding borrowings. They are now more cautious about committing short term deposits to long term mortgage assets and are rebuilding liquidity, after having suffered three times in the last ten years from the effects of serious disintermediation. The disintermediation occurred when savers tried to take advantage of higher interest rates on Treasury bills and other financial assets in periods of inflation—which provides further evidence of the extent to which inflation has contributed to higher housing costs. Reducing stll further the rate of inflation remains the most important way in which the Federal Government can help housing.

In addition to the long run problems caused by chronic federal deficits and inflation, the mortgage market suffers from severe cyclicality. We believe that this problem can and should be addressed by reforming the structure of our financial system. To achieve this, the Administration has supported the Financial Institutions Act proposal to obtain financial reform by removing deposit rate ceilings and smooth the flow of credit to thrifts. We are currently studying ways that financial reform can be implemented which will achieve our objectives for the mortgage market without imposing undue hardship on the mortgage lending industry. Meaningful financial reform which includes competitive deposit markets is necessary if we are to avoid the sharp swings in home construction which have occurred in the past decade.

The state of the multifamily housing sector remains as a source of considerable concern. When compared to other cycles, even to the relatively weak recovery of 1960–62, the performance of the multifamily sector has been lagging, although our most recent indicators are more promising. Currently, multifamily housing starts are 22 percent above the level of August 1975 and have increased by 57 percent from the cycle trough of December 1974. But the multifamily rate is still well below the peak rates of 3½ years ago. In considerable measure, this weakness is the residue of the exceptionally strong housing boom in the early seventies. Optimistic projections of demand for multifamily units generated a wave of overbuilding which quickly became unsold inventory when the economy fell into recession. As a result, vacancy rates rose to a peak of 6.3 percent in the second quarter of 1975, the highest level since 1967. With vacancy rates high, multifamily owners were unable to secure rents sufficient to cover rising costs, and investors tended to avoid new multifamily construction.

Recently, we have noted some hopeful signs in the multifamily sector. Vacancy rates have come down this year, and the rental absorption rates on new apartments have risen to record levels. These factors indicate that the multifamily sector may now be clearly on the road to recovery. However, recovery in the multifamily sector is necessarily a longer process than for single family homes; the process of multifamily development and construction is considerably more complex and requires more time. In order to stimulate and expedite the multifamily recovery, the Department has taken and continues to take action. In January of this year, President Ford authorized the release of $3 billion in Tandem funds for multifamily mortgages. On September 9, he authorized an additional $2 billion. These funds are earmarked for FHA-insured multifamily units, and will finance the construction of 200,000 apartments.

Our fundamental national goal is decent, safe and sanitary housing for all Americans. As the members of this Committee are by now well aware, I have long supported increased use of our existing housing stock for this purpose. The total cost, and therefore the demand made on the mortgage market for financing, is much less for restoring existing housing than for construction of new public housing. The Community Development Block Grants have been used by local officials in large measure to improve local housing conditions and to preserve and improve local neighborhoods with sound existing housing stock. This program provides the flexibility for local governments to address the housing problems specific to their local needs. In addition, the Section 8 rental assistance program provides substantial incentives for landlords to rehabilitate existing units and revitalize older residential neighborhoods. Under the Section 8 existing program, we have 219,000 contract reservations, of which 166,000 have come in fiscal year 1976 and the transition quarter. This exceeds our goal of 165,000 for this period.

Over 66,000 Section 8 units are now actually occupied. These figures are increasing rapidly as the program completes its start-up period. The number of occupied units, for example, has increased by 18,000 in the last month alone—38 percent in one month. We expect these rapid increases to continue. These families live in existing private housing which meets strict HUD housing quality standards. The taxpayers benefit because assisting families to live in sound existing housing is far less expensive than building new public housing, and landlords benefit because it increases the effective demand for units, rather than creating vacancies as public housing does. Section 8 participants have expressed a strong preference for the program over public housing because it allows them a choice of neighborhoods and buildings, rather than requiring them to live exclusively in government-built concentrations of other low-income families.

In our concern with rising costs, the housing of low-income families, and the economic health of the housing sector, we should not lose sight of the fact that the housing of the American people continues to improve. We are closer today to meeting the national goal of a "decent, safe and sanitary" home for all American families than we have ever been. There are many problems in housing, but I believe that we have made progress in resolving those problems in the past year and that, with the help of Congress, we can continue to make progress.

That concludes my statement, Mr. Chairman. I will be happy to answer your questions.

Representative LONG [presiding]. Thank you very much for your very enlightening statement, Madam Secretary.

I would like to ask one or two questions, and then pass on to Senator Percy and Congressman Brown.

Insofar as specifics are concerned under the more or less three-pronged program that the graduated payment mortgage, the reduced downpayment requirements and the increase in the FHA home price ceiling, do you have any specifics as to how many might be helped in each of these? Is there any breakdown on that?

Secretary HILLS. I think you have to look at a profile of the Nation's shelter problem. We have about 71 million households in this Nation of which about 25 million are renters. Some of these are people who want to remain renters. Out of that 25 million, we probably have about 7 million renters who are potential home buyers. And that is the group we seek to reach by reducing the downpayment to 3 percent for the first $25,000 purchase and then 5 percent up through $60,000. You are going to have a downpayment reduction of about one-third on the purchase of a $35,000 home, and a reduction of more than one-half the downpayment required on a $50,000 home. So that you are going to get a fairly broad impact.

It is hard for us to know what the impact will be in the private mortgage market, but in those markets where we are in competition, it is likely that when we get a favorable experience through FHA, we will find the private sector following suit. After all, that is what happened in the 1930's. Traditionally at that time, we had a 5-year mortgage with a 50-percent downpayment, and FHA showed the way to a 30-year mortgage and a 20- to 10-percent downpayment.

I think the raising of mortgage levels also permits the impact to be broader, because by rising the mortgage levels to $60,000 we are going to be able to cover about 87 percent of the sales.

And of course the graduated payment mortgage will have an impact, particularly to the young buyer on a $35,000 mortgage, it can reduce those early monthly payments from about $269 a month to $223 a month, which is a reduction of $46. I think it would be premature to say that we can give you the initial incremental impact. We would be reluctant to give high estimates, but we know that the people who could be benefited by this are quite numerous.

Representative LONG. Go back to the 87 percent again, if you would.

Secretary HILLS. Surely. Mortgage limits for FHA have been raised from $45,000 to $60,000, to cover sales up through $60,000. That means that the new limit would cover about 87 percent of the sales that occurred last year.

Representative LONG. Would that be about 87 percent, then, of your 7 million "sea" that you are looking at, is that correct?

Secretary HILLS. I think that in that 7 million "sea" you are going to find some people who make considerably over $25,000. And they will not necessarily be reaching for this price house. But that is your "sea of renters" who potentially could be looking to convert to homeownership.

Representative LONG. I recognize, as you mentioned, the difficulty of projecting what percentage of that 87 percent would be reached by FHA. And as you say, you are breaking new ground.

Secretary HILLS. Right.

Representative LONG. And it is difficult to tell to what degree the conventional market will follow you and consequently the degree to which you will have that market in FHA rather than the conventional market, having that particular aspect to the mortgage market. In view of the continuing decline in the last few years of the participation in the overall market by FHA, are you of the feeling that that will break that general trend which has developed of a declining participation by FHA in the overall mortgage market?

Secretary HILLS. I think it will have that tendency; there is no question about it. We are not in the market to outcompete the private sector. We have concentrated much of our mortgage lending in the inner cities where the private market has been less aggressive. And I think here again we will be breaking ground, which is a terribly valuable function for Government mortgage activities. I do not think we should be in, and lending to, the upper-income home buyer merely to increase FHA activity. So you are right—the FHA participation in the market has gradually declined over the years; as more and more mortgage lenders have been willing to take up the burdens of lending to middle America, our portion of that market has receded. Our portion of the market in the inner cities has not receded. And I suggest that our portion with respect to very low downpayments and graduated payment mortgages will be out in front at the outset. And if our projections are right, if this is actuarily sound, and has a market feasibility, I expect in our competitive free enterprise system, the private sector will come in right behind us. We will see the value of our proposal. And I hope they do outcompete us. That is what I consider as a terribly valuable function.

Representative LONG. You, in the administration, are satisfied with the Government playing that role as distinguished from the bigger role that it has played in the past in this regard?

Secretary HILLS. I believe that the role is quite analogous to what we played in the past. Our role has curved down as the private sector role has grown up. And when our role was at the maximum, it was because the private sector was not there to carry on this enterprise.

Representative LONG. Which is exactly the situation that we find now, and which is what you are hoping will be assisted in the program that you are initiating here?

Secretary HILLS. We certainly hope so. And that is our belief.

Representative LONG. Thank you.

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Senator Percy.

Senator PERCY. Thank you.

Secretary Hills, Senator Javits mentioned his dissatisfaction with conditions, heavy crime, abandoned buildings, et cetera—and of course we recognize that. I don't think we can do much about people's living habits and their ability to adjust to urban crime when they come from rural areas. But I would like to give you an opportunity to discuss some of the problems that Senator Javits did and what we can do. What is within your competence? Is there anything further you need from Congress? Do you need more funds for counseling, do you need more funds to take abandoned buildings and tear them down? What can we do with some of those problems? Is there anything further Congress can do to work with them to correct this blight in our urban areas?

Secretary HILLS. Senator, I think that one of the principal causes of abandonment has been the overproduction in some sectors, and in addition, the economic dislocation of the past couple of years. Senator Javits is well aware of the phenomena up in New York, which has had perhaps the highest abandonment ratio in any part of the country—50,000 units of housing are abandoned in New York. And that is compounded by a local problem, I think, in some substantial degree due to rent controls.

Senator PERCY. Haven't we also a problem that goes back decades to our basic decision to build high rises for families with children congregating in congested areas? In St. Louis, there were thousands of apartments in public housing that had to be abandoned because they were just a jungle. And we have other jungles. Those were basic decisions made by Government decades ago. We were benevolent, but people had to live in them, and when they congregated all the people with low incomes from deprived cultural backgrounds, and many with broken families, it was impossible really to make a community out of that.

Given those facts, what do we do now?

Secretary HILLS. We would agree with you, Senator Percy, that the problem of crime in many of our public housing projects has been compounded by the concentration of similarly disadvantaged people within the confines of the project. It is that concern, along with a number of others, which has pulled us toward less emphasis on institutionalized housing and more emphasis on housing like the neighbors have, namely, the use of our rental subsidy program. We shifted gears in 1974, reaching for a different approach which would enable families, within the means that we could allot them to shop for housing both of the design and in the neighborhood of their preference. But it is a complex problem. Abandonment goes on not only with low-income structure but even in moderate-income structures where the stream of income is insufficient to pay the maintenance costs. And I think it was to that situation that Senator Javits was referring, at least in part. And I believe that overproduction has been one problem resulting in a vacancy rate that has been very, very high, and the landlords have been unable to secure a rent level that is adequate to pay the costs of maintaining the units. Eventually it simply becomes cheaper for the landlord to abandon that dwelling than to continue to pay property taxes and other required costs.

Senator PERCY. With middle-income or higher-income people, we heretofore have gone very heavily for home ownership. The days of cheap fuel and cheap public utilities are over. Costs are just skyrocketing for homes, not only taxes but all operating costs, all maintenance costs, all repair costs. It must come as a shock to families who, 5 years ago, could maintain their homes to find that they really can't do it now.

Now, I think that it really means that we have to think in terms of a whole new approach. No one could be more enthusiastic about homeownership than I. But I am not enthusiastic when it is just going to be a crestfallen family when they realize they can't make the grade. We are going to have to move more into multifamily dwellings, I think. And that was why I was so encouraged with housing starts, the tremendous increase in the number of multifamily dwellings—five units and over. Now, in your judgment is it true that we really must emphasize multi-units rather than single family dwellings in the future more than we have in the past, and if so, how can we stimulate production in this area when today there is a relatively low rate of return on investment in that field? Could you comment on any of those points?

Secretary HILLS. We agree with you that there are benefits in multifamily construction, particularly for lower income families. The landlord does provide a protection where there is a lack of wherewithal to handle the maintenance costs. We are finding that the single family market is just booming along at almost record rates, and that more families are gravitating to homes—that is, the rate of increase into homeownership tenure is on an increase in spite of the problems in that sector. I surely think that we should try to do all we can do to encourage investment into the multifamily sector.

And I think this administration has tried to do so, first with the use of its tandem moneys which released $5 billion in this calendar year of 1976, which translates into 7½ percent money for 200,000 units of housing. We have 25 million units of rental housing, so that represents about 1 percent of the market when you put out assistance in that quantity for 200,000 units. And I think that is important.

But obviously one of the most important things we could do is to keep our economy on the right track. If we keep inflation under control there will be less reluctance for the investor to invest in multifamily housing for middle America. And there always will be a group that want to live in apartments, people with high incomes as well as low incomes, for convenience factors, mobility factors and the like.

So I agree with you, this is a component that we need. And I think we are watching that market very carefully. It has been troublesome. And as you point out, the recent facts are really quite encouraging.

Senator PERCY. The last question, and then I would like to yield to Congressman Brown. He has been very patient this morning, and we appreciate it very much. And we have another vote on over there, which is why our colleagues haven't come back. I would just like you to comment for the record on the Community Development Act of 1974. Has it been put into effect? Have we had some success with it? How much will the subsidy cost the Government? And if you would just like to answer that for the record, it would be perfectly all right.

Secretary HILLS. I am delighted to talk about the Community Development Act. And you are talking about our block grant program for providing flexible funds for our locally elected officials?

Senator PERCY. Right.

Secretary HILLS. I think it is one of the finest programs that the Federal Government has in working with local communities. It is so much more preferable than the approach that we used in the 1960's of having categorical programs. Over at HUD we had seven categories with pots of gold attached to each one. And when a locality came in and tried to address its community development problems, and would describe its top priority—which may be expanding or preserving housing stock for this lower income population—we so often said "we are terribly sorry, we don't have money like that. The category that has been legislated for us is, for example, open spaces. Can't you use a park today?"

And when the mayor would say in frustration, "that is about my 19th priority, and you are missing my top 18," we would say, "we are sorry, that is all the money we have left today."

In contrast, since 1974, we have given the locality these funds to address the needs, which they identify better than we do. And I think they are doing a good job of it to enhance the living environment of their communities.

Senator PERCY. I yield the balance of my time to Congressman Brown, and I will vote.

Representative LONG. Senator Proxmire.

Senator PROXMIRE. Good morning.

Madam Secretary, it is good to see you again. You and I are familiar with each other's attitude and problems and programs. And once again—I can't say it too often—you are a fine administrator doing as good a job as you can with what I think is bad policy. But considering what you have to work with you are doing a good job.

I would like to follow up on the question to the President's proposed housing initiatives that he announced at the University of Michigan. It seems to me that this really is a tiny little underfed pigmy of a housing program. It comes forward with two proposals as I understand it, one to reduce downpayments. Indeed those downpayments have been increased by your administration over the objections of those of us on the Housing Subcommittee in the Senate and the House, and now the President would only reduce downpayments for the FHA, an area where the downpayments are already relatively small, as I think has been brought out, that is, it deals with a small proportion of the housing market now, the FHA program does.

In the second place, the proposal that people be allowed to make smaller payments in the early years, so that they would be able to buy homes, although their means were modest, it seems to me that this really is a pilot program that Congress passed but which the administration hasn't permission to move. The calculations by the staff of the Housing Committee tell me that this would be about 1,000 houses in the whole country. And in view of the fact that we are 2 percent of the country we would get 20 in Wisconsin, for example. So if you put these two programs together they hardly amount to the kind of economic stimulation which the housing industry potentially can provide for our economy.

Secretary HILLS. Senator Proxmire, there are three basic proposals. One is to reduce the downpayments. And as I have testified, it would require only a 3 percent downpayment on a $25,000 mortgage, and 5 percent for amounts above that. That cuts the downpayment by a third for a $35,000 home and by more than that for a $45,000 home which is today's median.

The second proposal is to raise the mortgage limits to $60,000. This would enable FHA to cover 87 percent of the sales in this country today. That expands the market which we address.

And third, the graduated payment mortgage, by getting payments reduced, would give the opportunity on a $35,000 mortgage, to reduce payments by $46 a month in the early years, by reducing the monthly payment from $269 to $223.

