Interagency 1968 Task Force on
Housing and Urban Development
(Wood, Chairman)

THE UNDER SECRETARY OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D. C. 20410

December 18, 1968

MEMORANDUM FOR: Members of the Housing and Urban Development Task Force

SUBJECT: Draft Report of the Task Force

Attached is a draft of the Report on the Housing and Urban Development Task Force. A summary of the major recommendations on the 5 sections of the report is now being prepared and will be submitted to you within a day or two.

As the members of the various working groups on the Task Force will recognize, their work product with only very minor editorial changes has been incorporated as part of the report of the Task Force.

Will you please submit your comments on the report to Mr. Irving Margulies, HUD, by the close of business on Friday, December 20. Draft language should accompany any requested changes in language.

Will you please indicate to me whether you believe that resolution of issues with respect to recommendations contained in the report will require a meeting of the members of the Task Force.

Robert C. Wood
Robert C. Wood

Attachment

cc: Under Secretary Robert C. Wood, HUD
Assistant Secretary Charles M. Haar, HUD
Assistant Secretary Stanley S. Surrey, Treasury
Warren Smith, Member, Council of Economic Advisers
Roger Noll
Peter A. Lewis, Assistant Director, Bureau of the Budget

Howard R. Moskof, Executive Director
President's Committee on Urban Housing
Lawrence E. Levinson, The White House Staff
Matthew Nimetz, The White House Staff
Henry B. Schechter, HUD
William B. Ross, HUD
Irving Margulies, HUD

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HOUSING

Part I - General Discussion and Recommendations

The Housing and Urban Development Act of 1968 reaffirmed the national housing goal -- "a decent home and a suitable living environment for every American family". It committed this Nation to the construction of 26 million housing units - 6 million of these for low and moderate income families -- over the next 10 years, and the elimination of substantially all substandard housing units within that time.

The primary concern of the Task Force has been to identify those factors and conditions which could prevent these housing production goals from being reached and to consider actions which might be taken to overcome these constraints, or make them less burdensome, and so permit the production goals to be achieved in the most efficient manner.

Meeting the production goals

It is clear to the Task Force that a number of variables will affect both our ability to achieve these ambitious production goals and the composition of the mix of publicly assisted and nonsubsidized housing units which will make up the total production. The critical interrelationships are:

(1) the effect of alternative income maintenance programs on the need for, size of, and total cost of housing subsidies;

(2) whether, over the next few years, there will be any substantial change in the cost of producing standard housing;

(3) whether, over the projected production period, personal incomes will rise faster than housing construction costs, and the effect

of the projected relationship between increases in personal income and housing construction costs on the total demand for nonsubsidized housing over this time period; and

(4) the extent to which the process by which the existing supply of housing is filtered to lower income groups will be affected by substantial changes in construction costs, levels of personal income, and the relationship between these two.

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At present levels of construction costs and family income, every $1,000 reduction in the cost of a dwelling unit makes it possible for about 900,000 additional families to meet (with 20-25 percent of their monthly income) the monthly payment necessary to carry the unit. Conversely, if the cost of producing the dwelling unit remains constant, small increases in the level of personal income adds substantially to the number of families who can meet (with 20-25 percent of their monthly income) the monthly payment necessary to carry the unit.

More concretely, a $24.85 monthly subsidy is necessary to enable a family with an annual income of $6,000 to carry a $15,000 house with 20% of its monthly income. If the family income stays the same and the cost of producing the house rises to $17,500, a $46.27 monthly subsidy becomes necessary. If the family income remains the same and the cost of the house is reduced to $12,500, no subsidy is necessary. If the cost of the house remains at $15,000 and the family income rises to $7,200, no subsidy is necessary.

The cost of producing housing, the level of personal income, and the need for subsidy are completely intertwined. These considerations have lead the Task Force to conclude that the type and size of public programs which can enable us to achieve the national production goals most efficiently may vary during the production period because of changes in the cost of producing dwelling units, levels of personal income, and the relationship between the two.

While recognizing the implications of income maintenance programs, and changes in the relationship between levels of personal income and construction cost on the content of public actions which best further achievement of the housing production goals, the Task Force doubts that meaningful projections can be made as to the course of these variables over the period of the production program. Instead we stress that the size and content of public programs designed to further achievement of these production goals be carefully reviewed each year in the light of what is then known about these variables; and that each year an attempt be made to identify the then existing constraints that jeopardize achievement of the production goals.

