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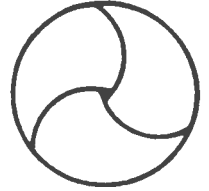
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Emerging Issues
in American Housing Policy

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Chapter 6

Emerging Issues in American Housing Policy

Roger Montgomery and Martin Gellen

FORCES AFFECTING HOUSING POLICY

In some sense every era is an age of transition. This is especially so in public policy because of the long lags that separate the appearance of new social forces and economic trends from their emergence as issues of policy. We are in the midst today of a transition between old policies shaped by past conditions and a new set of housing policies arising out of current forces in U.S. society. In this sense this chapter is not an exercise in crystal ball gazing. The shape of the transition is somewhat clear, and what follows examines some of its dimensions.

The Politics of Housing

In American academic circles housing policy typically denotes a style of rational, microeconomic analysis of alternative courses of government action (Aaron, 1972; Solomon, 1974; U.S. Dept. of HUD, 1974). This tendency should not obscure the fact that in most areas of public policy, ideology and interest politics often have a far greater impact on specific policy moves. Legislators holding critical positions in the distribution of power, the bureaucracy, and the regulatory agencies have become more or less the captives of the giant corporate suppliers. Housing, in this regard, offers a somewhat curious picture because the key lobbies do not represent highly concentrated industries. Rather, the fragmentation among housing suppliers supports a continuous debate over policy directions which in other sectors have already largely been determined. Housing policy often gives the appearance of an ongoing social dialogue. For

example, production policy assumes a continuing contest between those who favor an active role for government in setting targets, rationalizing supply factors (especially money), and using broad subsidies to bring the product within reach of mass demand, and those on the other side who favor a hands-off, minimum public intervention stance. The first group seeks to achieve high levels of production and believes the trickle-down and multiplier effects will take care of equity. The latter wants the best possible approximation of the classical marketplace; they tend to accept as inevitable certain market failures and seek to aid the unfortunate victims through a direct income strategy. The recent changes within the National Association of Home Builders (NAHB), a major lobby with extensive influence, illustrates perfectly this dichotomy in housing policy. When Nathaniel Rogg resigned as NAHB executive vice-president and took early retirement, a leading trade journal headlined the move "Staff Pilot Nat Rogg Leaving as Good Ship NAHB Swings to the Right" (*House and Home*, 1976a: 3). The balance of power in the NAHB now lies with conservative President Hart and his associates who are, according to *House and Home*: "little inclined to favor government programs as a way of life for the housing industry" (1976a:16).

Our two major political parties tend to reflect these positions. The Democrats generally advocate an activist role for government, while the Republicans seek to minimize regulation and omit direct financial aid. As the two parties alternate control of the presidency, the thrust of national housing policy fluctuates accordingly. Johnson's Great Society program set staggeringly high production targets and enacted a broad set of supply-side subsidies in order to attain them. The program was a brief success after a lag of several years. Ironically, success came only toward the end of Nixon's first term and lasted into the first year of his second term. That year marked a traumatic policy shift as Nixon extinguished overnight all the Great Society production subsidy programs in the "moratorium" of January 1973. Thereafter, the Republicans experimented with income supplements. In a small way, the Housing Act of 1974 contains the first steps toward this market approach to housing demand subsidies. Recent scholarly analyses have supported this shift in the orientation of national housing policy. Academics have argued that welfare economics generally confirms the demand-subsidy perspective and raises serious questions about the spillovers and unanticipated effects of the Keynesian Great Society production strategies.

In the next decade, however, housing policy will face a quite different range of difficulties. Primary among these are changes in the demographic structure of demand and housing price inflation. Judging from its previous policy preferences, the new national Democratic administration probably will be less wedded to a conservative microeconomic view of housing

policy. It is not clear, however, that the Carter administration and the Democratic majority in Congress will press for a return to the Great Society housing programs and the massive production subsidies that seemed so effective at an aggregate level in the early 1970s. Nor is it apparent what will become of the small beginnings of demand subsidies. In general, if inflation and this unique decade of housing-demand problems absorb the attention of policy-makers, we shall in all likelihood see the emergence of much broader ranging policies targeted at a much larger number of American households.

Demographic Changes Affecting Demand

Housing demand in the years to come will be shaped by two mutually reinforcing demographic factors. First, individuals born during the baby boom of the mid-1950s to mid-1960s, during which the birth rate averaged about 10 percent higher than during the immediate postwar period—are now arriving at the age of household formation. More of this new generation will choose to marry late, live alone, divorce early, and otherwise feed a sharp rise in the relative number of housing units the population will want to consume. Second, the number of elderly people, widows, widowers, and couples is growing both proportionately and in absolute numbers. Many of these older consumers will opt to live alone and thus add further to total housing demand relative to population.

These swelling extremities in the age pyramid are generating an effective demand because of increases in personal disposable income available to the young and elderly. As a result, per capita housing consumption among these age groups has increased relative to that of the rest of the population. Traditionally, at the beginning of the housing consumption life cycle, youth lived at home with their parents until marriage, perhaps even until the first children were born. Thus, prior to World War II, space consumption per capita was half of what it is now. Today young adults leave home and establish households much younger. The elderly and retired, instead of living with their children, live alone or in couples, supported by pensions, often occupying large family-size dwelling units.

At the same time, the increased labor force participation of women combined with a rising divorce rate produces an additional source of increase in per capita housing consumption. For example, during the past ten years women have entered the full-time labor force at unprecedented rates. As a consequence, the number of two-earner families in which both husband and wife work rose by 35 percent between 1966 and 1974. Even if the economy does not grow at a rapid pace in the future, there is little indication that these trends will be reversed (U.S. Dept. of HUD, 1976).