Now, you mentioned the small size of the FHA market. As I have already testified, I think the impact will be larger than the FHA current market, because after all the private sector will be in competition with us.

You mentioned that you have strived to lower downpayments—that the Legislative Committees would favor a proposal. We have adhered to the statutory requirements of FHA, so that the current downpayments are imposed by Congress. We will be coming to you and asking that they be in fact lowered.

You mentioned that the program of innovative types of financing our section 245 program has not been funded. In point of fact we do not require an appropriation. You estimate it would have an impact on 1,000 mortgages. Well, that again will require cooperation, which I fully expect from Congress. There is language in the authorization of section 245 which would limit our experimental impact to 1 percent of the aggregate in mortgages of FHA. Now, some able people have looked at that and felt that it meant 1 percent of the total portfolio. Apparently you are interpreting it in a more restrictive way to be the total mortgages entered into only in any given year. I have looked at it, and there is no legislative history, but lest there be any confusion, I am going to seek the removal of the 1 percent statutory limitation, so that the graduated mortgage payment approved can have a full impact. When you say it will not have the stimulative effect for construction, I should point out that what we are trying to do is to open a market.

And as I mentioned earlier, in the 1930's FHA was responsible for showing the private sector that you did not need a 5-year mortgage with a 50 percent down payment, that it was actuarily sound and could indeed be profitable business under our system of free enterprise, to have a 30-year mortgage fully amortized with a 20 percent down payment. We are doing something smaller, but of the same type, today. I cannot tell you precisely how many people are going to gravitate to this. I think that in some markets which have been highly competitive—for example, out in California there is a good deal of innovation in the lending industry—I would expect that this proposal would be looked at very carefully, and that we might stimulate considerable activity. In other markets they may lag a little.

Senator PROXMIRE. Let's take a look at that FHA down payment. Even for a $45,000 house the down payments are now only slightly above 8 percent. The family buying that is going to have to set aside something like $500 a month for principal, interest, taxes, utilities, insurance and so forth. So it would seem to me that he could scrape up $3,750. This isn't where the problem really is, is it? After all, the downpayment here is less now than it was under 235. The area where you have the problem is with the conventional housing where the downpayments are 20 and 25 percent. And this, it seems to me, is where a downpayment which is onerous and prevents families from buying.

Secretary HILLS. I think you point out our opportunity, then, where FHA has lower downpayments. You point out, I think, that when you reduce a downpayment by half on a $45,000 home you are making a massive impact.

Senator PROXMIRE. Why hasn't the conventional sector followed FHA up to now?

Secretary HILLS. I think they have. The conventional sector for the most part is at about 10 percent in many parts of the country. It varies depending on the aggressiveness of the competition. But between 10 and 20 percent is the cost common conventional downpayment. And if you looked at our old schedule, we had a 3-percent downpayment only up to $25,000. It was 10 percent on the balance up to $35,000 and 20 percent up to $45,000. So that we were in the range of the competition. I think that this will push down the downpayment; indeed I think it is going to do so in a very thoughtful fashion, so that we may see what the impact is before we jump massively in this direction. Now, there is a school of thought that one ought to look at a problem and throw a solution of mighty proportions, massive proportions, billions of dollars of risk proportions, at it. And there is the other thought that we work it out, and see what the impact is and proceed in a reasonable fashion. I think this is a reasonable approach.

Senator PROXMIRE. The trouble is, Madam Secretary, is that you have been trying to work it out and proceed in this cautious fashion now for 2 or 3 years, and we are still in the doldrums as far as housing is concerned. It is true that you are having a better year than last year, it couldn't be any worse, there isn't any way that housing could go but up.

And as far as the graduated mortgage payment is concerned, you say a thousand is the limitation placed by the statutory 1 percent now, and if you argue you would favor eliminating that——

Secretary HILLS. Yes.

Senator PROXMIRE. And permitting this to be more widely used. But you refuse to come in with a figure.

Secretary HILLS. I don't refuse——

Senator PROXMIRE. What will it be, 10,000, 50,000? You say it won't be massive, but at the same time you say it will be bigger. It seems to me that if we are going to stimulate housing we ought to know what we are talking about. This committee is not a housing committee, it is a Joint Economics committee. We are concerned with stimulating the economy, providing jobs in the economy in the private sector. It seems to me that there is no way we can provide substantial employment quickly without inflation as well as in the housing area. We had a couple of years of severe depression in housing and unemployment.

Secretary HILLS. Senator Proxmire, this is not the exclusive construction stimulant. The President said it was to extend homeownership. This would apply to existing homes as well. What we are trying to do is expand the opportunity for homeownership and to make it less hard for more people to enjoy the tenure of homeownership than they otherwise would have. My rough estimates on the effect of the lower downpayment might be as high as 150,000 homes. But I believe, based upon my conversations with people who looked at this proposal, that it might over the years have an even greater impact because of the impact on the private sector. But how do you predict what a demand program impact will have in the private sector when you have not even started it? And similarly in the case of graduated payment mortgage, we think, the impact will be about 100,000 homes or in that range. But that is not a commitment that next year we will have a 100,000 home impact. We have no way of making the lenders grant a graduated payment mortgage, nor do we have a way of making the home buyers seek a graduated payment mortgage. Both of these are demand programs. Our best estimate will be that we will have a substantial initial impact in the range of a 100,000, and that we believe the future impact will be more substantial than that.

Senator PROXMIRE. It is good to get that 100,000 estimate. And I hope it works out. And I want to do everything in the Senate and in the Chairmanship of the Banking Committee and the Appropriations Subcommittee to make it possible for you to do that.

Secretary HILLS. I appreciate that.

Senator PROXMIRE. Let me go back to this downpayment now.

Secretary HILLS. Surely.

Senator PROXMIRE. The Home Loan Bank Board says the average downpayment today in the country for a home priced $48,000 is $12,000, or 25 percent. That is the average downpayment. And those are statistics.

Secretary HILLS. Right.

Senator PROXMIRE. And that is why I say that although FHA has a downpayment of around 8 percent, or 10 percent for a house of this price, it hasn't had the effect that you expect this relatively modest change in downpayment to have a conventional mortgage. You still have most people buying their homes in the conventional area and they have these heavy downpayments that admittedly do discourage the families from buying.

Secretary HILLS. Under the old program $45,000 home price required a downpayment of 3 percent of the first $25,000, 10 percent of the next $10,000 and 20 percent of the balance up to $45,000. So it is below the competition. But there are other reasons why a home buyer at the $45,000 range might seek to go conventionally. When these downpayments are substantialy reduced there is a possibility that the private sector will either come closer to FHA competition, or that the buyer will gravitate to FHA. I don't think you know nor I know, indeed the range forecast by our economists is cautious, we don't want to come before you and say that the impact is going to be heavier than we believe reasonable. A 100,000 estimate seems to us to be a reasonable forecast. And that, of course, will be working exclusively initially through FHA.

Senator PROXMIRE. My time is up. You obviously are very well informed on this and make an extremely plausible sounding argument. I think that word cautious comes out louder than anything else you have said. Based on the record, and based on that chart we can see over there, you can see what has actually happened to Federal subsidized housing programs. In one kind of housing it is under the direct control of the Federal Government. It has gone down, down, down.

Secretary HILLS. That is a program for subsidizing bricks and mortar. And what has gone up, up, up, is subsidizing human beings. And although you have had doubts about our ability to utilize our contract authority to provide assistance to people, the graph on occupancy is going up, up, up. And I am happy to report to you that by the end of this transitional quarter we will have 80,000 people in occupancy, which is much more rapid than any public housing program you have brought to my attention. And I think your favorite one is Turnkey. I would point out to you that in comparison 2 years after Turnkey public housing was enacted there were 4,800 starts, and 2,500 in occupancy as compared to our rental subsidy program, which has starts in excess of 15,000 today, and occupancy that will be 80,000 in just 10 days. So I think we have to put our housing programs into perspective.

Yes; the subsidizing of bricks and mortar has gone down. You have heard the criticism of Pruitt Igoe. That project came into being during one of those high levels. I am not saying that all public housing projects are wrong, but I do think you have to look at what we are doing that is right.

Senator PROXMIRE. My time is up.

Representative LONG. Thank you, Madam Secretary.

Congressman Brown.

The conversation is so stimulating, Congressman Brown, that after you finish questioning you might let Senator Proxmire and Mrs. Hills resume their discussion.

Representative BROWN of Michigan. Mrs. Hills, it is very nice to have you with us this morning. You know, I get disturbed almost to the point of disgust to hear the many bleeding heart statements about the dismal housing situation and the dismal unemployment situation, when we know that in order to have housing starts, and so on, you have to have community services, you have to have water, sewers, sidewalks, and streets. And those in Congress, and many of those in the labor movement, had an opportunity to have a program ongoing as of March 1 of this year that furnished the community services necessary to permit housing starts greater than we have had, which would have provided practically all of its money for employment in the construction trade, our supplemental community development block grant program. And instead they opted to keep people unemployed for all this period of time so that they could come up with a wonderful public works project bill that as of today hasn't put a single person to work. And as of January 1 it won't have put a single person to work, I will wager.

Now, I think we ought to put our money where our mouths are. And we haven't done it.

And in this regard I wonder, what is Governor Carter's housing program? The only thing I have heard about his housing program and his interest in homeownership is that he is going to eliminate the deductability of interest on home mortgages. Now, that sure is a great incentive for homeownership. What else is he advocating in this regard?

Secretary HILLS. It is very unclear.

Representative BROWN of Michigan. What legislation is presently pending in this 2 to 1 Democrat controlled Congress for housing?

Secretary HILLS. It is difficult to identify a proposal that would really assist housing. I think the clearest housing proposal that has been articulated by Mr. Carter is that you would subsidize housing starts up to $2.5 billion a year. And that would put us back at a higher level than our highest housing production following the 1968 Act, which created the abandonment, the outmigration from our urban centers, and the tremendous waste of our existing resources in building and overproducing. Indeed, it was that era of our history, in my opinion, that led to the over production, the boom years in multifamily apartment construction, which led inevitably to the bust years that followed. You cannot have overproduction in any industry for a period that does not finally come to an end and result in underproduction in the next period. And that is what we have been working on.

Representative BROWN of Michigan. What are the specifics of his subsidy program, do you know?

Secretary HILLS. I have read everything that has been made available, and it is not clear.

Representative BROWN of Michigan. You indicated in your statement, Mrs. Hills, that there was a 2.5-percent price decline in homes as of July. Have you researched to attempt to determine the reasons for that decline in price?

Secretary HILLS. There was a drop. I think that the June prices were statistically high. We regarded them as unreal when we saw them. And I think that there was an adjustment that did occur. We do also feel the impact, I believe, of more construction of a modest nature. Now, the home builders have never built to the median-income family, they build to the top of the market just like auto manufacturers. Home builders build what the traffic will bear. And the median-income family, which is often a first time purchaser, does not reach for the house that is exactly in the middle between those that are more costly and those that are least costly, it reaches for the bottom of the line. That traditionally has been so, and probably will continue to be so. And that is their entry into the market, often through existing housing.

But we were happy to see that decline in cost. It is probably attributable in some measure to the righting of the economy, the building of houses below the higher prices of the market, and a statistical flip.

Representative BROWN of Michigan. One thing in your statement that confused me a little bit, you seem to approve of the idea that the ratio of median income to median-price homes has remained approximately the same, about 2 to 1.

Secretary HILLS. 2.8, the ratio of housing costs to income.

Representative BROWN of Michigan. The thing that concerns me, though, I just did some quick figuring here, if you went back and applied the interest rate applicable for purchasing a median home with a median income, and to amortize the financial cost and the purchase of that home, you find yourself in a more difficult position under today's circumstances even though the ratio has remained approximately the same than you were back then.

Secretary HILLS. There is no question——

Representative BROWN of Michigan. So I think that the thing we ought to compare is the ability to amortize off the purchase price of a home under these circumstances rather than just comparing the median-priced home with the median income.

Secretary HILLS. I couldn't agree more. I really think that the comparisons of the median-income family buying the median-priced home, which has never occurred in point of fact, is not focusing on the right problem. I will stipulate that it is more difficult to buy a home because of the added interest cost, and I do believe that in an inflationary economy it is easier to reduce the downpayment, assuming that the risk can be carried in the market. But we have to recognize that homeownership is still accelerating. Certainly homeownership in the seventies is expanding at twice the pace of the sixties.

Representative BROWN of Michigan. It certainly isn't going to accelerate if it appears to a person who is thinking about making a home purchase and committing himself to a home mortgage where now there is a tax advantage to be paying interest on that home mortgage, it may not be there as of next February.

Secretary HILLS. I certainly could not support the loss of the interest deduction. I think that that is what has moved this country to broad homeownership tenure. There is no question that it has provided a strong incentive toward homeownership. I think that is a social goal that this country ought to stand behind, that people who own their own homes tend to participate more in their own neighborhoods and their PTA's, their communities, and their churches. It is a highly valuable social goal which is one that this administration has supported.

Representative BROWN of Michigan. You were talking about interest rates and financing costs a second ago. Do you recall what the interest rate was, say, in 1965 for the median-price home? The median-priced home was $21,000 plus, and the median income was $7,000.

Secretary HILLS. My recollection was that the interest rate was about 6 percent, and that the median income was about $7,000. And that the median-priced home was about $22,000.

Representative BROWN of Michigan. So now if we put those things in perspective, what we have evidence of, we have a doubling of median income, a doubling of the median cost of homes, and about a 50-percent increase in the cost of money.

Secretary HILLS. That is correct.

Representative BROWN of Michigan. So it seems to me that it puts to shame a little bit the great emphasis on the high cost of money as being a deterrent to homeownership. The people that I have talked with are more concerned about the high costs of homes than they are about the high costs of money.

What has led to the substantial improvement in the multifamily sector recently?

Secretary HILLS. I think the improvement in the economy has been the principal factor, with overall personal income going up $83 billion, gross national product going up $200 billion, those kinds of factors cause investors to be more willing to invest in the multifamily market.

Second, I believe we have tended to work off some of our overproduction. By no means do we have tight markets in every single community across this Nation. But when you look back, we were in the range of 6 to 6.3 last year, and it has fallen down to 5.4 to 5.8. That is certainly more encouraging to someone who does not wish to build a white elephant, but wishes to get some return on his investment, to go out there and build. So I think that working off of the overproduction that came out of the sixties has been extremely valuable in producing a renewed interest in the multifamily sector.

Third, the shot in the arm that this administration has given the multifamily sector through the Tandem fund—after all, the release of 5 million dollars' worth of mortgage funds bearing 7½ percent rate of interest when market rates are in excess of 9 percent is bound to produce projects which otherwise would not have been economically feasible. So that those three factors, in my mind, rank as primary in encouraging a turn around in the multifamily sector.

Representative BROWN of Michigan. What was the reaction to your recent release of the $2 billion?

Secretary HILLS. There was considerable applause. We have tried to be cautious—and that is an intentional word—in spite of some suggestions about the use of the taxpayer's dollars. We have tried to watch the market very carefully, not only in starts, vacancies, and sales, but to add that stimulant when we feel that just a little nudge would enable the private sector to get on with its rightful job of construction. I think we have done that, and I would suspect that those people who are intimately familiar with the construction market—the home builders and the mortgage bankers and indeed those who are in tight markets as consumers—would applaud the decision. I certainly did not receive any letters suggesting that I had done the wrong thing.

Representative BROWN of Michigan. Mrs. Hills, I don't have any further questions. I think you have done an admirable job as you always do.

Secretary HILLS. Thank you, Congressman Brown.

Representative BROWN of Michigan. It was enjoyable to sit here listening to colloquy between you and Senator Proxmire. As he said at that time, I think he has met his match.

Secretary HILLS. Thank you.

Representative BROWN of Michigan. In view of the absence of other members, I guess we can stand at ease.

Is there anything that you would like to further contribute that you didn't get a chance to complete, possibly in your colloquy with Senator Proxmire?

Secretary HILLS. I think if that colloquy is to continue it might be preferable to have him here.

Representative BROWN of Michigan. I quite agree.

We will temporarily recess the hearing. Senator Proxmire will be right back.

[A short recess was taken.]

Senator PROXMIRE [presiding]. The committee will come to order.

Secretary Hills, I apologize for these interruptions.