In the judgment of the Task Force the presently existing constraints which could preclude sufficient housing production to achieve the national goal include (1) the inadequacy of the present organization of the home building industry, (2) the vulnerability of residential construction to restrictive monetary policies, (3) the high economic and social cost of building sites in the central cities (involving, as they often do, considerable demolition and a resulting displacement of people); and impediments to the use of sites in outlying metropolitan areas for subsidized housing, (4) the inadequacy of the labor pool available to the construction industry,

(5) limitations on the administrative capabilities of Federal and local bureaucracies to process the specific housing projects in connection with the occupancy of which subsidy payments are authorized by existing Federal programs, and (6) limitations on the amount of subsidy funds which may be appropriated.

The report of the Kaiser Committee, and the work of the National Commission on Urban Problems, deal with these constraints and contain a number of legislative and administrative recommendations. One of the principal aims of this Task Force has been the evaluation of these recommendations. Almost all of the housing recommendations contained in this report stem from the work of these two groups.

Costs and the production goal

The Task Force has no serious reservations as to the capacity of the residential construction industry, as presently constituted, to produce 26 million units over the next ten years. The production levels reached by the industry in the early 1950's is convincing proof that the required production can be achieved with the present organizational structure, if adequate financing is available and if there is sufficient demand to permit sale of the units produced.

Our concern is with the implications of the fact that the cost of producing residential units is increasing at a faster rate than personal incomes. Clearly, the production goal can be achieved if the nation is willing to meet whatever price the residential construction industry requires to get the units produced. But we believe that continued public acceptance of the production goal will be affected by the cost of achieving the goal.

If present cost trends continue, achievement of the production goals will require that, (1) an ever greater proportion of total residential production be publicly supported (as fewer and fewer families will be able to exercise effective demand for nonsubsidized housing), (2) deeper subsidies be provided (in order to permit publicly supported units to serve the same relative income levels they are now aimed at), and (3) those who meet their housing needs out of the nonsubsidized part of the total production, allocate greater portions of their income to housing. In such circumstances, it would become difficult to sustain continued public support of the use of subsidies to establish the effective demand necessary to clear the units produced by the construction industry.

These considerations also underlie the concern of this Task Force with the effect of interest rates, land cost, and labor productivity on the cost of producing residential units, and in large part motivate our later recommendations aimed at offsetting the effect on housing construction of restrictive monetary policies, the cost of building sites, and the limitations of the present labor pool.

We believe it essential that major efforts be made to expand the capacity of the residential construction industry -- and improve its productivity.

Organization of the homebuilding industry

Homebuilding in the United States is largely a localized industry dominated by thousands of small operators. The reasons for this have been examined a number of times, most recently in the work of the Kaiser Committee and the National Commission on Urban Problems. Among the most important are:

(1) the tremendous number of (over 4500) jurisdictions with separate building codes, separate subdivision regulations, zoning ordinances, etc.;

(2) the wide variations in climate, consumer taste, topography, and soil conditions in the many housing markets across the nation -- factors which make local knowledge an essential ingredient in the successful design and merchandizing of homes; and

(3) fragmented land ownership which makes assembly of relatively large in-city or close-in suburban parcels almost impossible without the use of powers of eminent domain.

The fragmentation of the residential construction industry has serious effects which tend to keep costs higher than they might otherwise be.

There is no producer large enough to bear the cost of a large research and development effort. No producer controls enough of the market to make feasible the development of standardized products, or investment in the advertising necessary to promote the acceptance of such products. Only the largest producers find it feasible to invest in developing advanced skills in their work force. Only the very largest producers can assemble parcels of land large enough to permit most efficient operations.

Two types of actions can be taken to overcome the disabilities placed upon the residential construction industry by its present fragmented organization. First, actions can be taken to promote the entry of large firms into homebuilding and to develop the capacity and improve the productivity of promising producers in the industry. Second, institutions can be created to perform those activities vital to the functioning of an efficient high-technology industry which it is not feasible for the individual firm in the homebuilding industry to conduct.

Entry into the industry of large manufacturing firms -- which operate on an industrial, rather than a craft, basis -- could result in significant economies of scale and technical innovations which could reduce cost. We believe the entry of such firms into the field would also introduce an element of competition that would tend to bring pressure on the rest of the industry to eliminate restrictive, cost increasing practices now imposed in collective bargaining agreements or local building codes.

-- The Task Force recommends that the Federal Government use its purchasing power to bring large manufacturing firms into residential construction and to expand the capacity and improve the productivity of promising producers in the industry: (1) by having the Department of Defense contract substantial portions of its total annual housing requirements to be produced by such firms to specified performance standards, and (2) by authorizing the Department of Housing and Urban Development to do the work necessary to develop public housing and other federally subsidized units when requested to do so by local housing authorities and other public bodies which have authority to construct and operate such units, and having HUD contract the construction of such units to be produced by such firms to specified performance standards.