The behavior of local housing markets in recent years splendidly typifies these developments. In favored areas like San Francisco, the total

number of dwelling units has increased and vacancies declined while total population continues to drop or remain stagnant. At the national level, these trends in housing demand are reflected in U.S. Census projections of 1,550,000 new households annually between now and 1985. This represents a continuation of the present annual rate of 1,543,000 over the period 1970-75 and more than a 50 percent increase over an average annual rate of 937,000 during the 1960s. Combining the number of new households with locational shifts in demand due to migration to the Sunbelt, the traditional need to maintain a sufficient vacancy rate to lubricate markets, plus replacements for losses due to catastrophe, public works, conversions, and abandonment, several independent forecasts have estimated new housing demand at about 2.25 million units a year through the mid-1980s (Birch, 1973; Frieden, 1977; Schechter, 1976). Only briefly during the early 1970s have suppliers been able to produce new units at such a rate. It seems unlikely that these production records will be matched at any time in the near future. Price and resource constraints on money, land, and energy promise to prevent a substantial fraction of this demand from becoming realized. It seems reasonable to expect that effective demand will remain well below 2 million units annually.

The Impact of Housing Inflation

The era of the suburban housing bargain has passed. Gone is the decent, affordable, single-family, detached, suburban villa for the stably employed working and middle class. Beginning in the middle 1960s, housing prices relative to income began a steady rise. Nothing suggests that this trend has yet run its course. In fact, prices can be expected to continue to rise faster than income. In a recent discussion of the performance of dwelling prices relative to income, Urban Institute housing researcher deLeeuw and colleagues conclude that "nearly a decade of increasingly burdensome housing costs is in prospect" (1976: 139).

This price escalation has many sources. Direct construction costs have increased somewhat faster than the consumer price index since 1968, partly because of the rising cost of lumber and oil. Financing costs have escalated because of higher interest rates. Maintenance, energy, and other utility prices, as well as property taxes, have all climbed sharply as well. Of all the cost factors, however, land has exhibited the most meteoric rise. The most recent Federal Housing Administration (FHA) data show that land prices doubled between 1969 and 1972, a period when the consumer price index increased by about 25 percent.

While the mid-1970s slowdown in construction may have tempered the inflation of housing cost, three convergent institutional forces have pushed hard on urban-fringe land prices. First, for almost fifty years officials in suburban communities have been forcing developers to internalize in the

sale price some of the social costs of urbanization such as streets, utilities, parks, schools, etc. The recent fiscal problems of cities is lending added momentum to this trend. Municipal cost-revenue studies have shown that many of the conventional forms of residential development aggravate the fiscal crisis. Local governments have used such studies to coerce developers into absorbing even more infrastructure costs, especially school construction. Second, the environmental movement in its desperate quest for amenity rights has succeeded in halting development in many suburban communities, notably in Florida and California. This trend also shows no sign of abating. The third of these convergent pressures—exclusionary zoning—may, however, weaken substantially as a result of legal action by civil-rights groups and developers and requirements for community development funding set by Congress. Yet even if suburban zoning barriers are lowered, increases in permitted development densities will not necessarily result in lower land prices; rising demand and tightness in the land market would probably keep land prices up and shift to landowners much of the productivity benefits of increased density.

The Demand-Price Crunch

Taken together, these broad currents on the supply and demand sides of the American housing market promise to trap middle-class consumers and the industry in a terrific crunch. With potential demand at unprecedented high levels, income rising only modestly, additions to supply constrained and costly, these ripple effects will intensify inflationary pressures, reduce vacancy rates to minimal levels, contribute to instability in financial markets, and lead to new low dwelling production rates. Barring improbable changes in exogenous factors such as startling increases in productivity or GNP and thereby real income, millions of people, particularly the old and the young, will experience great difficulty in obtaining housing. Either they will be forced to pay a burdensome price or to cut back in their expectations. These people will not be poor in terms of their access to other consumer goods. Rather, they will be in the mainstream of society and thus quite different from ghetto residents whose unfulfilled demand represented such a serious social problem in the 1950s and 1960s. These newcomers to the ranks of the housing-deprived will better fit the mold of the "submerged middle class" of the Great Depression and the immediate post World War II period (Friedman, 1968: 20-21).

Over the next decade, the problem of ensuring adequate housing for middle-income Americans suffering from the demand-price crunch will loom as the central issue of U.S. housing policy. The government will undoubtedly attempt to subsidize demand and production, reduce housing costs through regulation, or some combination of these. Unfortunately,

years of effort at cost reduction have offered little promise. The Kaiser Committee study of production efficiency in housing concluded that, at most, monthly costs of a single family house could be reduced by 12 percent through a variety of reforms, including the introduction of more efficient methods and technology. However, the authors added the reservation that for each 1 percent increase in interest rates, monthly costs would go up by 5.3 percent; so that if interest rates rose from 6 to 9 percent (as they have since 1968), most of the cost savings due to these efficiency measures would be eaten up by higher financing charges (Burns and Mittlebach, 1968).

Inflation in combination with the demand factors mentioned earlier will, however, lead U.S. housing policy in three directions. First, both financial institutions and the government will attempt to restructure the mortgage contract and to alter the institutional arrangements in mortgage markets. Second, consumers and government will adopt a more positive attitude toward the existing housing stock as the demand-price crunch continues; for as the reproduction cost of housing increases, the stock of existing dwellings will become a more highly valued resource. Finally, at the local level, the mismatch between demand and supply promises to release strong drives for broader regulatory power such as rent control and institutional changes in landlord-tenant relations.

THE ELEMENTS OF HOUSING POLICY

The four most important variables in our national housing policy are the demand for housing, the supply of housing (in terms of both services and stock), the supply of credit (purchasing power), and taxation. The first two are largely exogenous variables. The U.S. government does not produce much housing nor does it directly generate much demand aside from the military. It does, however, regulate money and collect taxes, and these have been the key variables for national housing policy ever since the 1930s. Through monetary policy, credit regulation, and tax deductions the federal government attempts to manage aggregate housing demand and supply. It is unlikely that this general framework of policy will change in the near future.