On the first page of your prepared statement you make a forecast that housing starts will be between 1,500,000 and 1,700,000 starts in the year from mid-1976 to mid-1977. Housing starts in August were about that figure, 1,540,000. So it appears that you are suggesting that we can expect little improvement in the next year in housing. Is that right or wrong?

Secretary HILLS. That is wrong, because we are after all predicting up to 1.7. I think you will find that over the past 18 months that my projections have been extremely conservative. And I think that is wise. I believe that 1.5 to 1.7 is a conservative estimate. We believe that the single family market is bubbling along at what may turn out to be in the range of the top 4 record years of the past 14, and we would not want to push it to unreasonable extremes. It has been at about 1,200,000. That is a pretty high rate for single family starts. We do see a recovery in the multifamily market. So that the proportions of multifamily and single family in composing the total of 1,700,000 will undoubtedly change or grow.

Senator PROXMIRE. But when you consider the fact that we have such heavy unemployment in the construction trades and you consider the facts that last year, 1975, was such a very dismal year, with housing starts around a million, it seems that then with the growth of the country and the family formations and so forth, that that would not be adequate. Also it would seem that the basis of the sales now, where the people who are buying houses are in the upper 30 percent of the income area and those who are in the bottom 70 percent are virtually out of the new housing market, at least, it seems to me that we are just overlooking that enormous potential, not only for multifamilies, but for single family housing.

Secretary HILLS. As you are aware, Senator Proxmire, the component of the total housing picture made up of new house purchases is a very small portion, about 3 percent. For the past 12 months we have literally seen records created in the transfer of existing homes. And just during the seventies we have had a rate of home ownership increase twice the rates as compared to the sixties. So homeownership is on the increase.

I share your concern about unemployment. But I do not think it would be productive to be artificially inducing a boom that could not be absorbed and create the problem of overproduction that we did in the 1960's. In other words, if you are trying to work out of unemployment exclusively through construction that cannot be absorbed, I think it would be counterproductive.

Senator PROXMIRE. But you say it cannot be absorbed. The study that we have not simply by our staff, but the studies by your staff, HUD itself, and studies by MIT specialists and others, argue that we could sustain very easily at least 2 million housing starts a year, and it goes up to 2.6 million, depending on whose judgment you take. We are well below that. And when you look particularly in the area of Government assisted housing, the goals we set in the 1960 act are 600,000 starts a year. We are down, as you can see in the chart over here, far below that. We are a little above a 100,000 starts a year.

What concerns me is the record of HUD compared to the Farmers Home Administration. The Farmers Home Administration has been quietly proceeding, getting 80,000 to 90,000 housing starts a year since 1971, year after year. They seemed committed to their program, and have accomplished their program. That is assisted housing program with a far lesser potential. And yet in your area where you have a potential probably 6 to 10 times as great, you just can't be providing houses for people who don't have incomes of $17,000 or $18,000 or higher.

Secretary HILLS. You are underestimating the starts. But I stand by the proposition that our projections of 1.7 million—which does not factor in the manufacturered homes which have a projection of an additional 300,000 to 400,000 units—really is reasonable in the course of our current economic upswing. And for the Government to subsidize high levels which would raise the interest rates for those already suffering from high interest rates who are not assisted families would be counterproductive. That is why our rental subsidy program, which utilizes existing stock that is sound of design and well located, and has to pass the matter of minimum property standards in effect, is a useful way to house low-income families at one-half the cost. It also uses the existing housing and prevents the abandonment by landlords and the blight with which our cities are having such a difficult time.

Senator PROXMIRE. Let me point out to you the sharp and dramatic contrast between the HUD program for assisted housing and the Farmers Home Administration. In 1971 HUD had about 400,000 starts compared to about 80,000 for Farmers Home. In 1973, it had 338,000 compared to 91,000. And then HUD dropped in 1973, 234,000 compared to 97,000. In 1974 HUD had only 90,000 starts compared to 81,000 for Farmers Home Administration. And in 1976, this present year, it is 41,000 for HUD and 78,000 or twice as many for the Farmers Home Administration. Now, there seems to me to be a sharp contrast—the same kind of conditions, the same kind of problems, the same kind of difficulties, certainly at least as much a need for suburban and urban housing as there is in the rural areas, which is the only place where the FHA can function, and yet you have this record for HUD of a drop to only about 10 percent of what you had in 1971, and the FHA has gone along at about the same level.

Secretary HILLS. A figure which I do not have at hand is what we anticipate for the future. As you know, the new construction phase of our rental subsidy program is beginning to create starts. And we think that the HUD subsidized starts will be up to 200,000 in fiscal year 1977. That is our best estimate. It may very well be, as our Regional Administrators anticipate, that it will be even higher than that. And I am cautious about giving a high figure. But I think that the program works with the market, Senator Proxmire. And there is no point in building an institutionalized project next door to a 45-percent rental situation that is in the private sector which is geared to the same market. Now, we would like to see starts underway where the markets are tight, and where the vacancy rates are low. We would like to utilize existing stock where the markets are soft and the vacancy rates are high. We have been plagued by that problem, and we think the program has a way of working better with the market than the old programs.

Senator PROXMIRE. I am going to run to vote. And Senator Javits will have a chance to ask questions.

I have one more question. Your program seems to be one, not entirely but to a considerable extent, one of providing money for people to stay in their present housing. I can understand that. And there may be some merit in that kind of program. But what we ovelook is that it doesn't do two things. No. 1, increase the housing starts of the country so that we can hold down prices for housing that is adequate, and No. 2, provide the jobs we so urgently need now, which we won't get if people aren't able to buy the newer homes that have the more attractive environment and the better living conditions that we have pledged for many years.

Secretary HILLS. An old home is not necessarily less desirable than a new home. And you yourself have stated that we went through a period of overproduction, ignoring our existing assets. The fact is, where people want to stay in their homes after shopping about with an option—and they do shop about—they ought to be able to. Their homes are upgraded in a great many instances. So the very fact that we are providing a subsidy means that we are upgrading our housing stock.

This Nation has thrown away its existing housing stock far too long. In other countries which are less well housed they hang onto their existing housing stock. And we could learn something about the use of the home rather than always throwing it away. We have neighborhoods that are good, that are viable, that are strong. And simply to ignore them to build something new in some other location, which also requires the building of roads and sewers, is counterproductive.

Senator PROXMIRE. I agree with that, I think there is something to be said for that. But I think we have gone overboard the other way. We are now in a situation where we are really transferring income to people, so instead of paying 40 percent of their income for housing they are paying 25. But in the meanwhile we aren't providing the opportunity to build the houses we need.

I am going to have to run. I know Senator Javits has some questions.

Senator JAVITS. Madam Secretary, I too will be unable to stay. And I understand that Senator Percy in my absence pursued at least one of the questions I had in mind.

But taking everything you say—and I agree with you in so much of what you have said—I must say that I still am very much dissatisfied with the nonabsorption factor. Housing is such a critical, important, and good investment that it seems to me that the nonabsorption factor is a confession of our inadequacy, or worse. If there is surplus labor there certainly is no dearth of material, and so there is no bottleneck in that regard.

There is an enormous need for housing, and yet if we cannot match up the two in a period when the economy is recovering and when we are moving to a period of relatively stable income for the overwhelming majority of the American people, there just seems to be something wrong.

Secretary HILLS. One of the things that has been wrong. Senator Javits, is because of our previous policies. We produced more housing, particularly apartments, than we could absorb following the 1968 act.

And this country has had to swallow up that overproduction. So it occurs any time there is an excess of inventory more than a given period can absorb; there is a drop off in the next period, namely, the bust from the boom. And that has occurred in housing. So that what we are doing now is utilizing some of our existing stock.

Now, I understand the need to use up the labor, and the fact that we want to put people in homes. But after all, we did produce these units. And it is a tremendous balance—these are difficult problems, as you well know. But our cities cannot stand the blight that is created from always abandoning our existing housing stock. Indeed, if you are to formulate a financial statement for our urban, or even our smaller communities, the most valuable asset that they can put down on their box is their existing housing stock. And they need to preserve it.

I think that what we have done since 1974 with the Community Development Act has been to give locally elected officials for the first time not only the resources, but the consciousness that there is a direct correlation between fixing curbing, improving street lights, and that kind of physical development of their cities and the value of the assets that they have and the prevention of the downward spiral of transitional neighborhoods.

So I think we have the opportunity to have the best housing with a bridge to community development that we have had in our history. And I would certainly hate to see that opportunity lost trying to solve another problem with mandatory or artificially high level of construction.

Senator JAVITS. I understand that too. But you still don't account for the fact that the oversupply is mainly in houses priced for high income levels and not for the income levels that have the need for housing. And this is what I know something about. I live in it. And it isn't happening. Sure, you have got oversupply in the good neighborhoods with the good housing for people, I would think in the $20,000 range. But you have got drastic, unbelievable, gruesome undersupply when you are dealing with people in the range of $8,000 to $12,000, $14,000, $15,000. And that is what is wrong, I feel, with our system.

Sure, you are right about supply and demand. There is an oversupply of Rolls Royces and Cadillacs too. But that doesn't mean a lot of people don't own cars or don't own cars that are absolutely dangerous for the road. That is all I am talking about.

I see that the housing supply itself has deteriorated badly. We are not even doing the job of renovation, or of making cooperatives possible, let us say, so the people have a better chance for renovation. Now, that is the thing I am directing myself to. I am asking you, because you know infinitely more about it than I do in this particular specialized subject, and we admire you greatly for it and respect you enormously. And so I ask for enlightenment on that issue. What are we doing. What can we do as a Government to open those doors?

Secretary HILLS. You are correct that in some regions of the country the supply does not match the need. And it differs from region to region. Our rental subsidy program strives to put the dollars in the pockets of those whom you say are facing a gruesome undersupply. If there is such an oversupply for the middle income groups, that releases some units which are not getting rented. And landlords frequently reduce their rents where there is a demand and the dollars are in the pockets of the lower income families to move into those. That is one way to supply that need.

On renovation I have to tell you that based upon any criteria that census has put forward on dwellings lacking plumbing, leaking roofs, wet basements, or whatever, that our housing stock has been improving at a very rapid rate, so that whereas in the fifties we had 35 percent of our stock deemed substandard, today it's less than 7 percent. And I think that the effect of utilizing the existing stock that we have, by upgrading it to meet our standard before we will provide the subsidy, is a tremendous asset in this renovation process.

I agree with you, this rehabilitation must take place. When housing prices start to climb, it is a fact that renovation in the private sector goes up. People tend to stay put and fix up their homes rather than move on. So we have seen in the past year tremendous numbers of private sector dollars going to renovation. I regret very much that although this administration asked for $850 million of contract authority to work with our rental subsidy programs, Congress saw fit to cut us to $675 million. That means we will be able to help fewer families.

It also means that those families will move into fewer units, and fewer units will be upgraded to meet our standards of what is decent, safe, and sanitary.

The problem is complex. I agree with you that we have a problem. I think that we have the ability with the programs we have to address the problem.

There is one further thing. It may not be so much a problem in your State, but in many parts of the country our ability to turn around homes that we have acquired through foreclosure is very, very slow. With a lengthy judicial process and congestion on the calendar, the period of redemption is very slow. And we may hold onto abandoned units longer than we should. Although it is a fact that we cut the turnaround time for selling properties to get them back into our housing inventory from 13 months to 11 months on an average—and we are working on reducing it even more—when we face a 2-year congestion and a 1-year period of redemption, we have a considerable problem. Therefore we have sent forward the Uniform Foreclosure Act. We think that is something that Congress could act upon, and I understand it has been introduced.

Senator Javits. I must go and vote too, Madam Secretary. But before I do I would like to put two questions for the record, and I hope you will answer them in writing.

Secretary Hills. Of course.

Senator Javits. What can we do about cooperatives for relatively low income housing, because that is the way to maintain it? And we have seen wonderful examples of that in New York.

And second, what is your advice, especially to my State, about this horrible abandonment question, both in a technical, professional sense and in a financial sense? If you will be good enough to give us that I will appreciate it.

[The following answers were subsequently supplied for the record by Secretary Hills:]

QUESTION ON COOPERATIVES

Answer. Cooperatives represent one important means of expanding homeownership among the population. There have been markedly successful cooperative ventures in providing housing for low-income families, including some in New York City. However, they do have certain basic problems, which were discussed in a 1975 HUD study of cooperatives and condominiums, conducted in response to Section 821 of the 1974 Housing and Community Development Act. Ownership in a cooperative permits families to own housing, but it also imposes risks. All participants in the cooperative are subject to unlimited liability for the venture, so that high vacancies may result in substantial losses for the participants actually residing in the structure. Lower-income families are likely to be less able to take this risk, and many therefore find condominiums a preferred way to purchase apartments.

HUD is currently authorized, under Section 236, subsection (k) of the National Housing Act to insure mortgages for cooperatives for lower income families. There has been little demand for insurance under this section to date.

QUESTION ON ABANDONMENT

Answer. HUD has been concerned about abandonment for several years, ever since the problem first became a national concern. We have several studies of the abandonment phenomenon, which have concluded that it is part of a general pattern of neighborhood decline and deterioration. It appears that abandonment cannot be attacked in isolation from other aspects of neighborhood preservation and revitalization. As Chairman of the President's Committee on Urban Development and Neighborhood Revitalization, I have been particularly concerned with the entire process of neighborhood change. The Committee is now preparing an Interim Report to the President, which will set forth our views on the nature of best means of dealing with the process, which I believe will contribute importantly to solving the problem of abandonment. As I have repeatedly testified, however, one crucial element must be to avoid artificially stimulating overproduction, which inevitably leads to abandonment, and a greater reliance on using and upgrading our existing housing stock.

Senator JAVITS. I don't want to keep you anymore. And as to the other witnesses, I will go over and try to get Senator Humphrey for one of us to come back and deal with the problem of other witnesses.

The hearing will recess now for 10 minutes.

Secretary HILLS. Thank you very much, Senator Javits. Does that mean that I am excused from this hearing?

Senator JAVITS. Yes. Thank you.

Secretary HILLS. Thank you.

[A 10-minute recess was taken.]

Chairman HUMPHREY [presiding]. Might I ask Professor Rosen and Mr. Schechter to come to the witness table together.

Gentlemen, you have sat through this rather disorganized session that we have had today because of the enumerable procedural votes that we are having in the Senate. And we will have more. So I am going to ask, if you will, to go through your statements for us and summarize as best you can. And we will of course place in the record the full text of your prepared statement. And we will see if we can't find the time here to make some inquiries on your responses.

We will start out with you, Professor Rosen.

STATEMENT OF KENNETH T. ROSEN, PROFESSOR OF ECONOMICS AND PUBLIC AFFAIRS, PRINCETON UNIVERSITY

Mr. ROSEN. Thank you, Mr. Chairman and Senator Proxmire.

I would like to summarize my statement. There is probably a little more rhetoric in it than need be.

Chairman HUMPHREY. Please do that. That would help.

You might also want to comment in any way that you desire upon the testimony of the previous witness.

Mr. ROSEN. Fine.

I think one of the major questions that I was asked was what was the outlook for housing in the next 2 years.

Before forecasting the future it is useful to provide a perspective on the anatomy of the past recession. The housing recession of the past year and one half began in a traditional fashion with a "money crunch—disintermediation" period leading to a constraint in the supply of mortgage funds. This initial money supply induced decline in activity, however, quickly degenerated into a housing recession of a different character by late 1974 and early 1975. The housing industry in this period, and even at present, faced a "real demand" and "real supply," not a monetary supply, crisis of unprecedented proportion in the postwar period. The multifamily market virtually collapsed due to the inflation—unemployment induced decline in real weekly earnings, the collapse of the REITS, the substantial overbuilding in the condominium sector of the market, and the cost-price squeeze facing the potential multifamily developer. In the single-family market the same real factors, a demand shortfall and an inventory buildup, were in evidence, though to a somewhat smaller extent.

What I would like to do is talk about two key factors that I think will affect what happens in housing in the next year. The first is the relative cost of housing. And the second is the fate of the multifamily sector.

I think the United States is today in the midst of a housing cost problem of major proportions. The magnitude of this problem can be best appreciated by considering the simple fact that nearly two-thirds of all American families cannot afford to purchase the home in which they now live. Of even greater concern, however, is the fact that most new entrants to the housing market, young families and other first-time home buyers, cannot afford to purchase any home at all.

Chairman HUMPHREY. What is that figure?

Mr. ROSEN. In terms of the percentage of people who cannot afford it, about 60 percent.

Chairman HUMPHREY. Sixty percent could not afford to purchase a median price home?

Mr. ROSEN. That is right.

Chairman HUMPHREY. What do you mean by median price?

Mr. ROSEN. The median price today of a new single family home is about $45,000. It changes from month to month.

Chairman HUMPHREY. And then you had a figure following that.

Mr. ROSEN. I didn't have a figure, I said that a great number of young families could not purchase any home at all. I don't have a number for the actual proportion. But it is obviously affecting those families worse than others.

Now, the consequences of these market conditions are that an increasing number of Americans are becoming what you might call "housing poor" and that the institution of homeownership has over the past few years become available only to the fortunate few. These fortunate few include households who entered the market prior to the inflationary induced surge in housing prices and mortgage interest rates, and those families earning an annual income over $20,000. This, of course, excludes most low- and middle-income households, most minority households, and most young families.

In the testimony, I talked about some particular cost indicators. What has happened in the last 5 years is that the cost of the homeownership has risen about 8.3 percent per year vis-a-vis the overall rate of inflation, which has risen at 7.7 percent—so the relative situation has gotten worse.

In sharp contrast—and I think this is an important point to consider—is that the cost of renting, the rental component of the CPI, has gone up only 5 percent a year. And this again vis-a-vis a 7.7-percent rate of inflation. What this means is that the rentor is better off in the last 5 years; his costs have been going up less rapidly than the overall rate of inflation. I think that is an important statistic and somewhat surprising.

In summary, looking at the CPI components, which are broadbased indicators of housing costs, we get a mixed picture. If you look at sales prices which is the most visible indicator of housing cost, you see that the sales price of a new home has risen 9.4 percent in the last 5 years and the sales price of an existing home has risen at a rate of 10.7 percent. This is obviously much faster than the rate of inflation. In the past 12 months—and this itself is a very startling indicator—the sales price has risen between 10 and 12 percent on new homes. So you have a very large rate of inflation in the housing industry in the last 10 to 12 months.

Now, we must view these numbers with caution. I think there is reason to believe that they may not reflect what is actually happening in the market. The first reason is that these cost figures, the sales price figures, represent median figures for transactions, and do not represent the change in costs for the same quality house. And if you standardize for the quality of the house, the size of the house, the number of square feet, the number of bedrooms, and the size of the lot, you find that the sales price of the new house has risen only about 1 percent faster than the overall rate of inflation.

The second thing you have to remember is that the cost numbers for the past year reflect the fact that the single-family housing market has really recovered from a very severe depression. So when you are comparing numbers from year to year, you are really comparing depression prices of a year ago with those in a period of very strong demand. So again you have to view these numbers with some caution.

Now, at the same time that there is a curtailing demand because of the prices rising, there is also a supply impact on the housing market. And this should be a positive factor for the supply of housing units if you are rebuilding homebuilder margins, because during the recession there was an increase of bankruptcies and a number of builders really slashed their profit margins, and during a period of recovery you would hope that the profit margins would go back to some sort of normal level.

In addition, you have other sets of increased costs which are truly increased costs. And these would be due to the spread of the no-growth philosophy and excessively stringent land use controls. The land component is really the most important element in the rising cost of housing.

If one were to summarize the effects of these various factors, I would say that two-thirds of the relative price rise in single family homes is due to quality improvements, increased demand, and improvement in builder margins. Only about one-third of the increase is due to cost factors, which is equivalent to perhaps 2 to 3 percent of the sale price of a home, or $1,000 to $2,000.

In my mind, however, the major impact of the inflationary surge—and I have done a considerable amount of research on this topic over the last few years—has not been on sales prices but rather on the interest rate on the mortgage loan. The mortgage interest rate is a function of the expected inflation rate and a real interest component. The high inflation rates of the past 5 years have raised the contract interest rate and so raised the monthly carrying costs of a conventional mortgage by nearly 20 percent. Compared with a 1- to 2-percent inflation world, the present monthly carrying costs of a conventional mortgage are nearly 50 percent higher than would be expected in a low-inflation economy.

This inflationary impact is made especially severe by the traditional institutional mechanisms of the mortgage market. The institutional arrangements of the mortgage market were basically established for a low-inflation world. As a result, the standard mortgage instrument is a level payment, amortized loan, which is not well adapted to an inflationary environment. It takes no account of inflation rises in money income or inflation-induced increases in the underlying value of the property. Thus, from the borrower's viewpoint, the standard mortgage instrument completely ignores the positive inflation-induced dynamics of the housing market. However, the standard mortgage instrument does attempt to anticipate the negative influences of an inflationary environment on the particular contract. Through the calculation of the mortgage interest rate, and so the household's monthly payments, the lender attempts to incorporate expectations of inflation over the life of the loan.

It is this situation which has created a dynamic mismatch between the cost of the mortgage loan to the borrower and the borrower's ability to pay. This dynamic mismatch, which only takes into account the negative impact of inflation, but ignores the positive impact of inflation on the borrower's income and property value, is the major element of the housing cost problem.

The multifamily sector has been the major factor in the fairly low level of housing starts reported in the past year. At present multifamily construction activity is still near its recession low, with starts at an annual rate of 320,000 units. This is far below previous peak levels and reflects a number of major structural problems in this sector. The multifamily section is still faced by an inventory and overhang problem of undetermined proportions, a cost-price squeeze which makes new construction uneconomic in many areas. a major shift in demographic demand, and a reluctance of lenders to commit funds to this sector of the market.

The inventory problem in the multifamily sector was caused by the tremendous amount of overbuilding in the early 1970's. This inventory problem was especially severe in the condominium and vacation dwelling markets. While this problem is slowly being resolved, it continues to depress the market in key markets such as southern and central Florida. Nationwide, figures on vacancy rates and on the market absorption of new units indicate that the multifamily sector is now meeting demand with present activity levels. As the economy and so demand improves, vacancy rates will decline further and may put some moderate pressure on the multifamily sector in certain market areas. Widespread shortages are, however, not at all likely.

The major problem facing the multifamily market in most areas is not excess inventory, but rather the lack of strong demand for this type of unit. The severe economywide recession depressed demand in the very cyclically sensitive individual household groups. In addition, we are now in the middle of a major demographic shift in the economy which will lessen demand in this sector. The postwar baby boom of the late 1940's is now moving into the 25- to 40-year age group, which traditionally demand single family units. Thus, the recent shift in composition of starts away from multifamily units is probably not temporary and represents the beginning of a long-term secular shift away from this sector.

In addition, the multifamily sector is faced by a severe cost-price squeeze. Rents have risen far slower than the overall rate of inflation and construction costs. This is due to weak demand, overbuilding, and to rent controls which are imposed in some of our largest urban areas. In order to resolve this cost-price squeeze and encourage much new production rents would have to rise 10 percent in real terms over the rise of inflation in order to get much new building in many of the depressed areas like the Northeast.

Now, let me just give you my housing industry outlook.

Chairman HUMPHREY. May I say that I have got to give you my voting outlook. I will tell you that this is an exasperating experience. I think Senator Proxmire will be back.

[A short recess was taken.]

Senator PROXMIRE [presiding]. Mr. Rosen, will you go right ahead?

Mr. ROSEN. I have just given a view of the problems of multifamily sector and the cost problems. Now I am about to give the housing industry outlook.

First, turning to the mortgage supply, it appears that mortgages will be plentiful during most of 1977. The liquidity crises of the past will fast fade and thrift institutions will have a very adequate flow of funds and liquidity levels. This liquidity, along with a decline in the long-term bond rate due to a stabilization of inflation, 4 to 6 percent, will push mortgage rates down to the 8- to 8½-percent contract rate range. I am assuming in this scenario that the Federal Reserve will follow a moderately easy monetary policy designed to keep the 91-day Treasury rate in the 5.8-percent to 6.3-percent range, with the rate averaging 6.1 percent for the year.

Second, in terms of consumer demand, there will be a continuing strengthening throughout the year. I expect 1977 to show continued good improvement in economic activity. The economic recovery is here, it will be solid, and it will be substantial. The year as a whole should show a 5- to 6-percent real growth rate, with the unemployment rate dropping below 7 percent by the end of 1977. This optimistic real growth forecast is dependent on the absence of any large inflationary shocks to the economy.

The major constraints to the housing recovery are the potential dampening impacts of cost increases, and the slow recovery of the multifamily sector. I expect housing prices in the next year to increase at a rate not much faster than the overall CPI. I expect the multisector to show a moderate recovery reflecting strength in certain geographic markets.

I have made a specific housing start forecast using several econometric models I have developed. The most likely output levels for 1977, are about 1.3 million single-family units and about 400,000 multifamily units, for a total of about 1.7 million housing starts. This reflects gradually strengthening of activity throughout the year. Above average activity is expected in the West, South, and Southwest. The Northeast will make only a very slow recovery reflecting the outflow of a great many people for this area.

I would like to add one thing which is not in my testimony here. I should emphasize that these forecasts are dependent on the absence of any major inflationary shock to the economy. As you probably are all aware, there is a fairly large potential for an inflationary shock in the first half of next year from the potential oil price rise by the OPEC oil countries. Assuming this happens, and I think there is about a 30-percent chance that you will have this large inflation shock, then I think that you will find that inflation will shoot back up to the 8- to 10-percent interest, and short-term interest rates will shoot back up, and we could abort the housing recovery about to 1978.

Senator PROXMIRE. What do you base that forecast on? You say it is a 30-percent chance?

Mr. ROSEN. It is an intuitive judgment, no other. If that does happen—then I think there will be a need for some sort of policy factor to offset it. That is an intuitive judgment.

Senator PROXMIRE. How much of an oil price increase do you have in mind now?

Mr. ROSEN. About $4 a barrel, which is what they are talking about, 25 percent. I am not sure the market can stand that. If there is this shock, I think all the forecasts you will be hearing really will have to be looked at very carefully, because the key to the housing start forecast is the short-term interest rate, and that is very sensitive to inflation rate, as is the long-term rate. And I think if you get that inflationary shock and if it is not offset by a tax decrease or something like that, you are going to look at a miniscenario like 1974 or 1975, not the same thing, not the same order of magnitude, but it could be similar. So I think there is a chance of recession in the housing sector and also in the economy as a whole.

Finally, I would like to outline ways in which the Government could accelerate the housing recovery and improve the long-term outlook for housing.

First, in order to moderate cost increases in the single family sector an active effort should be made to discourage excessively stringent land use restrictions and slow growth ordinances which are proliferating on the State and local level. While these attempts to control the pace and nature of land development have merit, it must be recognized that they may be denying nonhomeowners the opportunity to purchase a home at a decent cost. An equitable and efficient tradeoff between these goals must clearly be sought.

Second, a real effort must be made to improve the opportunities for young households and low- and moderate-income families to purchase their own homes. This effort should involve a better matching of mortgage payments with incomes over time, possibly through some type of graduated payment mortgage. Second, a mechanism for helping these families accumulate down payment requirements is also crucial. I would suggest that legislation similar to Senator Brooke's Young Family Housing Act would be most helpful.

Third, in order to stimulate the multifamily sector, rent controls should be actively discouraged. Rent controls are a most inefficient and inequitable subsidy. Instead, I would recommend a set of direct demand subsidies which would improve the buying power of low- and moderate-income households.

Finally, I think the most important effort that the Congress can make in improving the outlook for housing, is to design a set of programs and policies which will reduce the cyclical instability in the industry. This would involve a coordination of Government mortgage programs, a reform of the financial structure, and greater use of counter-cyclical direct demand programs.

Only with an active, coordinated, and consistent set of policies and programs can the Federal Government contribute to the goal of a decent home in a suitable living environment at an affordable cost. Thank you.

[The prepared statement of Mr. Rosen follows,:]

PREPARED STATEMENT OF KENNETH T. ROSEN

For the past two years new housing production has generally been in a state of extreme distress. The market has shown only a moderate response to a number of normally bullish factors: a sharp inflow of funds to thrift institutions, a tax rebate which substantially increased real disposable income of consumers, a $2000 housing tax credit, a sharp rise in consumer wealth due to an advance in stock prices, and a fairly substantial rise in employment in the economy. These factors have fostered some recovery in activity, but the increase in housing starts is small when compared with previous recovery scenarios and the depth of the present housing recession.

Before forecasting the future it is useful to provide a perspective on the anatomy of the past recession. The housing recession of the past year and one half began in a traditional fashion with a "money crunch—disintermediation" period leading to a constraint in the supply of mortgage funds. This initial money supply induced decline in activity, however, quickly degenerated into a housing recession of a different character by late 1974 and early 1975. The housing industry in this period (and even at present) faced a "real demand" and "real supply" (not a monetary supply) crisis of unprecedented proportion in the postwar period. The multi-family market virtually collapsed due to the inflation—unemployment induced decline in real weekly earnings, the collapse of the REITS, the substantial overbuilding in the condominium sector of the market, and the cost-price squeeze facing the potential multi-family developer. In the single family market the same real factors, a demand shortfall and an inventory buildup, were in evidence, though to a somewhat smaller extent.

The importance of these real factors made the past housing recession unique in some sense, and will crucially influence the future course of the housing market in the next year.

In particular the role of two real factors: (1) relative housing costs and (2) the fate of the multi-family sector hold the key to the housing market outlook.

HOUSING COSTS

The United States is today in the midst of a housing cost problem of major proportions. The magnitude of this problem can be best appreciated by considering the simple fact that nearly ⅔ of all American families cannot afford to purchase the home in which they now live. Of even greater concern, however, is the fact that most new entrants to the housing market (young families and other first time home buyers) cannot afford to purchase any home at all. The proximate causes of the crisis are: high and rapidly rising home prices, high mortgage interest rates, substantial and often prohibitive downpayment requirements, and high maintenance and utility costs.

The consequences of these market conditions are that an increasing number of Americans are becoming "housing poor" and that the institution of homeownership has over the past few years become available only to the fortunate few. Those fortunate few include households who entered the market prior to the inflationary induced surge in housing prices and mortgage interest rates, and those families earning an annual income over $20,000. This of course excludes most low and middle income households, most minority households, and most young families.

Given this background it is useful to examine some specific measures of the cost problem in housing. They are summarized in table 1 which follows:

The highly inflationary environent of the past five years has of course had adverse effects on the entire economy. The housing sector, however, has been especially damaged by the inflationary forces. In particular the relative cost of homeownership has risen substantially since 1970. The cost of homeownership has risen at an annual rate of 8.3 percent compared to an overall rate of change in the CPI of 7.7 percent. The major elements of this relative price rise have been rapidly rising sales prices, rising mortgage interest rates, and rising utility and maintenance costs. In sharp contrast, however, the rental component of the CPI has risen at only 5 percent per year, or ⅔ the rate of change in the overall CPI. This somewhat surprising statistic implies that renters have experienced some relative gain in the past five years.

While the CPI index components give somewhat mixed evidence, the most visible indicator of housing costs, the sales prices of new and existing houses, provide a more pessimistic view of the cost problems. The sales price of a new home has risen at a rate of 9.4 percent, while an existing home has risen at a rate of 10.7 percent per year; both substantially higher than the overall rate of inflation. In the past twelve months sales prices have risen at a rate of between 10–12 percent nearly double the overall rate of inflation. These numbers have justly stirred concern in both government and industry circles.

TABLE 1.—HOUSING COSTS

	Homeownership component CPI (1)	Sales price of new home (2)	Sales price of existing home (3)	Effective mortgage interest rate (4)	Gas and electricity housing component CPI (5)	Downpayment requirement on new home (6)	Rent component CPI (7)	Overall CPI (8)
Year:								
1970	128.5	$28,900	$23,030	8.45	107.3	$8,178	110.1	116.3
1971	133.7	30,300	24,810	7.74	114.7	7,787	115.2	121.3
1972	140.1	32,200	26,710	7.60	120.5	7,470	119.2	125.3
1973	146.7	35,600	28,920	7.95	126.4	8,081	124.3	133.1
1974	163.2	38,900	32,040	8.02	145.8	9,413	130.6	147.7
1975	181.7	42,500	35,330	9.01	169.6	10,158	137.3	161.2
Annual rate of change (percent)	8.3	9.4	10.7	1.3	11.6	4.8	5	7.7

Source: Federal Reserve Bulletin, Federal Home Loan Bank Board Journal, Bureau of the Census (C–27), National Association of Realtors.