Housing Finance

The supply-demand problem in housing credit policy has traditionally been viewed as a problem of stabilization, that is, managing interest rates and expansion of the money supply so as to provide adequate finance for housing purchase and construction. Since 1966 the federal government has relied on restrictive monetary policies to reduce the rate of inflation in the economy as a whole. This approach to controlling inflation has de-

stabilized the housing sector. Housing has borne the brunt of anti-inflation policies not simply because credit plays such a large role in housing purchase and construction, but also because the bulk of funds used to finance housing have come from short-term, highly liquid deposits of savings associations and banks. During periods of monetary restraint, upward swings in short-term rates interact with interest-rate ceilings (Regulation Q) to induce depositors to withdraw savings deposits for the purpose of investing directly in treasury notes, treasury bills, commercial paper, etc. Twice in the past seven years these wild fluctuations in the supply of credit have forced mortgage-lenders to ration credit, thereby reducing both the level of housing purchases and construction starts.

At the same time, lenders tied into fixed interest rates and expecting the purchasing power of their money to decline in the future because of inflation have added sizable inflation premiums to the interest rates they attach to new mortgages. These premiums interact with the rising sale price of both new and existing houses to generate extraordinarily large increases in monthly mortgage payments. This practice has produced distortions in the payment stream of the traditional fixed-level payment, fully amortizing mortgage. Inflation premiums tilt the time profile of monthly payments expressed in constant dollars upward in the early years and downward in the later years. Borrowers are thus forced to make considerably higher monthly payments in relation to income in the early years of the mortgage (Poole, 1972). The most severe impact falls first on owners, particularly young families who because of their growing numbers in the adult population constitute a growing proportion of today's mortgage demand (McElhone and Cassidy, 1974). Unable to meet high monthly costs, these borrowers have reduced their demand for housing in terms of quantity and quality or have simply foregone purchase until they accumulate enough savings to cover a larger down payment and thereby achieve a lower monthly payment. Both consumers and lenders believe some type of structural reform of the mortgage credit system is necessary in order to ensure an adequate supply of credit at suitable prices and to stabilize the supply of and the demand for housing at a level commensurate with the current rate of household formation.

One avenue of reform lies in the direction of altering the structure and regulatory environment of financial markets themselves. Conservatives, for example, believe that the removal of Regulation Q interest-rate ceilings on time deposits and savings accounts would solve the supply problem. In their opinion, Regulation Q represents an unnecessary bit of tampering with the market. Were interest rates allowed to find their "natural" level, adequate supplies of credit for housing would be forthcoming (Meltzer, 1970). The savings and loan associations, however, have opposed this type of measure for fear that in an unregulated savings

market commercial banks would easily outcompete them and reduce their market share. In order not to run the risk of further disrupting mortgage markets, Congress has supported the savings and loan's and refused to remove Regulation Q.

In terms of reforming financial markets, the most logical approach might be the development of a mortgage system based on the matching of the maturities of a lender's assets and liabilities. Under this approach, the vast bulk of housing credit would come from long-term liabilities such as mortgage bonds and pension funds. The Canadian mortgage system, for example, operates with such a matched maturities system and maximizes the supply of credit by utilizing roll-over mortgages. The latter have been widely used in Canada since the 1930s. In 1973 virtually all single-family residential mortgages were of the roll-over type. They were written with a twenty-, thirty-, or forty-year amortization rate but with a fixed interest rate for only a five-year term. When the term is renewed the interest and amortization rates can be renegotiated. The bulk of savings deposits in Canadian institutions are five-year certificates. Although inflation has affected housing costs in Canada over the past decade, the Canadian mortgage market, because of its matched maturity system, did not suffer the effects of credit rationing in 1970 and during 1973-74 which were so widespread in the U.S. (Lessard, 1975). Since it would require a vast institutional restructuring of financial markets with all sorts of unanticipated distributive effects, this approach has received little attention in the United States except as a means for expanding the financial base of the secondary mortgage markets (Ganis, 1974).

Both Congress and the mortgage-lending industry broadly support some type of reform of the mortgage contract as the main way to overcome inflationary distortions in mortgage markets. The fixed-level payment, fully amortizing mortgage was designed for an era subject to periodic declines in property values and income. If over the long term both income and property values are going to rise, however, and if the federal government is firmly committed to preventing the onset of a deflationary cycle, then the fixed-level payment, fully amortizing mortgage is clearly obsolete as a financial instrument for homeownership. A mortgage instrument adapted to an inflationary environment would require a mechanism for adjusting cash flow to fluctuations in money market rates so as to allow institutions to continue to depend on short-term liabilities. At the same time, it would have to adjust the payment burden in the early years of a mortgage so as to accommodate first-owners (Lessard and Modigliani, 1975).

The revised mortgage design favored by financial institutions is the variable rate mortgage (VRM). Under a VRM, the interest rate on the outstanding balance is allowed to move up or down in accordance with some agreed upon "reference rate." This may be a deposit rate or a

short-term money market rate. VRMs are being used extensively today in both New England and California. Approximately half of all new originations in California are VRMs (*Business Week*, 1976). The VRM, however, does not really alleviate the demand effects falling upon first-owners. California lenders, for example, charge a rather large inflation premium on VRMs so that they carry an interest rate at origination only .25 percent below that on fixed-rate mortgages.

Congress, on the other hand, favors the graduated payment mortgage (GPM). Under this design, the monthly payment is set initially at a low level with an imputed interest rate presumably below the market rate. The monthly payment is then adjusted upwards as the borrower's income rises over time. The rate of upward adjustment can be tailored to whatever rate at which the borrower's income can reasonably be expected to grow. Sweden has experimented with such a plan under a system called government parity mortgages. Despite implementation problems, it was relatively successful. Lending institutions in the United States object to GPMs because they reduce cash flow in the early years of the mortgage and probably exacerbate some of the supply-side effects mentioned above (Cohen and Lessard, 1975).

Given the shortcomings of both VRMs and GPMs, Congress and the mortgage-lending industry have come up with a compromise in the Young Families Housing Act (S 3692) sponsored by Senator Edward Brooke of Massachusetts. The bill proposed an equity adjusted mortgage (EAM) which combines a fixed interest rate for the borrower with a variable rate for the lender. The fixed rate would be set at 7 percent. The difference between that and the variable market rate would be covered by a loan from the Government National Mortgage Association (GNMA) for each year of the mortgage term that market rates exceed the contract rate. When the house is sold, the borrower would pay off the accumulated borrowings from GNMA out of the proceeds from the sale (U.S. Senate, 1976).

While this design is well suited to the needs of young middle-income borrowers as well as institutional lenders, it may bode ill for buyers of older central city housing. Under the EAM, the total indebtedness does not drop below the original loan amount until after some nine to ten years. The EAM design assumes that property values will increase at a rate equal to, or greater than, the difference between the borrower's subsidized interest rate and the lender's market rate—or at a minimum of about 3 percent per year. If property appreciates at a lower rate, the homeowner will be unable to pay off the GNMA loan with the proceeds of the sale. Since property values in large portions of the older central cities of the North Central and Northeast sections of the United States are rising slower than the national average (and even declining in some instances),

an EAM system may give lenders an added incentive to practice redlining in these cities.

Nevertheless, something like the EAM with increased use of mortgage insurance is probably in the cards for most homeowners over the next decade. Despite its previous resistance to VRMs, Congress recently gave the Federal Home Loan Bank Board (FHLBB) and the Alternative Mortgage Instruments Study Committee approval to evaluate all the above proposed mortgage designs and to determine which would work best. If the FHLBB can come up with a plan that satisfies both consumers and mortgage-lenders, Congress will probably pass legislation in 1978 directing FHA, VA, and all federally chartered financial institutions to adopt the new mortgage design.

Taxation Subsidies

Despite criticism that reformers have directed at "loopholes" in the federal income tax system during the past few years (Stern, 1972), the tax expenditure approach to subsidizing housing will probably endure and perhaps be expanded in several directions. The Tax Reform Act of 1976, for example, appears on the surface to be an attempt to pare down the widespread use of tax shelters. However, real estate has emerged relatively unscathed and as a result may well attract the bulk of funds that have been going into tax-sheltered investments over the past six years. This means a high demand by investors for residential income properties.

In addition, residential investment property will be favored over commercial and industrial real estate by the gradual phase out of the practice of reducing the recapture rate after a seven-year holding period. For low-income and moderate-income housing the phase out will not begin until 1982. This will give subsidized rental housing a slight edge over conventional rental projects for the next five years. Also, the five-year write-off for rehabilitation investment in low-income rental housing has been extended and refined (U.S. Congress, 1976).

The future will probably bring expanded income tax benefits for homeowners, especially if President Carter's upcoming tax reform program receives congressional approval. Proposed deductions will cover rehabilitation, improvements contributing to energy conservation, and special tax credits for first homeowners. State governments have themselves been moving in this direction through programs of property tax relief for the elderly and tax abatement for rehabilitation. The idea is not new. New York City has used the property tax system to subsidize housing for years. Today all fifty states have established some form of relief, and twenty-six provide special abatement programs (Aaron, 1973).

Generally speaking, property tax subsidy and relief schemes are designed to aid the middle class more than lower-income groups. In addi-

tion, the strong emphasis by state governments on relief for homeowners means that only a small proportion of these subsidies will find their way to renters. The use of the property tax system for subsidizing homeowner operating costs and rehabilitation will increase significantly over the next five or six years. Many states, especially in the Midwest, Far West, and South, periodically accumulate large surpluses in their treasuries, much of which can be used to finance tax relief. Because state governments cannot run deficits without engendering a legal and political crisis, this type of subsidy approach has distinct and relatively fixed limits as an escape valve for the high pressure of inflation unless property tax relief is federally financed.

Neighborhood Preservation

The contradiction between strong demand among middle-income households and the spiraling inflation that afflicts new construction has turned popular attention to preserving the existing stock of housing. Ever since the Eisenhower administration began to aim some of its housing efforts in that direction some twenty years ago, rehabilitation, code enforcement, and neighborhood betterment have played a minor but noticeable role in housing policy. Recently, under Nixon and Ford, a new rhetorical emphasis and locally determined portions of block-grant revenue sharing programs have added to these efforts. Now the market has joined in. Led by adventurous and youthful sectors of the middle class, buyers have begun searching in older areas for the housing bargains of the 1970s and 1980s. As a result, prices have risen swiftly in these areas. This illustrates the tight linkage between new construction and existing dwellings. The high price of new construction has rippled through the entire stock. Even in some of the most depressed inner city markets, islands of old houses located in defended neighborhoods have experienced substantial appreciation in value.

As middle-income demand shifts to housing bargains in older areas, a process begins for which the British have coined the work "gentrification": units filter up from lower to higher income occupants. Price increases reinforce the upward filtering of the stock. In terms of the model developed by Leven and his colleagues (1976), a *reverse* arbitrage takes place. From the standpoint of the physical condition of the stock, the shift produces a highly beneficial result. Increased income triggers a sequence that includes catching up on deferred maintenance, investment for rehabilitation and modernization, and upgrading of neighborhood facilities and services. Conversions occur, not to maintain rents in the face of poorer classes of tenants, but to respond to the demand of small middle-income households. Gentrification makes it possible to preserve neighborhoods that a few years ago would have been "urban renewed" or

abandoned. The irony of this is underscored in strong inner city markets like San Francisco, where a massively destructive urban renewal program limps along in the face of a buoyant market for old houses, particularly the "Victorians" that renewal action targeted.

Associated with gentrification is a powerful demand for antiredlining policies. Blessed for years by the FHA and regulatory authorities, banks, savings and loan associations, and other mortgage-lenders practiced redlining as a systematic way to avoid the high risk associated with low-income and changing neighborhoods. Attacks on this practice have become a popular cause in the mid-1970s. As the market picks up in older areas, these traditional discrimination practices come under fire. At the state and federal level disclosure legislation has forced certain classes of lenders to reveal the geographic patterns of their activities. This applies moral suasion directly to the lender and arms consumer activists with hard data on their practices. As more middle-income people join this consumer movement, pressure for change will build. Antiredlining activity will have the effect of bringing to the older standing stock and its new owners more of the package of housing finance aids that traditionally have supported middle-class demand in suburbia. This nicely illustrates another of the ironies of the present and near future: as trickle-down becomes trickle-up, downward filtration—the cornerstone of America's traditional low-income housing policy—comes to a halt.