It is, however, important to view these numbers with caution for several reasons. First, they represent median figures for transactions and do not represent the change in costs for the same quality house. Standardizing for quality, we find the cost of a new house has risen only about 1 percent faster than the overall rate of inflation. Second, the cost numbers for the past year reflect the fact that the single family housing market has recovered from its recession. A comparison of today's prices with those of a year ago, is really a comparison of "depression" prices with those in a period of strong demand. Furthermore, the acceleration of prices while surely curtailing demand to some extent, will also have a somewhat positive impact on the supply of housing. This positive supply impact depends on the extent to which price increases represent improvements in the home builders profit margin, rather than merely increased costs associated with excessively stringent environmental factors, the spread of the no-growth philosophy, and increased land, labor, and material costs.

If one were to summarize the effects of these various factors, I would say that two-thirds of the relative price rise in single family homes is due to quality improvements, increased demand, and improvement in builder margins. Only about ⅓ of the increase is due to cost factors, which is equivalent to perhaps 2–3 percent of the sale price of a home ($1000–$2000).

In my mind, however, the major impact of the inflationary surge has not been on sales prices but rather on the interest rate on the mortgage loan. The mortgage interest rate is a function of the expected inflation rate and a real interest component. The high inflation rates of the past five years have raised the contract interest rate and so raised the monthly carrying costs of a conventional mortgage by nearly 20 percent. Compared with a 1–2 percent inflation world, the present monthly carrying costs of a conventional mortgage are nearly 50 percent higher than would be expected in a low inflation economy.

This inflationary impact is made especially severe by the traditional institutional mechanisms of the mortgage market. The institutional arrangements of the mortgage market were basically established for a low inflation world. As a result the the standard mortgage instrument is a level payment, amortized loan, which is not well adapted to an inflationary environment. It takes no account of inflation-induced rises in money income or inflation-induced increases in the underlying value of the property. Thus, from the borrower's viewpoint, the standard mortgage instrument completely ignores the positive inflation-induced dynamics of the housing market. However, the standard mortgage instrument does attempt to anticipate the negative influences of an inflationary environment on the particular contract. Through the calculation of the mortgage interest rate, (and so the household's monthly payments) the lender attempts to incorporate expectations of inflation over the life of the loan.

It is this situation which has created a dynamic mismatch between the cost of the mortgage loan to the borrower and the borrower's ability to pay. This dynamic mismatch, which only takes into account the negative impact of inflation, but ignores the positive impact of inflation on the borrower's income and property value, is the major element of the housing cost problem.

MULTI-FAMILY SECTOR

The multi-family sector has been the major factor in the fairly low level of housing starts reported in the past year. At present multi-family construction activity is still near its recession low, with starts at an annual rate of 320,000 units. This is far below previous peak levels and reflects a number of major structural problems in this sector. The multi-family sector is still faced by an inventory and overhang problem of undetermined proportions, a cost-price squeeze which makes new construction uneconomic in many areas, a major shift in demographic demand, and a reluctance of lenders to commit funds to this sector of the market.

The inventory problem in the multi-family sector was caused by the tremendous amount of overbuilding in the early 1970's. This inventory problem was especially severe in the condominium and vacation dwelling markets. While this problem is slowly being resolved, it continues to depress the market in key markets such as southern and central Florida. Nationwide figures on vacancy rates and on the market absorption of new units, indicate that the multi-family sector is now meeting demand with present activity levels. As the economy and so demand improves, vacancy rates will decline further and may put some moderate pressure on the multi-family sector in certain market areas. Widespread shortages are, however, not at all likely.

The major problem facing the multi-family market in most areas is not excess inventory, but rather the lack of strong demand for this type of unit. The severe economy-wide recession depressed demand in the very cyclically sensitive individual household groups. In addition, we are now in the middle of a major demographic shift in the economy which will lessen demand in this sector. The postwar baby boom of the late 1940's is now moving into the 25–40 age group, which traditionally demand single family units. Thus, the recent shift in composition of starts away from multi-family units is probably not temporary and represents the beginning of a long-term secular shift away from this sector.

In addition, the multi-family sector is faced by a severe cost price squeeze. Rents have risen far slower than the overall rate of inflation and construction costs. This is due to weak demand, overbuilding, and to rent controls which are imposed in some of our largest urban areas. In order to resolve this cost-price squeeze and encourage much new production rents would have to rise 10 percent in real terms. In the past year rents have risen only 5.8 percent. Unless demand pressure becomes substantial larger rent increases are unlikely. Thus, the multi-sector while showing moderate recovery is unlikely to advance rapidly in the present demand and cost environment.

HOUSING INDUSTRY OUTLOOK

With these two key factors, the cost of housing and the depressed multi-family sector in mind. we can now look at a specific housing market outlook.

First, turning to the mortgage supply, it appears that mortgages will be plentiful during most of 1977. The liquidity "crises" of the past will fast fade and thrift institutions will have a very adequate flow of funds and liquidity levels. This liquidity, along with a decline in the long-term bond rate due to a stabilization of inflation (4–6 percent), will push mortgage rates down to the 8–8½ percent contract rate range. I am assuming in this scenario that the Federal Reserve will follow a moderately easy monetary policy designed to keep the 91 day Treasury rate in the 5.8 percent to 6.3 percent range, with the rate averaging 6.1 percent for the year.

Second, in terms of consumer demand, there will be a continuing strengthening throughout the year. I expect 1977 to show continued good improvement in economic activity. The economic recovery is here, it will be solid, and it will be substantial. The year as a whole should show a 5–6 percent real growth rate, with the unemployment rate dropping below 7 percent by the end of 1977. This optimistic real growth forecast is dependent on the absence of any large inflationary shocks to the economy.

The major constraints to the housing recovery are the potential dampening impacts of cost increases, and the slow recovery of the multi-family sector. I expect housing prices in the next year to increase at a rate not much faster than the overall CPI. I expect the multi-sector to show a moderate recovery reflecting strength in certain geographic markets.

I have made a specific housing start forecast using several econometric models I have developed. The most likely output levels for 1977, are about 1.3 million single family units and about 400,000 multifamily units, for a total of about 1.7 million housing starts. This reflects gradually strengthening of activity throughout the year. Above average activity is expected in the West, South and Southwest. The Northeast will make only a very slow recovery.

In summary, you might characterize my 1977 outlook for housing and mortgage markets as mildly optimistic. It does appear that we will have a fairly solid housing recovery in 1976.

GOVERNMENT ACTIONS

Finally, I would like to outline ways in which the government could accelerate the housing recovery and improve the long-term outlook for housing.

First, in order to moderate cost increases in the single family sector an active effort should be made to discourage excessively stringent land use restrictions and slow growth ordinances which are proliferating on the state and local level. While these attempts to control the pace and nature of land development have merit, it must be recognized that they may be denying non-homeowners the opportunity to purchase a home at a decent cost. An equitable and efficient trade-off between these goals must clearly be sought.

Second, a real effort must be made to improve the opportunities for young households and low and moderate income families to purchase their own homes. This effort should involve a better matching of mortgage payments with incomes over time, possibly through some type of graduated payment mortgage. Second a mechanism for helping these families accumulate down payment requirements is also crucial. I would suggest that legislation similar to Senator Brooke's Young Family Housing Act would be most helpful.

Third, in order to stimulate the multi-family sector, rent controls should be actively discouraged. Rent controls are a most inefficient and inequitable subsidy. Instead, I would recommend a set of direct demand subsidies which would improve the buying power of low and moderate income households.

Finally, I think the most important effort that the Congress can make in improving the outlook for housing, is to design a set of programs and policies which will reduce the cyclical instability in the industry. This would involve a coordination of government mortgage programs, a reform of the financial structure, and greater use of counter-cyclical direct demand programs.

Only with an active, coordinated, and consistent set of policies and programs can the federal government contribute to the goal of a decent home in a suitable living environment at an affordable cost.

Mr. ROSEN. I have been asked to make some comments on Secretary Hills' statement. And maybe I will do that very briefly. I think that both concepts that were proposed, downpayments and a graduated payment mortgages, are theoretically correct. I think both suggestions would improve the outlook in the housing market in the long run. But I do have a severe reservation about the mechanism they are talking about in terms of implementing these programs. The Federal Housing Administration really severely limits the ability to affect very much of the housing market, even if they are talking about rasing the mortgage ceiling. I think there is a lot of institutional resistance because of redtape and a number of the negative experiences with the FHA during the 1960's by the people using FHA programs. I think you really eliminate any sort of potential for the program by using FHA.

I would suggest that if the administration is serious about these programs they should issue a directive, or at least ask the Federal Reserve Board to come out in support of a graduated payment mortgage instrument, because most loans are made in the conventional sector of the market by commercial banks and savings and loan associations. So if you are serious about it I think you really have to prod the markets, and not merely lead by example. I think you really want to use some more persuasive arguments.

Finally, I think that the program that is being talked about reducing the downpayment on FHA loans from 10 percent to 5 percent is really quite meager. I think you are hitting a very small segment of the market. And I don't think it is a desirable thing to do, as a matter of fact.

Mrs. Hills talks about eliminating the default risk. I think you are eliminating default risk to the lender but increasing it for the Government. I think every study has shown that when you move from a 10-percent minimum to a 5-percent payment you are increasing by three times the probability that the household is going to default on that loan. So you are making a much more risky loan. Instead I would really focus on stimulating the accumulation of savings that are needed for housing, either through an individual housing account or something like that. I think you really want to aim at the conventional sector of the market where the down payment is 23 to 25 percent. I think that is the segment of the market you have to aim at.

Also I think you have to recognize that anything you do to improve homeownership opportunities will decrease the viability of the multifamily sector of the market. There is basically a 1-to-1 substitution, or something like a 1-to-1 substitution effect. If you take one family out of the rental market and put him in the homeownership market there is going to be less housing activity in the rental market. And I think finally you clearly have to realize, that this program is not a program for low- and moderate-income households. You might have middle-income households, but low-income households are not going to participate in a program like this. And I think that there really has not been enough attention given to the problems of low-income households. We are trying to stimulate construction, but we are not aiming at that group which needs to be helped most. And I think there is room for more efforts in that area.

Thank you very much, Mr. Chairman.

Senator PROXMIRE. Unfortunately there is another roll call. But I will be back I hope in about 10 minutes.

[A 10-minute recess was taken.]

Senator PROXMIRE. Mr. Schechter, go right ahead, sir.

STATEMENT OF HENRY B. SCHECHTER, DIRECTOR OF URBAN AFFAIRS, AFL-CIO

Mr. SCHECHTER. I appreciate the opportunity to appear before this committee today to present the views of the AFL-CIO on the serious housing situation facing the Nation. In fact, after sitting here the last 2 hours I appreciate the opportunity even more.

I will probably depart from my paper to summarize.

Senator PROXMIRE. The entire prepared statement, including the excellent appendix, will be printed in full in the record.

Mr. SCHECHTER. Thank you. And as I go along I would like to introduce some new facts which might give us a somewhat different interpretation of history than Secretary Hills' interpretation.

As far as housing needs are concerned, I think there is a tendency to overlook how great they are, and from where they stem. The post-World War II baby boom was not only during the 1940's, and we are not over it. Actually it was between 1954 and 1964, with the peak year in 1957, when 4 million births came in each year. So we are now beginning the decade when we are pretty certain to have a net increase of about 1.5 million households per year. That happens to be about the middle projection of three made by the Census Bureau.

We also have at least 750,000 units a year lost from the supply, the last surveys of housing showed 790,000. That gets us up to a basic need of 2¼ million.

Chairman HUMPHREY. What was the latter category? I missed that.

Mr. SCHECHTER. The units that are lost from the supply each year from the catastrophe and old age.

In addition, there has to be an allowance for increase in vacancies as increased occupied units are provided, in order to allow for mobility and second homes which are absorbed from the supply and keep growing in number. With a historical factor of about 9 percent for all of those needs, we come to another 150,000. So the total needs are 2.4 million a year. And this is before making any allowance for any replacement of occupied substandard units, of which I estimate there are about 3½ million.

Even if we had 300,000 mobile homes a year to fulfill the housing needs, we would still need 2.1 million conventional homes. And I would submit that if we continue to underproduce relative to needs we will get additional inflation, housing prices will rise as we have seen in the last few years.

As a matter of fact, this is the third year in a row, that we have a deficiency of housing starts relative to needs. In 1974 it was 1.350 million. In 1975 it was 1.17 million. And this year we have between 1.4 and 1.5 million starts. The cumulative 3-year deficiency is about 2.3 million units.

Secretary Hills lays great stress upon using the existing supply, those leased through section 8 and otherwise, claiming this is more economical than new construction to house people. But this overlooks what is available to meet the needs. Against that 2.3 million deficiency of the last 3 years we now have available for sale or for rent about 2.2 million vacant housing units. They are not all in the right place or of the right size by any means. For example, one-third of the vacant single family units have either one or two bedrooms, one-half of the rental units have only zero or one bedroom. They apparently would not be available to house large families.

About 12 percent of the rental units and 4 percent of the sales units are lacking some or all plumbing.

The main point is, even if we overnight, by some magic, were able to rehabilitate every vacant unit—and we haven't even succeeded in rehabilitating a small part of them—we would still be faced with a serious shortage. And unless we can accelerate housing production, we will get the inflationary effects.

Now, Secretary Hills also mentioned the point that we might overbuild, and claims that we overbuilt in the early 1970's because the housing programs that were enacted in 1968 caused us to build so much. There is a lot of history which has been swept under the rug as to what happened in the early 1970's.

Those 400,000 and more housing units a year that were being produced as subsidized housing, as you know, were cut back drastically by the 1973 moratorium which was never completely lifted. What gave rise to that moratorium, in part, were the scandals which were attributed to the subsidized housing programs, although there were also abuses of the section 203 regulating FHA-insured housing program and the 221(d)(2) subsidized housing program.

We should relate to what happened, the fact that HUD was reorganized; and there were new area offices established, and they were staffed to some extent with political employees who did not have adequate experience. This was brought out a few years later by a report of the Civil Service Commission, condemning the setup in HUD with political clearance for many appointments, including some of its area directors.

Now, what happened, when some of these inexperienced people were placed in charge of offices; the fast buck artists began to commit fraud. And this was with a number of single-family home programs, not just section 235. And there was not enough experienced staff to stop it. We see the result in the Department of Justice record. Between fiscal 1971 and 1976 inclusive there were 1,316 indictments for housing fraud; 867 convictions have taken place. There were 202 dismissals. And at the end of fiscal 1976 there were some 247 cases still pending. I think those programs that were suspended and never fully reactivated cannot be judged without looking at that part of history.

Senator PROXMIRE. By that you mean the corrupt as well as incompetent administration of the programs?

Mr. SCHECHTER. Yes, Senator.

Senator PROXMIRE. That is to be blamed rather than the concept of the programs themselves or the legislation?

Mr. SCHECHTER. That is what I have in mind.

Now, as to what can be done in the way of Government initiatives to accelarate a more adequate housing recovery, I believe that the programs which are on the books can be used. No one knows better than you the resistance to the use of the public housing program to provide low-income housing where it is needed. Under the section 235 program which was reinstituted early this year there have been about 1,000 unit starts. And the section 8 program, in which great hope was placed to provide low-income housing, the number of starts to date is less than 15,000.

Now, I am not sure that with all the efforts that have been made—and I am sure Secretary Hills has been sincere in trying—I am not sure that the Department is functioning adequately now. There was a report by a consultant recently on the organization of the Department by the Coopers Lybrand accounting firm. It had been commissioned by HUD and they found great deficiencies in the matter of a lack of adequate data or data interpretation to know what was going on; a lack of uniformity in field offices as to interpretation of central office directions, a lack of clarity. I think the first priority would be an adequate staffing of HUD. And by adequate I mean not only in terms of numbers, but thoroughly trained people who could do the job.

There was also a good deal of talk about the great record of single-family housing production, the great lift, and this is attributed to the improving economy. Undoubtedly some of it is due to increase in income. But there was a very vital element in this so-called recovery, namely, how much of the homes were supported by 7½ percent mortgage financing under the tandem plan. For the fiscal year ending June 1976, there were 181,000 single-family home mortgages under the tandem plan delivered to GNMA. In the last few months since then, although unit figures are not available, based on the dollar figures, and using a reasonable average mortgage amount which was available through May, I believe that in August, for example, there were over 17,000 tandem plan home mortgages delivered to GNMA.