Federal aid seems certain to flow toward neighborhood preservation in increasing amounts. Already localities have directed a significant portion of their Community Development Block Grant (CDBG) money (some 62 percent in fiscal year 1975) to housing and neighborhood preservation. Using CDBG funds, hundreds of cities and counties have gone into the housing finance business. Many more will follow, for the movement has just begun. Typically, a city forms a partnership arrangement with one or more local banks or savings and loan associations. The city deposits a substantial sum with the institution and this is leveraged into a much larger revolving loan pool. The deposit, and the interest it generates according to some locally agreed formula, is used to offset risk to the lender, reduce the effective interest rate to the borrower, provide for loan servicing and program administration, or some combination of these. Though the start-up has been slow and money scarce, these local programs look very promising in their broad outlines. In addition to CDBG dollars, some localities have financed their rehab programs from local taxes or general revenue sharing while others have floated tax-exempt revenue bonds for this purpose.

Neighborhood preservation has stimulated neighborhood organization. Today this is an active movement centered around the defense and de-

velopment of older urban areas and particularly focused on issues like redlining. In addition to relatively traditional activities such as lobbying city hall for improved services and putting the heat on recalcitrant neighbors about unmowed grass, the new generation of local organizations demands some real decentralization of power (Perlman, 1976). A few wield an effective veto over new development. Some seek historic district status with its attendant local control over practically every physical detail—and through such control exercise considerable influence over social and economic matters. Although formal public policies in the next decade may not actively encourage neighborhood organization among the middle class in a way that parallels the encouragement given the poor to organize in the 1960s, events promise to nurture them, and public policy must perforce take them into account.

Perhaps the most interesting aspect of all this activity, and the one that holds the greatest meaning for the future, is the degree to which it puts local government firmly in the business of housing and housing finance. General purpose governments and special districts have traditionally held entrepreneurial responsibility for important pieces of community development and neighborhood preservation, but not for housing. Basic services and facilities, parks and schools, main streets and trunk drainage, recreation, education, and public safety typically came from local government in neighborhood-sized chunks. What is new, and what promises to burgeon in the years to come, is direct intervention in housing finance and in relations among owners, tenants, landlords, and financial institutions.

Perhaps the best model of this new type of intervention appears in the quasi-public Neighborhood Housing Services (NHS) program that originated in Pittsburgh and spread experimentally to some twenty other cities under the aegis of the Federal Home Loan Bank Board (Ahlbrandt and Brophy, 1975). NHS offers an attractive interlocking of flexibility in finance, direct counseling to residents, and coordination of public services. Their experiments with rehab loan arrangements—especially nonamortizing, often zero interest rate, open-period loans that run as a lien on the property until paid off at sale—suggest the range of these approaches. Suppose all housing debt was carried this way: transferred at purchase to the new owner, with a nonmarket, income-related, monthly charge levied by the public-private housing "credit" institution. It is safe to say that this will not happen in the foreseeable future. But as the next decade unfolds, cities and counties may find themselves offering neighborhood housing and preservation services that could become as complex and fundamental to modern urban life as the services embodied in public education or public safety.

Local Housing Institutions

The recent growth of neighborhood preservation programs suggests that much of consequence in future housing policy will emerge in government and regulatory law at the local level. Traditionally speaking, most regulation in housing markets comes from state and local law. With the exception of zoning, local regulation has by and large remained passive. In the future, however, local and state governments are going to intervene more actively in housing markets through special finance agencies, strong efforts to preserve the standing stock, rent control, and eventually perhaps a restructuring of landlord-tenant relations. The design of such intervention raises critical policy issues.

Since the mid-1960s, state governments in different parts of the country have subsidized the financing, and in some cases actually sponsored the development of multiunit housing. This has been particularly true in highly urbanized states with large tenant populations and strong trade union movements where not only low-income but also middle-income rental housing is required in such large quantities that its provision must be specially encouraged and organized by government. New Jersey, New York, and Massachusetts are prime examples and Massachusetts, New Jersey, and Minnesota have developed Fair Share plans for the allocation of low-income subsidized housing which are supported by state housing finance agency (HFA) programs. In other places, HFAs are instrumental in financing rehabilitation of both rental and owner-occupied housing. In all, about thirty-two states now operate HFAs, although only fifteen have active development programs (Stegman, 1974; Betnun, et al., 1974). Many states are planning to expand these programs over the next decade.

Working at the same time, inflation in operating costs of rental housing and the spread of community organizing techniques have been responsible for growing interest in rent control and tenant unions: rent control movements have developed in California, Massachusetts, and New Jersey. Working from bases in university towns with tight housing markets, activists in California and Massachusetts have fought for rent control in local communities and made it an issue at the state legislative level. Massachusetts has passed enabling legislation empowering localities to control rents. The California legislature, on the other hand, approved law last year reserving these powers for the state, thus prohibiting localities from controlling rents. This legislation was initiated by powerful real estate lobbies in response to rent control initiatives in Berkeley and Davis. In a last-minute switch, Governor Brown vetoed the act. Should the law pass a second time, a veto may be politically impossible. In New Jersey the situation is more dramatic. Nearly 150 localities, primarily middle-income suburban communities, have instituted rent controls, and the state supreme court has repeatedly upheld their right to do so. Wash-

ington, D.C., Bangor, Maine, and a number of Connecticut localities also have rent regulation laws.

These developments on both coasts illustrate the remarkable degree to which the current crunch in housing costs has opened the possibility of local public regulation of the rental market on a scale never before seen in peacetime United States outside of New York City. Especially as middle-income tenants experience sizable annual rent increases, this type of market regulation gains enormously in political appeal. Unlike the rent controls of the World War II era, this "second generation" of rent control has received little federal encouragement. In fact, the Department of Housing and Urban Development has overridden local regulations covering federally subsidized projects and projects financed with federally guaranteed mortgages.