Now, the tandem plan commitments available for single-family home financing are running out. What remain available as of the end of August is enough, probably, to support about an additional 30,000 units. So I don't think the single-family sector is as strong on a pure market basis as some believe. Furthermore, I think it should be much stronger.

Senator PROXMIRE. May I interrupt there. We have just had hearings on the tandem plan. We concluded yesterday. And the argument was that it was admitted that it was attempted to be administered as a countercyclical program, they were borrowing from the future.

In other words, the starts they had been getting are starts we will not get down the pike in a few months. Wouldn't that indicate too that as this money runs out, say, with only 30,000 starts remaining, you are also going to get some adverse effect from the fact that you had used starts that you had gotten perhaps in the future?

Mr. SCHECHTER. I can't really agree with that, given the need we have, and the facts that are there are tremendous pressures, and the fact that it was 7½ and 8 percent financing that really stimulated sales. There probably was some substitution, there were some people who probably could have bought homes at 9 percent interest rates——

Chairman HUMPHREY. Their figures were a little different. They gave figures of over 300,000 authority starts under the tandem plan. Maybe their period was different from ours. They said only 115,000 of these, I believe, were starts that otherwise wouldn't have been.

Mr. SCHECHTER. I think I am familiar with a little bit of that reasoning. Von Furstenburg was one of the first to testify, I believe. And he has made an analysis of the net effect of the tandem plan on consumer reactions. And it involves a rather tricky use of interest rate elasticity of demand for housing. And the only data we really have on that goes back for many years, when the interest rates were at a lower level. And there is quite a difference, I think, in effect—when there is an interest rate difference, let's say, between 5½ percent and 7½ percent verus 7½ and 9 percent. In other words, I think the effect will be much greater at the high-interest-rate ranges and I am not sure that studies using the old data would reflect differently.

Chairman HUMPHREY. I am going to have to go to another rollcall. I am awfully sorry.

[A short recess was taken.]

Senator PROXMIRE. Mr. Schechter, you go right ahead.

Mr. SCHECHTER. We are referring to the talk about single family home sales in terms of records, as though this were achieved under controlled conditions. But conditions have changed greatly. The demographic data indicate that between 1970 and 1974 the average annual increase in the number of households with heads aged 25 to 44 was 632,000. From 1974 to 1980 the projected comparable annual increase is about 870,000. Looking at those figures, and considering the fact that the number of single family units lost from the supply each year is in the neighborhood of 500,000, there is a good prospect that single family construction could be sustained at a level of perhaps 25 percent higher than the 1.1 to 1.2 million plateau that has prevailed thus far in 1976.

If the potential for increased home sales is to be released, however, it probably require increased Federal assistance for homeownership.

As you mentioned earlier, the Farmer's Home Administration has done a good job in this respect, and continues to. Now, one of the reasons they do it, I believe, is because they have about 1,700 offices around the country. The person obtaining a home loan goes into the farmer's home loan office. He sits at a desk and his budget is reviewed. It is not somebody anxious to sell a home who is going to approve that loan, it is somebody who is really concerned as to whether the home can be paid for. And I sometimes think it will be desirable if somehow we could combine the Farmer's Home Administration and the HUD–FHA system and use the Farmer's Home Administration facilities to make Government loans that way.

In the rental area, the demand is strongest at the low run level. But we are getting almost no unsubsidized units being produced there because of the high cost of land and construction and the high mortgage interest rates.

The availability of tandem plan 7½ percent money for rental housing will undoubtedly help, particularly in getting the section 8 program underway in a respectable manner. I believe a large part of the

$7\frac{1}{2}$ tandem plan money for rental housing will be used to support the section 8 program.

Incidentally, on the reservations that have been made, particularly on starts thus far, I suspect that a good many of the old 236 properties, which were in the pipeline, were converted to section 8, as probably are some of the earlier starts, because that was one way the sponsor could move ahead.

Now, on public housing, the funds that have been appropriated for fiscal 1977 would support about 12,000 rural housing units, and Indian reservation area housing units, and that would take about $35 million in contract authority. An additional 8 million, I understand, is to be used for amendments to contracts for older projects in the pipeline, which need increases because costs have gone up. That leaves about $42 million for 14,000 units of urban public housing. There are 10 large cities that could absorb—in fact there are six large cities that could absorb about 10,000 of those 14,000 units. And there are many areas where the use of public housing would be the one way in which low-income rental housing could be provided quickly. And it is needed.

I would hope that Congress deem it desirable to authorize more funds for public housing, and we will have an administration that will be willing to use them.

One word about the question of the longer range cyclical problem and the relationship between housing and inflation. As long as we continue to rely on general monetary policy as a tool to counterinflation, we will repeat the housing cycles we have gone through. Market forces will be reinforced by tight general monetary policy and high interest rates. And we will again get the very sharp declines in housing which is most sensitive to high interest rates.

I would recommend serious consideration of having the Credit Control Act of 1969 implemented, to have selective credit regulation when the economy overheats, so that we might be able to counter inflation while we keep interest rates low, instead of depending upon high interest rates as the method of countering inflation.

I have looked at President Fords' housing proposals. And I agree with comments that have been made, that I don't think it would have much of an effect. At the moment, the maximum FHA mortgage to finance a single family home is $45,000. The total monthly payment on a $45,000 mortgage at the $8\frac{1}{2}$ percent interest at 30-year maturity is $341. Other housing expenses, including insurance, taxes, utilities, maintenance and repair, would bring total housing expenses to about $500 a month. It is doubtful whether the families which can meet such monthly payments are deterred from purchasing a $50,000 home because the downpayment is $4,750 instead of $2,000. If the downpayment were reduced and the mortgage amount increased by $2,750, it would increase the required monthly payment by about $20. On a $35,000 loan the required downpayment presently is only $1,750 on an FHA basis. Total monthly housing expenses are over $400 a month, and the reduction of the down payment by $500 as proposed would have very little impact upon the capability of a prospective purchaser to buy a home.

Under the President's proposal, the maximum FHA insured mortgage amount would be increased from $45,000 to $60,000. With the proposed reduced payment it would be possible to buy the $60,000 home with only a $2,500 downpayment, leaving a $57,500 mortgage. With the same terms mentioned previously, the monthly payments for principal and interest would be $438. The total housing expenses would most likely be $600 per month, requiring an annual income of $28,000 at a 25-percent housing expense-to-income ratio, or $36,000 at a 20-percent ratio, which would be more common at that income rate. Only families in the top 5- to 10-percent of the income range can afford such homes. And the great majority of them are well housed, with mortgage loans bearing much lower than current rates. The increases in insured mortgage loans might help a handful of affluent families buying homes.

The graduated payment plan, in the second proposal, would have a moderate decrease in mortgage payments in the initial years, and higher payments in later years.

One of the objections I have to any graduated payment plan is, we build more inflation into the economy. One of the reasons we have two-thirds, almost two-thirds of the families in this country as homeowners is because the working man with a moderate income was able to buy a home with fixed payments. And a great many of them lived in it until they had paid off the mortgage. They don't have an increase in payments, they can take care of the home. At an older age they are in a better position, and they don't need assistance, or assisted housing for the elderly, whereas a graduated payment plan does put more burden upon the homeowner as he goes along in life. And not only that, but he is going to end up paying more interest in the long run.

Under the plan, as given by HUD, with a 3-percent per year payment increase, if somebody lives in the home for 30 years and pays off the mortgage, it will cost him $6,000 more than if he had a fixed payment of an 8-percent mortgage. This is with a $35,000 mortgage. Also with a $35,000 mortgage, by about the fourth year the outstanding mortgage loan amount would be about 2 percent more than the original mortgage amount. If that person has to move and sell his home he would also have to pay a 7-percent real estate commission. And there might be other expenses such as points to finance the home that is being sold, and the owner therefore would have to sell the home for roughly 10 percent more than he paid for it a few years ago.

Now, if we want to bet on continuing inflation, which is what the President may be doing when he proposes this plan, then perhaps this is all right. But I hate to think of making policy on the basis of continuing inflation in the economy.

Furthermore, as Mr. Rosen indicated before, even under inflation the average income is likely to increase. But of course the average is just a measure of a central tendency of a statistical series. And we have many people on both sides. There are many people whose income will not increase. And there are some people who may find themselves unemployed as their housing expenses are rising.

So that it does become a rather risky program to adopt.

I would also like to mention, getting back to one of Secretary Hills' statements before, she looked upon a strong home sales market as a reflection on the fact that the median income has kept pace with the median sales price. But actually, as the HUD people and FHA know, when they underwrite a mortgage they don't look only at the sale price, they look at the total housing expense that a homeowner has to meet, including the interest payments, taxes, insurance, fuel. About 1965 or earlier FHA pretty well kept the median housing expense-to-income ratio to 25 percent or less. In recent years it has been 29 and 30 percent. So the homeowner's capability to meet his housing expenses has not kept pace with those housing expenses.

Thank you.

[The prepared statement of Mr. Schechter follows:]

Prepared Statement of Henry B. Schechter

I appreciate the opportunity to appear before this Committee today to present the views of the AFL–CIO on the serious housing situation facing the nation. The Executive Council of the AFL–CIO has repeatedly called for Federal assistance to spur the construction of needed housing and thereby reduce unemployment. As we all know only too well, housing production continues to fall far short of the minimum annual housing requirements; and there are growing shortages of standard housing affordable to low- and middle-income people, the so-called housing recovery—particularly with respect to multifamily production—has gone flat and housing costs continue their inflationary rise. It is extremely timely for this Committee to be conducting these hearings on the status of the housing industry and searching for effective initiatives to further stimulate the recovery.

I plan to discuss the rapid rise in housing costs; the continued national underproduction of housing units relative to need, particularly with respect to low- and moderate-income housing; and the need to accelerate utilization of existing programs and to develop new initiatives.

Before beginning my discussion of these matters, I would like to take time to briefly mention a dangerous socio-economic condition created by high concentrations of unemployed persons, which bears upon possible solutions to inadequate housing conditions in older central cities. In recent weeks, numerous occurrences of vandalism and violence by bands of youth in Detroit and New York have assumed mini-riot proportions. Such incidents, which serve as grave reminders of the full-fledged riots of the sixties, have serious repercussions. They create an urban environment which decreases the desirability for residence in such areas, or the likelihood of revitalizing them through rehabilitation and occupancy of existing vacant units. This environment exacerbates the net out-migration from the older cities and decreases their economic base and fiscal capacity. Any consideration of future housing policy and programs for older central cities will need to address the high unemployment problem if the housing program in those areas is to be successful.

A HISTORICAL PERSPECTIVE

What has been the pattern of housing construction activity and housing costs over the last twenty years?

Residential construction has been subject to sharp fluctuations five times during the past twenty years. Instability in housing construction induces instability and inefficiency in the general economy. Although residential construction has accounted for only between 3 and 6 percent of GNP during the past two decades, when it declines significantly (e.g., about 25 percent from 1973 to 1975), it sets the stage for a general economic recession. (See Appendix A). Housing starts, which fluctuate more sharply than the spaced out expenditures, declined more than 50 percent between 1972 and 1975.

The pattern of cyclical fluctuations in residential construction is related to the high sensitivity of housing to the level of interest rates. Each of the housing construction declines started during or following a period of general economic expansion, when credit became relatively tight and interest rates rose markedly. The situation was further aggravated by the Federal Reserve Board's use of tight monetary poilcy which reinforced the pressures for high interest rates.

The AFL–CIO has advocated the use of selective credit regulation to combat an overheating economy. Such regulation, which is authorized under the Credit Control Act of 1969, could be used to restrict credit for expansion of activities for lower social priority goods and services, and leave more available for housing at lower interest rates.

During tight money periods, there are marked downturns in housing construction, and unemployment in construction reaches high levels. During 1975, construction unemployment averaged 18 percent with 600,000 fewer workers employed in contract construction than in 1973. In August (1976), construction unemployment remained at 17 percent—over twice as high as the unemployment rate for the overall economy. There is also unused capacity and high unemployment in industries that extract, manufacture and distribute materials, structural components and mechanical equipment that go into housing. There can be little doubt that the depression in residential construction is a significant factor in the high level of overall unemployment and retarded growth of the economy.

THE COST OF HOUSING AND THE IMPACT OF HIGH INTEREST RATES

In fact, periodic sharp declines in housing construction have contributed to subsequent recessions, and huge losses in national product and income, as a result of money market forces and monetary policy. As the money market operates, those who are willing and able to pay higher interest rates, which can then be passed on to the consumer, are in a better position than home mortgage borrowers in the competition for funds. When the economy is operating at a high level and loanable funds become relatively scarce, interest rates rise. In such periods, funds have flowed more heavily to non-housing uses. Buyers of non-housing goods and services are more willing and able to pay higher interest rates in the price of goods or services than residential homebuyers or renters (who pay the interest in their rent). On a $35,000 mortgage, each 1 percentage point rise in the mortgage interest rate represents an increase of $24 in monthly payments. This increased cost burden can eliminate many prospective homebuyers from the market. Those least able to pay, low- and moderate-income families, suffer the most during tight money, high interest rate periods.

During such periods, thrift institutions suffer savings withdrawals in a magnitude which theatens their survival. As mortgage loan investors, they are not in a position to pay competitively high interest rates for savings which other lenders, who make other types of short-term loans, can pay. As a result, the volume of household investment in savings accounts declines significantly and thereby reduces the availability of mortgage funds for potential homebuyers.

Furthermore, as mortgage funds become scarce, lenders require larger down payments and become more selective regarding the credit-worthiness of borrowers and the quality of properties. After the economy subsequently goes through a recession, more funds become available and borrower and property qualifications are relaxed by the borrowers generally have adjusted to the prevailing interest rates. From mid-1973 to mid-1975, mortgage interest rates rose from about 7¾ percent to about 9¼ percent, and they are still at about a 9 percent level today. Since savings and loan associations now have an average cost of money of close to 6½ percent, and they also must cover expenses and reserves for losses, it is unlikely that mortgage rates would come down by more than an additional 1 percentage point.

The effect on housing costs to the consumer from a minimal reduction in the interest rate would be favorable. Under housing supply conditions, however, it would be far outweighed by inflation in housing prices aggravated by growing local shortages, and rising utility costs and taxes. As of July (1976), the median sales price of a new home had increased 83 percent since 1968. Even more shocking is the fact that over the same eight year period, there has been a 94 percent increase in the median sales price of an existing home. The following figures provide another index of the erosion of available moderately priced housing: in 1968, 29 percent of new homes sold cost less than $20,000; in the first six months of 1976, only 4 percent of new homes sold for less than $25,000 (no data available for less than $20,000 because the number was so insignificant). In 1968, only 9 percent of new homes sold cost more than $40,000 compared to 60 percent in the first six months of 1976. Thus, there has been a heavy demand for mortgage money to buy existing homes which generally cost less than new ones, despite their inflationary price increase. Renters also have been paying more and more for their housing, reflecting rising operating expenses, as well as the effects of the shortage. Since July 1968 (according to the Consumer Price Index), rents have increased approximately 42 percent or 5.2 percent per year.

In 1974, 40 percent of all renters were paying more than 25 percent of their income for rent; and more than one million families were doubled up with another family.

COSTS OF HOME OWNERSHIP

Since the marketability of housing is dependent not only on the selling price of the house but also upon the complete cost of home ownership that the occupant must meet, it is necessary to look at the trends of the components that make up the selling price of the home, as well as at the trends in full home ownership costs which are related to the structural makeup of the house.

As shown by available data, for 1969 and 1974 (Appendix B), of the thirteen separate cost categories—six under Home Purchase Costs, alone—only five consumed a greater share of the total cost of home ownership in the fourth quarter of 1974 than they did in 1969. The share of total costs represented by mortgage interest costs, plus the constructon financing costs increased from 22 percent in 1969 to 24.3 percent in 1974.

The costs of repair and maintenance have been increasing at a faster rate than total costs, accounting for 17.6 percent of the total in 1969 and 18.3 percent in 1974. The share accounted for by heating fuel, gas and electricity rose from 15.7 to 17.5 percent. Labor costs represented only 4.6 percent of total homeownership costs in 1974 down from 5.4 percent in 1969.

PRODUCTION LEVELS AND BASIC HOUSING NEEDS

Private, non-subsidized production is not meeting housing needs. Inflation in housing prices and rent, and high unemployment in costruction are prevalent. In order to counteract these conditions, increased Federally-assisted housing production is necessary.

Annual housing needs (as defined in Appendix C) are estimated at 2.4 million units for the period 1975–1980. The components of this estimated need are as follows:

Annual housing needs, 1975–80

Annual increase in households	1,500,000
Replacement of losses from the supply	750,000
Additions for the vacancy "float" and absorption of units for seasonal and secondary homes	150,000
Total annual basic requirement	2,400,000
Less: mobile homes added	300,000
Total net regular unit additions needed	2,100,000

The above figures do not include replacement, through new construction and rehabilitation, of some 3.5 million occupied substandard units. Assuming it would be national housing policy to replace all occupied substandard units within a decade (as had been contemplated in the 1968 national housing goals), 350,000 units per year would be required for that purpose.

How have recent production levels compared to the estimated annual basic need of 2.1 million units? The 1973–1975 downturn in housing was the deepest and most prolonged since World War II. Total annual housing starts (public and private) dropped 51 percent from a high of 2.38 million in 1972 to only 1.17 million in 1975. It is estimated that only between 1.4 and 1.5 million units will be started in 1976. Thus, 1976—with a shortfall of about 650,000 units below needs, will mark the third consecutive year of production deficiency relative to needs. The deficiencies in 1974 and 1975 were about 750,000 and 900,000 respectively. The three year cumulative production deficiency is about 2.3 million, and this does not include replacement of occupied substandard units.

Housing construction starts in rental-type structures of five or more units has remained within an annual range of 200,000 to 300,000 units compared with a range of 800,000 to 900,000 in the years 1971 to 1973. Of total housing units started, the proportion attributable to multifamily starts has dropped significantly in the last two years. Between 1969 and 1973, between 38–39 percent of all units started were multifamily; in 1975, less than 18 percent were multifamily. As the data suggest, the greatest potential for increased production lies in the rental segment of the market.

The seasonally adjusted annual rate of new housing starts reached a trough during the first half of 1975 when it averaged 1,015,000. Then, in the second half of 1975, it averaged 1,312,000 and in the first eight months of this year the average was 1,430,000. The improvement was all in the 1- to 4-family home segment of the market, where the starts rate in recent months has equalled or exceeded that of the peak years of 1971–73. Significant further improvement is doubtful, however, since the total number of unsold homes rose from 374,000 in February to 414,000 in July representing over eight months of supply at the July sales rate.

There are currently about 2.2 million vacant units available for sale or for rent. However, a large proportion of the vacant units are not in habitable condition or of the right size in the right place to meet needs. Twelve percent of the vacant rental units and 4 percent of the vacant for sale units lack some or all plumbing facilities. About one-half of the vacant rental units have either no bedrooms or one bedroom, and about one-third of the single family units have only one or two bedrooms. Apparently many of the vacant units could not serve families with children.

As a practical matter, therefore, the effective vacancy rate to meet housing needs is significantly lower than published vacancy rates indicate. Even if all of the vacant units could overnight be brought into acceptable condition it would not provide sufficient housing of the right size and location. The useable vacancies are insufficient to compensate for the significant production deficiency of recent years, or to preclude the effects, which are becoming evident of inflation in the cost of housing as local housing shortages develop.

Due to the age compositions of the population and the housing stock, housing needs will be so great during the next ten years, that it will be necessary to conserve the existing stock as much as possible, and also to produce new housing at a level about 50 percent above the 1976 level, if extreme shortage and severe inflation in housing prices and rents are to be avoided.

GOVERNMENT INITIATIVES CAN ACCELERATE THE PACE OF THE HOUSING RECOVERY

Under the impetus of programs enacted in 1968, Federally-assisted housing production contributed significantly to the boom production years of the early seventies. The annual level of low- and moderate-income units started under Federally subsidized housing programs rose to 430,000 in 1970 and 1971. In January 1973, a moratorium on new approvals was instituted by the Nixon Administration, and total subsidized housing program starts declined to 181,000 in 1973 in 1973 and further plummeted to about 100,000 in 1975. Thus, when the private sector of residential construction was in its deepest recession, production under Federal programs was greatly cut back and then not effectively increased to permit the housing sector to act as a catalyst for the economy to recover fully from the recession. The net impact of changes in Federally-assisted housing production, therefore becomes critical, both from the viewpoint of ameliorating inflation in the housing sector and in order to create jobs to reduce unemployment.

Part of the problem in expanding subsidized production lies with the present organizational capacity and commitment at HUD. The programs exist at HUD which could be used as vehicles for increasing subsidized starts. However, the aftermath of the 1973 moratorium has been a negative attitude within HUD toward the older, established subsidy programs, while placing major emphasis upon trying to make the Section 8 housing assistance payment program work. This has resulted in an under-utilization of the available tools.

Demographic data indicate significant additional potential for new home sales. Between 1970 and 1974, the average annual increase in the number of households with heads aged 25–44 (age when most families consider purchasing a home) was 632,000. For 1974 to 1980, the projected comparable annual increase is around 870,000.

Looking at those figures and considering the fact that the number of single family units lost from the supply each year is in the neighborhood of 500,000, there is a good prospect that single family housing construction could be sustained at a level of perhaps 25 percent higher than the 1.1 to 1.2 million plateau that has prevailed thus far in 1976. If the potential for increased home sales is to be realized it will require increased Federal assistance for home ownership.

More of the potential for increased single-family homes sales can undoubtedly be realized through effective utilization of the revised Section 235 program for home ownership assistance, which makes mortgage loans available to purchasers of limited income at effective interest rates as low as 5 percent. About $250 million in Section 235 annual payments contract authority is available, enough to support about 250,000 home purchases. As of July 30, just over 1,000 units have been started. Under the Housing Authorization Act of 1976, the program was extended until September 1977 and mortgage amount and income limits were increased.

With implementation of these changes, the Section 235 program is likely to gain momentum, although its program activity level will probably remain well below its full potential. As a production vehicle, the original Section 235 program achieved a volume of over 100,000 units a year in 1970–1971. It would probably require a determined HUD processing effort in order that 50,000 units might be started during the remaining 12 months of authorized program life. The program level could probably be raised by about 20,000 units in fiscal 1977 through increased application processing capacity at HUD. If the program were extended, by fiscal 1978, a level of 100,000 starts could probably be achieved.

In recent years, when interest rates have risen and there has been a drastic shrinkage in market demand for housing, middle-income subsidy methods have been adopted. The most widely used device of this sort has been the "tandem plan" under which the Government National Mortgage Association (GNMA) makes commitments to purchase and later purchases home mortgages at below-market interest rates, then sells them to investors at a discount to provide lenders with a current market yield.

Such "tandem plan" financing for "nonsubsidized" housing had been initiated and maintained for a time in 1970, under the regular "special assistance" functions carried out by GNMA under Title III of the National Housing Act. The program was reactivated on a large scale in early 1974, and enlarged and extended to the present under the Brooke-Cranston Emergency Home Purchase Assistance Act.

During the 12 months ending June 1976, GNMA purchased 181,000 tandem plan home mortgages. Outstanding commitments as of July 1 would produce only about 50,000 more purchases. The tandem plan program is a practical method, under present general monetary policies, of supporting housing construction. It undoubtedly helped in the limited housing recovery of 1976, but has not been effective in bringing housing construction back to a high level because it does not bring about a reduction in interest rates. In fact, high mortgage interest rates on loans from private sources were sustained because the mortgages were sold to lenders at a discount to provide market yields of about 9 percent. Consequently, most families seeking to purchase homes from sellers who cannot provide tandem plan mortgages are still faced with high mortgage interest rates on loans from private sources, and are squeezed out of the market.

During the same 12 month period there were 40,000 new homes, purchased with interest-credit loans made and insured by the Farmers Home Administration under its Section 502 program. The subsidy in rural home loans made by the Farmers Home Administration is similar to the Section 235 loans. The eligible buyer pays a low mortgage interest rate, related to the level of his income.

Inflation in housing costs has hit low- and moderate-income families the hardest. The thin supply and greater market strength at the lower end of the rent range is reflected in a recently released Census Bureau report on the market absorption of 216,000 unfurnished new rental units completed during 1975 in privately financed, non-subsidized buildings of 5 or more units. The percentage distribution of the newly completed rental units, and the percentage within each rental class that was rented within three months after completion was as follows:

Rent class	Percent of total	Percentage within each class rented in 3 months
Less than $125	1	86
$125 to $149	6	80
$150 to $174	16	77
$175 to $199	21	74
$200 to $249	28	73
$250 or more	28	58
Total	100	70

Where the demand is strongest, at the low-rent level, almost no unsubsidized units are being produced, because of high costs of land and construction and high mortgage interest rates. At the upper rent levels, the market is thinner and rentals more difficult, detering a marked acceleration of new rental housing construction.

HUD counted mainly on the Section 8 housing assistance payments program, enacted in August 1974, to meet low- and moderate-income rental needs. The Section 8 program is authorized under the same basic legislation as the public housing program. It provides, however, that contractual annual assistance payments would be made to private owners of housing units in which eligible low-income families would reside. Financing of new construction has to come either from private sources, almost invariably with FHA-insured mortgages, or from State housing finance agencies.

Private developer financing for new construction has been hard to obtain, because, in order for the mortgage to be FHA-insured, the project has to have demonstrated marketability on a non-subsidized basis. Also, the rents cannot exceed "fair market" rents established by HUD. There are between 30 and 40 State agencies, but only a few of them are actively engaged in program development and financing.

Although the Section 8 program was enacted in August 1974, as of July 30, 1976, only 12,430 new units had been started. There were an additional 151,000 unit fund reservations for new or substantially rehabilitated construction, which may be started over the next 12 to 30 months, or optimistically at a rate of 60,000 units per year. A larger part of program resources are being devoted to assistance for leasing of existing units.

Another subsidized rental housing program that is just getting underway is the revived Section 202 program of fully repayable direct loans for housing for the elderly and handicapped. Originally enacted in 1959, the Section 202 program was a small but highly successful program, producing about 43,000 units—with only one project failure—before being phased out by the Nixon Administration. The program was revived in the Housing and Community Development Act of 1974, with a mandatory tie-in to the Section 8 assistance payments program. The first fund reservations, based on preliminary project approvals of 136 projects with a total of 12,600 units, were made by HUD in May 1976; there had been 1,527 project loan applications. The Congress has since enacted a supplemental appropriation of $375 million of which $125 million has been used to place an additional 8,000 units under Section 202 fund reservations. These projects will still need to fulfill the Section 8 requirements. As of September 20, only three projects had received preliminary Section 8 approval. Thus, construction will probably not begin until 1977.

Conventional low-rent public housing is generally recognized as the one program that serves really low-income families. Enacted in 1937, it is the oldest subsidized housing program and provides low cost rental housing for about 1.2 million households. Tenants are required to pay between 15 and 25 percent of income as rent. In a few peak years, immediately prior to 1973, annual program levels ranged between 60,000 and 100,000 units started. However, this program has been a phase-out condition since January 1973, except for projects that were already in the processing pipeline. Thus, in 1975–76, the annual starts level has been at about 10,000 units.

In recently enacted authorizations and appropriations for fiscal year 1977, however, the following amounts in annual assistance payments contract authority were designated for new and substantially rehabilitated public housing:

	Authorization	Appropriation
Total	$117,000,000	$85,000,000
Indian housing	17,000,000	17,000,000
Rural housing	18,000,000	18,000,000
Other	82,000,000	50,000,000

The $35 million in available contract authority for Indian and rural housing will support construction of about 12,000 units. Based on past experience, they probably will not be started for about two years.

About $8 million of the remaining $50 million in available contract authority is to be used for contract amendments for projects with a total of some 21,000 units that have been in the processing pipeline for years. In the interim, increased construction costs have made increases necessary. About 10,000 of these units could be started in fiscal year 1977 and the balance in fiscal 1978.

Only $42 million would be available for about 14,000 units in urban areas. As many as 10,000 of the 14,000 units that can be funded for new urban projects could be started in fiscal year 1978 in large urban areas which have had projects planned and ready to go for years. In five eastern cities alone (Boston, New York, Newark, Baltimore and Miami) a total of 10,000 units could be started within 18 months. These and other large cities may be limited, however, in the amount of fund reservations that would be allocated to them under a statutory requirement that population as well as housing conditions must be considered in the allocation of available authority.

In summary, therefore, under authority presently released by appropriations, the fiscal 1976 level of about 10,000 public housing starts could be maintained in fiscal year 1977 and the level might be increased to 20,000 in fiscal 1978. To be able to provide additional low-income housing where public housing must be used, more contract authority would have to be made available.

The most immediate improvement in rental housing construction is likely to be production financed with 7½ percent mortgages provided through the Government National Mortgage Association (GNMA) tandem plan. Earlier this year $3 billion out of an appropriated $5 billion was made available for rental housing mortgage commitments. Due to apparently insurmountable difficulties in assuring cost and quality control, the funds were not made available for conventional financing, only for FHA-insured mortgage financing. By June 30, the $3 billion had been committed. With this financing, as a rough estimate, about 120,000 rental units could be started over the next twelve to thirty months, with perhaps 20,000 in fiscal year 1977 and 80,000 in fiscal year 1978. Recently (September 9) HUD announced the release of the remaining $2 billion to be used solely for multifamily financing. An unknown but significant proportion of the units to be financed with the tandem plan funds, perhaps 60 percent, will be used to finance projects also supported by Section 8 housing assistance payments.

RECOMMENDATIONS

Labor and capital resources are available to raise the annual production level from 1.4 to over 2 million units. For that reason, the options discussed below are designed to maintain a relatively stable, high level of housing construction, which would also contribute to high employment and stable economic growth.

The options presented below are not mutually exclusive. In fact, some combination of the proposed components probably would be necessary if a reasonable amount of decent housing is to be provided for low- and moderate-income families who otherwise could not afford to pay for it.

1. **Revitalize the Department of Housing and Urban Development by reestablishing a national commitment to meet housing needs, and by providing HUD with** an adequate staff in terms of numbers and quality of training to process a greater number of applications annually than has been projected on the basis of experience in recent years. It would then be possible to implement effectively the recommendations which follow.

2. Increase and accelerate existing subsidized housing programs.

(a) The Section 235 program should be extended, by legislation, for two more years, to September 1979. Present funds would support 250.000 units, but only an estimated 50,000 will be started in fiscal year 1977. With program momentum and increased processing capacity at HUD, it might be possible to accelerate starts in fiscal year 1977 and achieve much higher levels in fiscal years 1978 and 1979.

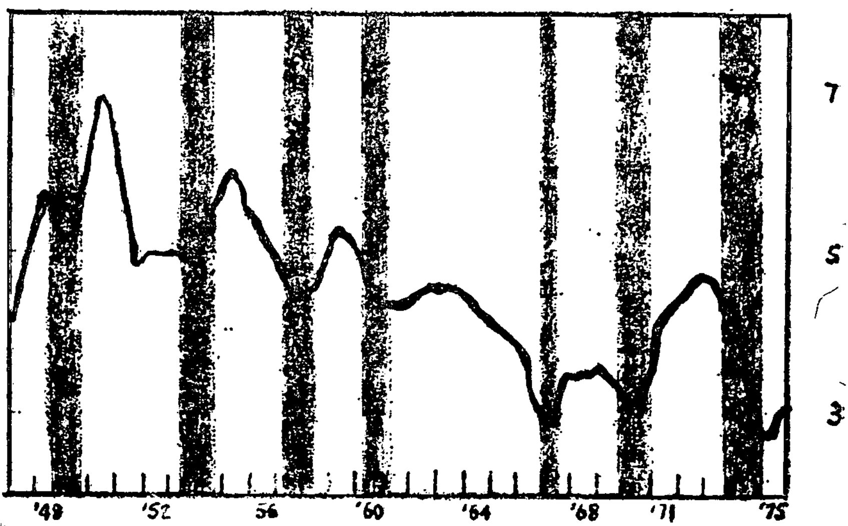
(b) Public housing payments contract authority which remains unappropriated ($32 million) should be released by Congressional appropriation action and contract authority should be authorized. In many cities, public housing will be the only means of providing needed low-income housing. The $42 million of annual contract payments authority available for urban projects that never were in the pipeline will support only about 14,000 units. This will not allow many of the more than 2,000 local authorities to make a dent in meeting their local housing needs.