Other more daring forms of local regulation may also be in the offing. Tenant unions, for instance, have appeared only fitfully in the past. Now they may become more prevalent as the crunch deepens. If they proliferate, local or state governments may seek to establish and supervise—either formally or informally—collective bargaining relations between tenant and landlord. In the past, tenant unions were commonly found among lower-class renters, particularly where effective community organizers had been at work. In the years ahead, we may see instead the growth of coalitions of lower-class and middle-class tenants. Already intimations of this have appeared in the amazing neighborhood-based, multiclass tenant movement in Dallas, Texas. In a city with 60 percent of its population renters, the Dallas Tenants' Union has as its goal the establishment of a collective bargaining system for the Dallas rental housing market (Bois d'arc Patriots, 1977). The flowering of a large tenant movement may prove to be a long and slow process because of enormous political resistance to the idea on the part of landlords and banks; but the objective basis for it may develop swiftly if rents continue to rise faster than income and community organizing continues to spread throughout big cities in the United States.

These various trends in local housing market regulation will undoubtedly reinforce one another and may eventually lead to an elaboration of large organizations by the different factors in the market. We may, in fact, be witnessing the "cartelization" of the housing market as tenants, landlords, and lenders operate more and more through organized interest groups and associations. Perhaps the recent saga of the Coop City rent strike in New York foreshadows this type of evolution. Coop City's 50,000 residents live in 15,000 units laid out in an isolated, comprehensively planned development with nearly all urban services provided on the site. Many of the tenants are retired trade unionists with long experience in collective action. The strike was in effect a conflict between occupants

and lenders over the pass-through of large-risk and inflation premiums on a refinanced mortgage and of unanticipated increases in operating costs charged by suppliers of services. The state government, which had guaranteed the mortgage, finally stepped in to mediate the conflict after thirteen months and brought it to a resolution by refinancing the mortgage on terms more favorable to the tenants. This case illustrates how state or local government activities in subsidizing or encouraging the supply of certain types of housing or housing services can lay the groundwork for direct intervention in managing the housing stock.

Some observers have envisioned an even more futuristic restructuring of market organization. Gallagher (1976), for example, predicts that by the year 2000 individual homeowners, small landlords, and savings associations will have given way to huge management corporations, special corporations administering pension-fund investments in housing, and large government regulatory agencies set up to ensure the smooth operation of the local housing sector. The management corporations would act in concert with local government to provide profits to lenders (the pension funds) and service suppliers: stability, legitimacy, and power to government; and an affordable bundle of acceptable housing services to occupants. This scenario is no doubt a bit extreme. However, it does typify the degree to which the housing sector institutions in the United States are coming to resemble less and less those of the "free market" and more and more those of a highly cartelized and regulated industry.

STRATEGIES TO MEET HOUSING NEEDS

The overriding importance of the conflict between rising middle-income demand and price inflation has begun to redirect attention away from several other housing policy issues that were of much concern in the recent past. These issues, many of them key components of Great Society programs, include production targets, deep subsidies to the poor (as distinguished from shallower subsidies to middle-income households), technological solutions to high unit costs, new towns and the related idea of new towns in-town, and the concept of geographic dispersion of racial and lower-class minorities in order to achieve the ideal of a balanced community. Discussion continues to revolve around these issues, but with less sense of national urgency.

Production Policy

Since the 1930s Americans have shown enthusiasm for housing policies that emphasize high rates of new unit construction. Behind this lies the firm conviction that trickle-down is good and works. This means that new homes and new urban or suburban environments are, in Downs' word,

"inserted" at the top of the income spectrum. This, in turn, opens up a chain of vacancies permitting the rest of us to march through the housing stock, or "filter," in carefully ordered class and income-defined cohorts. Great Society housing policy adhered to this tradition. A series of well-known studies (U.S. National Advisory Commission, 1968; U.S. National Commission, 1969; U.S. President's Committee, 1969) has defined the policy problem as a shortage of standard quality units and, secondarily, as the inability of a poor minority to afford such standard units. Put another way, the problem was a supply that was inadequate to keep filtering going at a rate sufficiently high to satisfy all of the needs for shelter. Once quantified, the need figures became production targets: 26 million new or substantially rehabilitated units in ten years, 6 million of which would be subsidized so that they could be inserted at lower levels in the income spectrum (U.S. President's Committee, 1968).

The production targets were based on determinations of housing need. They combined generous projections of new household formation with estimates of the units needed to replace demolitions, conversion to other uses, catastrophic losses, and other diminutions in the housing stock. To arrive at the final need figure, the calculation added in arbitrary quantities representing a substantial increase in vacancies plus a sufficient number to replace all existing and projected-to-exist substandard and dilapidated units. Presumably these added quantities would allow new subsidized units—combined with the vigorous filtering triggered by massive, new, market-rate construction and lubricated by high vacancy rates—to rehouse all Americans in decent homes within the decade.

Congress embodied the targets in the Housing Act of 1968 and enacted a new set of supply-side subsidies to support new construction through the real estate and home building industries. Under these subsidy programs the federal government paid the difference between debt service at FHA market rates and a below-market rate that could go as low as 1 percent; the saving was passed on to the consumer. Over the next five years production rose dramatically, thanks in large part to these programs, and to the sharply increased delivery of mobile homes, a type of housing heretofore not included in national accounts. Though production in the five years between 1969 and 1973 fell short of the targets, it came close, 12 versus 13 million units.

Democrats and Great Society supporters have interpreted the target shortfall as an exacerbation of the housing problem. Not so, in fact. High production policies had worked so well that even before these programs had begun to take effect, substandardness and overcrowding had ceased to be the dominant housing problems they once were. Perversely, instead of solving a no longer critical old problem, the high production policy helped create new problems of neighborhood decline and price inflation.

By stimulating new home production at a rate substantially above the rate of household formation, the policy intensified filtering and suburbanization, thus destabilizing old neighborhoods and hastening their abandonment. By adding to the stock at the high end of the price continuum, and destroying units at the low end, it tended to shift upward prices of the standing stock. By maintaining market pressure on land and money resources the Great Society programs helped power inflation.