(c) Appropriate and release $2 billion of the $5 billion in GNMA Tandem Plan funds already authorized by Congress, but not appropriated. These funds could be divided between multifamily and single family mortgages. If $1 billion were used for multifamily housing, it would support about 40,000 more units, which would probably all be started in fiscal year 1979. If the other $1 billion were used for single family mortgages, 30,000 units could be generated, most of which could be started in fiscal year 1977.

If all of the foregoing recommendations were adopted, the potential net increase in housing unit starts in fiscal year 1977 and 1978, above what would otherwise prevail, would be 50,000 units in fiscal year 1977; and 135,000 in fiscal year 1978. Assuming 1.2 man years of work per unit, these net added units in each of the next two years would provide the following additional construction jobs: 60,000 in fiscal year 1977 and 162,000 in fiscal year 1978. Given the August 1976 unemployment level of 782,000 construction workers, and little likelihood that more than a minor fraction might be absorbed as a result of improved market forces, the proposed recommendations would serve to alleviate the heavy unemployment burden borne by construction workers. The Bureau of Labor Statistics studies, from which the employment estimates are derived, indicate that almost an equal number of jobs would be created in building materials extraction, production and distribution. This would help to reduce unemployment in construction-related economic activities.

3. Selective credit regulation should be implemented to avoid a repetition of the sharp cyclical declines in housing construction when the economy overheats and a rise in interest rates is reinforced by tight general monetary policies. Restrictions on credit use for increased facilities to provide goods and services of low social priority, having relatively limited markets, would leave more funds at reasonable rates available for housing. The Credit Control Act of 1969 provides authority for such selective regulation.

APPENDIX A.—RESIDENTIAL CONSTRUCTION EXPENDITURES AS A PERCENTAGE OF GROSS NATIONAL PRODUCT, 1947–75*



*Three quarter moving average of seasonally adjusted data.

Note: Shading indicates periods of recession or economic weakness.

APPENDIX B

PERCENTAGE DISTRIBUTION OF COSTS OF HOMEOWNERSHIP, 1969 AND 1974

Cost item	Percentage distribution 1969	1974
Home purchase, total	31.7	28.5
Labor	5.4	4.6
Material	11.7	9.4
Land	7.0	6.0
Financing	2.2	2.8
Overhead and profit	4.1	3.4
Other cost	1.3	2.3
Mortgage interest	19.8	21.5
Property taxes	10.0	9.2
Property insurance	2.8	2.6
Maintenance and repairs	17.6	18.3
Fuel (heating)	3.4	5.0
Gas and electricity	12.3	12.5
Water and sewerage services	2.4	2.3
Total	100.0	100.0

Note.– Components may not add to 100 due to rounding.

Source: AFL–CIO, based on relative weights of the components of the cost of homeownership in the Department of Labor's Consumer Price Index, with the purchase price subcomponents distributed in accordance with annual data available from the National Association of Homebuilders.

Appendix C.—Estimate of Annual Housing Needs, 1975–80

This summary presents the major findings of an analysis of housing needs.

NET INCREASES IN HOUSEHOLDS

Three alternative projections of the number of households in the United States published by the Bureau of the Census in August 1975: high, medium and low. The medium series projects a total of 79.36 million households by 1980 and 87.19 million by 1985. The last Census Bureau estimate of the current number of households, as of July 1, 1975, was 71.66 million households. Based on the foregoing data, the average annual increase in households would be 1.54 million between 1975 and 1980, and 1.56 million between 1980 and 1985. For purposes of this analysis a rounded estimate of 1.5 million has been adopted.

REPLACEMENTS OF UNITS LOST FROM THE SUPPLY

According to the findings of the 1974 Annual Housing Survey, conducted by the Bureau of the Census, the average annual number of units lost from the housing supply was 690,000 during the first 3½ years of the seventies, compared with 571,000 annually during the sixties and 381,000 during the fifties. During the period October 1973 to October 1974, an additional 790,000 units were lost from the housing supply. In light of the upward trend and the continuing aging of a large number of units in the supply, average annual losses for the remaining years of the 1970's are estimated at 750,000.

SEASONAL AND OTHER VACANT UNITS

This component of housing requirements includes units that are vacant but held off the market for seasonal, vacation and other second home purposes, and units already rented or sold out but not yet occupied. It also includes vacant units for rent or for sale. Based on past experience, seasonal and other vacant units are conservatively estimated at 9 percent of the total supply. Thus, an equal proportion of units newly added to the housing stock would be absorbed for vacancy purposes. The net annual increase of occupied units, 1.5 million new households, represents 91 percent of the net increase in the total housing stock. Approximately 150,000 units would be required annually to fulfill the 9 percent annual vacancy requirement.

REPLACEMENT OF OCCUPIED SUBSTANDARD UNITS

In 1974, there were 2.3 million occupied units lacking some or all plumbing facilities. This represents 200,000 fewer occupied substandard units than in 1973. Therefore, it can be assumed that the number of substandard units has since been reduced by at least 300,000, leaving 2 million occupied units still lacking some or all plumbing facilities. Based on Components of Inventory Change data from the 1970 Census of Housing, it is estimated that there were an additional 1.5 million occupied units that had all plumbing facilities but were dilapidated. According to limited criteria of plumbing and dilapidation, without considering adequacy of heating or neighborhood conditions, there would be a total of 3.5 million occupied substandard units.

Senator PROXMIRE. Thank you very much, Mr. Schechter.

Mr. Rosen, you have been challenged now to some extent by the Secretary and I would like your response.

And I would like you, if you would, to indicate whether or not you think that your graduated payment proposal would be a countercyclical program in any significant sense, which seems to be what the administration is pushing for.

Mr. ROSEN. I think the graduated proposal—I think you are talking about the administration's graduated proposal?

Senator PROXMIRE. Either one. Yours is the one I am more familiar with, because you testified very ably before our Banking Committee.

Mr. ROSEN. I guess on the Brooke program, that equity adjusted mortgage, I think that would be countercyclical with respect to housing when inflation is right, which means that interest rates are low. So with respect to housing it is a countercyclical program. There are upsets because you cannot have countercyclicals with respect to the economy if you want to reduce inflation. But I think in respect to the housing market it is just what you want, reducing in instances an increasing demand when the housing market is down.

Senator PROXMIRE. How big would it be? The Secretary challenged it, pointing out that what we have got on the books that the President is supporting—it would only be a 1,000 units in the whole country, and she said 100,000, if they could remove the 1-percent limitation.

Mr. ROSEN. My intuitive feeling is that the program that is being proposed by the President is only in a small segment of the market, if you discount it 10 to 5 percent on a small amount of homes. You want to produce downpayments——

Senator PROXMIRE. I am talking about the graduated.

Mr. ROSEN. She was talking about the downpayments.

Senator PROXMIRE. She was talking about both—she was talking about downpayment when she talked about the $100,000.

Mr. ROSEN. It may have been the net effect. I think through FHA, you really can't expect—if you are lucky, maybe $20,000, if you remove that 10 percent from it.

Senator PROXMIRE. My question to her was directed at the assumption that the staff had made that this was only about 1,000 houses, a pilot program, that they wanted to take a look at.

Mr. ROSEN. Assuming you remove the pilot program status, I assume it would have some effect, and maybe in the first year on the order of $20,000 or something like that.

Senator PROXMIRE. In the first year, about $20,000.

Mr. ROSEN. You really can't tell, because it is only a small segment of the market, and it would be vital for FHA to move into an area that they haven't moved into.

Senator PROXMIRE. How do you meet the Secretary's argument that this is based on the assumption that you are going to have inflation?

Mr. ROSEN. The graduated payment program is, I think, not an assumption that you are going to have inflation, but it tries to offset the impact of inflation.

Senator PROXMIRE. Supposing we don't, suppose we achieve 2- or 3-percent inflation?

Mr. ROSEN. If you had that, it is fine. So you still have good payment income situation. What I think you should offer is that if inflation is down, the adjustment goes down, so you don't have that sort of program.

Senator PROXMIRE. What do you do by financing that program? Suppose someone comes in and wants to make lower payments in the first few years, because they are a family that thinks they are on their way up? The banker might not be willing to take it unless he gets some concession.

Mr. ROSEN. I think the banker might want to get a point more. But when he has a lot of money—and at the moment the banks are loaded and would like to make loans—I think you would find that he would be a problem. You think you have to realize, there is just an option—you are not saying you have to take this loan; it is just an option. And this instrument, I think, will only appeal to young families who cannot buy a house now. And Mr. Schechter mentioned what would happen if someone became unemployed. But the first 10 years under a graduated payment plan he is still paying less than on a standard payment. But he will be accumulating equity——

Senator PROXMIRE. Not as much equity, no.

Mr. ROSEN. True.

Senator PROXMIRE. How about the fact that he is paying $6,000 more interest on a modest home.

Mr. ROSEN. I have not calculated that, but that number sounds very high to me.

Senator PROXMIRE. He gave his assumptions very clearly.

Mr. ROSEN. It is $6,000 more interest?

Mr. SCHECHTER. The total payments will be $6,000 more. And therefore it has got to be interest, because it is the total payments minus the principal, the original principal. And I had the HUD figures. And I think the arithmetic is fairly simple.

Mr. ROSEN. To me it sounds quite high. I don't have the numbers, so I can't really respond carefully. But it means that you are going off to borrow an awful lot of extra money. It seems like a high number, but I don't have the figures to back it up. But it is easy to calculate if you have a mortgage table.

Mr. SCHECHTER. Under the HUD plan, you indicated that you owe more than the original amount for the first 9 years. So in the 10 years you will come back to it. And therefore 3 years, or 4 years, where your outstanding balance is at least 2 percent greater. So during all of those years, you are not even really meeting total interest payments, of course.

Mr. Rosen. True. But $6,000 extra sounds like a very large sum of money on the amount of the mortgage. I would think you would want to get a very careful assessment on that possibly from HUD. Because it is very easy to calculate from a mortgage payment.

Mr. Schechter. Let me say, the initial payments increased each year by 3 percent is what the payment would be for the first 10 years, multiplied by 12—maybe my figures are wrong. If you recall, they said the last 20 years it would be $300 a month. And you multiply that, and add the previous years' payments, and it comes out.

Mr. Rosen. That is not a fair assessment of the instrument, because if you are borrowing money you have to pay interest on the money you are borrowing. The extra amount would be somewhere around $15,000, and that assumes a 3- or 4-percent graduation.

Senator Proxmire. I thought that the big news today was that Carla Hills, Secretary of HUD, predicts that there will be housing starts this coming year, beginning in the middle of 1976 and ending in 1977, of 1.5 to 1.7 million.

Now, this is on the eve of the debate on economics between the President and his challenger. And it is 40 days before the election. And we are told from the one sector which I thought almost everybody agreed would be the most stimulative, potentially, at least, for the economy, you are not going to get any stimulation at all. Mr. Schechter, say we take a midpoint on that, say we have 1.6 million housing starts in this period between July 1976 and July 1977, would that constitute any significant stimulus to the economy? What would that do for unemployment?

Mr. Schechter. It would have very little impact on the present 17 percent unemployment rate among construction workers. And given the consideration that the construction supply industry makes to the overall economy, that is, the people who cut the wood in the forests, the people who make the refrigerators at the plants, and all up and down the line, they are a heavy component of the overall 7.9 percent unemployment rate as well as construction workers. And I think if we increase housing starts by another 5,000, the effect would be——

Senator Proxmire. Supposing they follow the Schechter recommendations, particularly that section 235 could be expanded by 203,000 units, and public housing and the use of the tandem plan—I think those are really rather modest proposals and conservative proposals—what effect would that have on housing starts?

Mr. Schechter. I think they would have perhaps 4 or 5 times the effect that Secretary Hills is foreseeing. In other words, instead of 50,000, we might be able to get up, say, by 200,000 units. And what we are then beginning to talk about is not a cure for unemployment, but at least we could create a few hundred thousand jobs.

Senator Proxmire. It would seem to me that with the enormous potential that you have talked about, with the fact that we have a deficit now for 3 consecutive years, with what you have talked about in family formations, the demographic figures, and so forth, the potential is far greater than that. I would think that we could put together easily a program that would provide another 500,000 starts with 1 million jobs, or even more than that, without moving into anything like what the Secretary warns us about of overbuilding.

Mr. Schechter. I agree with you. I think probably I have been conditioned too much by all the frustration that we have had in trying to get more housing under the subsidized programs. And so in a way the position is a pragmatic position. I would like to see us have a Congress that would approve and an administration to utilize a program of 500,000 subsidized units a year.

Senator Proxmire. Mr. Rosen.

Mr. Rosen. I guess I would like to express a couple of disagreements, unfortunately. First, on the unemployment question, in the construction industry. The high unemployment rate really has a lot to do with the nonresidential sector. The nonresidential sector is very depressed. As to how many starts can you reasonably expect next year based on demographics, I don't agree that there will be a large deficit. What happens is that households themselves are less likely to form during a recessionary period.

Senator Proxmire. I am not talking about based on demographics, they only indicate potential. You could have better demographics, and have fewer starts if your policies are bad with respect to interest rates and Government-assisted housing that makes it impossible for people who want a house to buy one.

Mr. Rosen. I agree. But we could not get 500,000 more housing starts without putting tremendous inflationary pressures on the economy.

You asked, what is the most housing starts that could be consistent with demographic needs?

Senator Proxmire. Where does the inflationary pressure come from? We are nowhere near the capacity operation in these areas that supply housing. We have 17 percent unemployment in housing. And there is no pressure on manpower, at least there doesn't seem to be any.

Mr. Rosen. I think the main area, for example, if you take the two major components, lumber prices and land prices—lumber prices have advanced sharply—they rose from approximately $120 to about $170. I think that this is a fairly substantial increase. And with land prices the pressures will occur. Also for single family starts, if we get them to the 1,300,000 or 1,400,000 level, that is really a very good level of housing starts. The problem in housing starts, the reason housing starts are low is the multifamily sector.

Senator Proxmire. Mr. Schechter.

Mr. Schechter. I would like to comment first on the unemployment. All our building trades people tell us that people who specialize in housing do have the highest unemployment rates. For example, carpenters around the country quote 40 percent, and so on. And they are primarily in light building construction and residential construction. As far as the lumber goes, in the first year of the Nixon administration there was a task force to reexamine the housing goals and see what constraints might be encountered in trying to meet the goals. And lumber was the big focus. And at that time it was concluded—and this was projected—it was concluded that until we hit about a 2,200,000 housing starts level, we really would not be creating lumber shortages for the economy as a whole, we might get some price increases, but the lumber would be there. And it was on that basis that the second annual report of national housing goals came to the Congress with a one page foreword from President Nixon in effect saying the housing goals could be accomplished.

Senator PROXMIRE. On that point, yesterday, I specifically requested the witnesses when we had our oversight hearings on the lumber prices, the homebuilders. They argued that they thought lumber prices might go up sharply. You have a very useful breakdown of the various costs that go into housing. You have materials, 11.7 percent of the total housing cost in 1969 and 19.4 percent in 1974. Supposing lumber costs rise—lumber costs I understand are about, what, 25 percent of your total material costs? Something like that, 30 percent, they are a high figure, the highest of any other figures.

Mr. SCHECHTER. They might be 25.

Senator PROXMIRE. I think they are 30 percent. If you double you would still get only about 3 percent increase in housing costs, is that right?

Mr. SCHECHTER. Yes.

Senator PROXMIRE. That is big, but it seems to me it is not so big as to be the kind of inflationary problem that would worry us.

Mr. SCHECHTER. The builders of course will stress that much more than I would, because they look at their selling price—I do think they should be looking at the total housing costs as indicated in this table. And if they did, lumber isn't that big a factor. In being able to sell a home, after all, they have to qualify the home buyer to be able to meet the total cost, it is not just the price of the house, although they do focus on the price of the house.

Senator PROXMIRE. Gentlemen, I want to thank you. The hour is late. You have been so patient and waited so long. Both of your statements are extremely useful. And I apologize for the fact that we weren't able to give you a hearing at which other Senators could have been here. But the problem on the floor of the Senate this morning with the number of procedural votes that were very important just made it impossible. You have been fine witnesses, and I am going to call this to the attention of the other members of the committee, because you have done a very good job. Thank you.

The committee will stand adjourned.

[Whereupon, at 1:20 p.m., the committee adjourned, subject to the call of the Chair.]

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