Policy analysts have defined a number of other flaws in what Solomon calls our "obsession with new construction" (1974: 7). Among these are the inherent problems of using new production to aid poor people. Efficiency considerations would suggest that such aid draw largely on the less expensive standing stock. Solomon's cost-effectiveness figures developed from data on Boston show that standard quality housing leased from the existing stock costs but 64 percent as much as newly constructed public housing units (1974: 184). At a constant level of expenditure the lease program would house nearly 60 percent more households. This last figure illustrates a strong equity argument against a high-production policy. Of course, American production policy has never intended to aid many poor people directly; it meant to help them indirectly through filtering. The perversities of this approach were dealt with above. Neither new low-rent construction nor trickle-down puts enough sound housing within reach of enough low-income households in stable neighborhoods with affordable maintenance and services.

Despite these counterarguments, the building industry and its allies will continue to advocate high production. Now, however, formal targets have all but disappeared in the split between the pro- and anti-federal interventionists. The new national policy emphasis on supporting middle-income demand will place an effective floor under production and thus deflect the conflict. In the years to come, demand changes coupled with the revived interest in old houses, a strengthening market in many metropolitan areas, and the two decades or more of heavy demolition behind us suggest that high production will have less destabilizing, abandonment-provoking effects than it has had in the recent past. In a perfect demonstration of the lag phenomenon so characteristic of public policy, now discredited production targets as such may reappear later in this decade. If that happens they will be resurrected ironically in close synchrony with a precipitous drop in household formation that can be predicted for the late 1980s from present declining birthrates.

Subsidies to House the Poor

Almost as a by-product of policies directed at maintaining high levels of economic activity and employment, the federal government has since the 1930s provided a small quantity of deep and expensive subsidies aimed at housing the urban poor. The great bulk of this effort has gone into

constructing low-rent public housing projects. After more than forty years of program activity, these units sheltered about 4 percent of the population with 1970 and 1972 incomes below \$6000 (Aaron, 1972: 115; U.S. Dept. of HUD, 1974: 128). Little has changed since. This program has been under almost continuous attack since its birth in the New Deal. During the intervening years it has been closed down repeatedly due to Supreme Court action, lapsed enabling legislation, congressional failure to appropriate authorized funds, and hostile policies like the Article 34 referendum requirement in the California State Constitution. Only a die-hard public housing management lobby with occasional help from big labor and big city mayors has kept it alive at all. Now even they seem to have failed the cause of low-rent public housing. In recent years the final blows have come from the same scholarly program evaluations that questioned production policy, the moratorium of 1973, and the dynamiting of the infamous Pruitt-Igoe project in St. Louis which provided the coup de grâce.

With low-rent public housing thoroughly discredited, and with the overshadowing policy issues generated by the effects of inflation on middle-income demand, perhaps the less said the better about the future of deep subsidies. Despite the fact that during his campaign President Carter took pains to inform the housing policy community that he once lived in a Plains, Georgia public housing project, there is little to suggest that the program will rise again. To some extent this embodies another of those familiar lag-generated ironies. In response to problems and criticisms, the Great Society programs included a critical and effective modification of public housing practice. Under the so-called Section 23 program, instead of constructing new projects, public housing funds could be used to lease units in the existing stock, paying market rents, but renting them to poor households at a deeply subsidized rate. In operation, Section 23 seems to have been as nearly perfect as a low-income housing program could be. Among its many demonstrated virtues were use of lower-cost existing units, impetus to rehabilitation, strengthening of weak markets, flexibility in time and location, invisibility and lack of stigma, public acceptance, and outreach to the old or infirm or other low-income people who need housing counseling and assistance. Whether it would continue to work so well in the tightening markets that lie ahead is open to question. In any case, its modest success lies buried under the wreckage of the conventional public housing program.

Out of this disenchantment a strong thrust has emerged to shift deep subsidies to the demand side of the market. Among the early advocates of this shift, sociologist Rainwater (1970), who studied daily life in Pruitt-Igoe, came to believe that only an income redistribution strategy could cope with the defects of the projects. Soon economists joined in. With the arrival of the 1973 moratorium, it seems fair to say that a preponderance

of analysts supported housing allowances or other demand-side policies. Based on this HUD undertook a number of social experiments designed to reveal the efficacy of the approach (RAND, 1977; Solomon and Fenton, 1974). So far, reported results are inconclusive. While people do use earmarked aid to improve their housing and to reduce its economic burden, the experiments indicate a substantial fraction of the aid can end up as inflated rent. As markets get tighter, it is safe to predict that rents will increase faster. Demand subsidies may not look as promising from the vantage point of the late 1970s as they did five or ten years ago. Also, from a political point of view, it is unlikely that an expensive, new program of income supplements or housing allowances for the poor will be enacted in a period when the middle class is experiencing such a crunch. Perhaps the decade to come will not see major efforts directed at housing the poor.

Technological Innovation

Most considerations of technological advances in housing have centered around new construction techniques that reduce costs. For years the vision of industrialized housing production captured the imagination of architects, materials suppliers, aerospace companies, and appliance manufacturers, who felt that with the aid of government-financed research and development programs such a new era of low-cost mass housing production might be within reach. Unfortunately, Operation Breakthrough became a breakdown. This experiment in technology-transfer exemplified what unions have always claimed: the high cost of new construction is the result of high land and financing charges. Labor costs and site construction methods themselves account for only a relatively small part of the inflation that has ravaged the housing sector over the past ten years.

However, technological innovation in housing has not become a dead issue. Its orientation will shift radically over the next decade. As utility costs continue to escalate, architects and engineers will introduce innovation in structural design and mechanical systems to make houses more efficient in their use of resources. In the case of heating, for example, estimates by the Federal Reserve Bank of San Francisco (1976) show that the cost of natural gas will rise from \$1.05 per cubic foot in 1975 to \$3.45 by 1985. California's situation is by no means atypical. Even now the extreme winter of 1977 has generated a great ground swell of support for deregulating interstate natural gas prices and letting them float upwards as an incentive for producers to develop new supplies. Solar heating and vastly improved insulation methods will mark the introduction of conservation-oriented technologies in housing.

A similar wave of innovation will also alter the design of plumbing systems if the water shortages predicted for the end of the century are realized. Although today it may appear bizarre to some, chemical toilets

and water recycling systems may be standard on new housing a quarter century from now. If constraints on the availability of natural resources are intensifying, as ecologists claim, so will the incentives for technological innovations which reduce household consumption of energy and water.

New Towns

No housing policy has been more tenaciously advocated by city planners and architects than new towns; many continue in their enthusiasm. Yet, after the fiasco of the Great Society era programs directed at stimulating construction of new towns, any early return to such a policy seems out of the question. At last report only three of the fifteen federally approved projects remained on the list; the others, having gone bankrupt, are now being liquidated by HUD. Of the three, only Woodland near Houston has shown any real economic vitality; HUD has kept the other two afloat for what appear to be primarily political reasons (*House and Home*, 1976b).

The much vaunted "new town in-town" program variant has met with even less success. On the surface it seems unlikely to revive. However, one rather remote constellation of factors may lead to a few cities flirting once again with the new town in-town idea. In those areas where enormous abandonment has occurred, where inner city property values have in fact depreciated to nearly zero, and where the city holds title to vast amounts of land, a modest, incrementally planned, comprehensive development could orchestrate a gradual awakening of market interest or public initiative. In more active markets the experience with Fort Lincoln, Cedar-Riverside, and Yerba Buena indicate that front-end costs are as prohibitive as those in true new towns. These same cases demonstrate that energetic resident defense of their home turf has also made the idea unworkable in inhabited neighborhoods (Derthick, 1972; Hartman, 1977).

In contrast, truly depressed areas like inner city St. Louis, Detroit, and Cleveland may possibly host large, comprehensively planned projects meriting the label "new town in-town." Such projects, perhaps on the order of New York's Coop City, may become feasible if the demand for central city locations revives—by no means an unrealistic prospect. In fact, it becomes more and more likely given the shift in cities to publicly supported corporate entrepreneurship, the effects of inflation on the middle-class, energy problems, the availability of vast areas well served by urban infrastructure, and the burning out of the abandonment process. Architects and planners may yet get another chance.

Dispersion

Housing policy, the balanced-community concept, and a concern with racism have had a long-standing association. Among the earliest federal policies related to these themes were FHA regulations designed to insure

homogeneous neighborhoods in race and class terms. Only recently have these objectives changed, at least in terms of official action. The principal thrust of these newer policies has been directed at dispersing housing opportunities for low-income and nonwhite people on a metropolitan-wide "fair-share" basis. Beginning with the Dayton Plan in 1970, recent successes of dispersion in the Minneapolis-St. Paul metropolitan area and in a few other places support modest hopes. However weak the federal administration of the dispersion provisions of the 1974 Housing and Community Development Act, the cumulative effect of it, the A-95 review, and the subsidization of metropolitan planning have generated quite a bit of momentum behind this thrust.

Much policy in this area is now being made in the court system as legislatures have evidently found race too tough a question for open action. This trend is likely to continue. It will grind painfully slow, especially since the U.S. Supreme Court has taken a hard line, acting only against overt racial discrimination and not admitting litigation on class and income discrimination. State courts, however, show much variation in outlook, and one, New Jersey, stands out for its activist position on class and race dispersion policy. Other state courts are likely to follow New Jersey's lead in mandating fair share allocations of low- and moderate-income housing to all comers. In California, for instance, groups seeking a Mt. Laurel type judgment have formed, and one has already scored a small initial success. The next decade should be an active one, though courts and litigating parties will make more policy than will legislatures and lobbies (Falk and Franklin, 1976; *House and Home*, 1977a).

The legal campaign for dispersion has already had a relatively significant impact in several states. In Massachusetts, for example, where an antisnob zoning law has been on the books for a number of years, the number of communities with 10 percent or more of their housing stock devoted to low-income subsidized units has doubled since 1973 (Altman, 1976). Yet it is not clear what the eventual social impact will be. Without redistribution, dispersion may only create minighettos scattered through broad suburban expanses of metropolitan America. As Harrison (1974) has argued, dispersion by itself does not improve minority welfare, but only redistributes low-income minority households geographically.

CONCLUSION

In the decade to come, more and more Americans, especially those just starting households, will find themselves unable to afford what they have come to define as a decent home and a suitable living environment. To some extent they will react individually and psychologically by redefining downward their own subjectively ordered housing standards. They will

also modify their preferences in the opposite direction in terms of their ideas about what is affordable. New Yorkers, for instance, have been conspicuously successful in doing both of these things for years. Some people will find traditional housing standards inappropriate as they opt for single, nonfamily life-styles or adopt resource-conserving ethics. For most people, however, the decade will witness a real contradiction between rising costs and restricted supply on one hand, and less swiftly rising incomes and competition for housing because of high household formation rates on the other.

To a great extent, the central questions for policy-makers will revolve around maintaining the effective demand of the great middle-class mass. These problems may prove to be so intractable that the traditional policy issues—substandard housing and provision for the poor—will fade into relative insignificance. From this vantage point, it looks as though the response of public policy to these new conditions will lead to a changed housing economy which looks less and less like the classical market and more and more like the state-managed housing economies of Western Europe.

While such a shift in policy orientation may emerge simply through drift, it is more likely that political clashes over extending government intervention in our housing market system may become almost as heated as those of the 1930s and the immediate postwar years. During the previous decade we have witnessed a continuing debate over the rationale for, and the forms of intervention in, housing, health care, and other services. In the housing policy area these debates are bound to intensify as the costs of housing market disequilibrium grow at a compound rate and the demands for intervention multiply. Ideological differences will also intensify, especially if property relations are altered by interventions such as rent control. Indeed, as local governments become more active in regulating housing markets, we may find that debates over policy which to date have been confined to small groups of academics, bureaucrats, and politicians that cluster around federal and state agencies will be extended to countless citizens who have an enduring stake in these issues.

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