As presently constituted the residential construction industry cannot itself promote the research and development activity or create the institutions which a high-technology research construction industry must have. To fill these essential needs that the industry cannot now meet the Task Force recommends that the Federal Government:

-- Increase the annual level of Federal funds for research and development to $100 million over a three-year period.

-- Establish a technical advisory body to help HUD select the research and development activities to be supported by Federal funds.

-- Establish within HUD a testing facility which would evaluate the technical suitability of new building products and materials.

-- Establish (possibly as an independent government institute) a Building Standards and Testing Institute which would: (a) promote voluntary industry coordination of dimensions, (b) develop performance standards for building materials and construction systems, (c) draft model uniform standards for construction, and (d) coordinate the testing of building products and subsystems.

-- Establish within the Urban Institute an Association for Urban Technology which would: (a) publish technical journals on housing, (b) serve as a professional association for urban technologists, (c) oversee administration of training and fellowship programs in urban technology, (d) assemble an information bank on housing research and development, (e) carry out an "extension service" to those in need of technical help, and (f) maintain systematic contacts with foreign institutes concerned with housing research.

-- Establish a single set of Federal construction standards applicable to all Federal or federally assisted residential construction.

The availability of financing and its cost

The effects of tight money and high interest rates on housing production are now well known. When money is scarce and interest rates high, the net flow of funds to the residential mortgage market is drastically reduced, and those funds which do flow into housing can be obtained only at interest rates which greatly increase the monthly payment necessary to carry the dwelling unit produced.

As a direct result of the monetary policies adopted in 1966 and the scarcity of credit and high interest rates which resulted, the net flow of funds into residential mortgage financing dropped from $19.8 billion in 1965 to $12.7 billion in 1966 -- an abrupt decline of $7.1 billion or more than 35 percent, and housing starts fell from 1.5 million to 1.1 million. During the same period the net use of credit decreased less than $1 billion; a striking illustration of the fact that housing bears the brunt of monetary policies adopted to restrain plant expansion and speculation at the top of the business cycle.

High interest rates have a greater effect on the cost of housing than on other items produced. The monthly payment necessary to amortize a $15,000, 30 year mortgage is increased by more than $10 a month by an increase in the interest rate on mortgage money from 5.75 to 6.75 percent. An increase in the interest rate of this magnitude has the same effect on the size of the monthly payment required to carry a $15,000 dwelling unit as would a 13 percent increase in total development and construction cost of the unit.

There are three types of action that can be taken to increase the amount of capital available to finance the production of housing, and to keep the cost of money as low as possible. First, actions can be taken which will enable the homebuilding industry to compete more effectively for funds in the capital markets. Second, those responsible for determining the mix of monetary and fiscal policies to be used to promote economic growth and maintain price stability can be urged to assign greater weight to the need for housing production, and provided with more effective and flexible methods of using fiscal policies to accomplish their purposes. Third, steps can be taken to insulate the homebuilding industry (to some extent) from the adverse effect of restrictive monetary policies when it is determined that they must be adopted, and selective actions -- which bear more on other segments of the economy than housing -- followed.

Legislation enacted in 1968 will enable the homebuilding industry to compete more effectively for funds. Measures adopted will increase investment in the secondary mortgage market through changes in the organization of the Federal National Mortgage Association and in its investment powers, enhance the attractiveness of VA and FHA mortgages, and improve the capacity of financial institutions to invest in the mortgage market.

The Task Force recommends the implementation and extension of the policies embodied in 1968 legislation, including

-- Elimination of permanent statutory interest rate ceilings on FHA and VA housing loans.

-- Full implementation of the authority of the Government National Mortgage Association to guarantee private bonds or debentures secured by federally insured or guaranteed mortgages.

-- Authorization for the Government National Mortgage Association to buy unlimited quantities of subsidized federally insured or guaranteed mortgages and to issue securities backed by such mortgages.

-- A change in current budgetary practice to reflect in the budget only the nonrecoverable cost to the government with respect to GNMA borrowing in any year rather than the entire amount of the borrowing.

-- Requiring when the effect of monetary policy has severely limited the amount of credit available for housing, that the Federal Reserve Board purchase, through its open market operations, obligations issued or guaranteed by Federal housing agencies in lieu of Treasury securities.

LARGE scale PRODUCTION

CAPITAL MKTS — LAND — INSTITUTIONS

Assuring adequate sites

Studies done for the Kaiser Committee indicate that production of the units assumed in the national production goal will require about double the current annual rate of land consumption for residential and related development. The Kaiser Committee concluded that "[A]vailability of enough land at non-inflationary prices could become one of the major obstacles to overcome in achieving the 10-year goal of 26 million additional housing units".

Recommendations made later in this report would establish Federal programs to assist State and local governments in assembling large contiguous plots of land to be developed as entire new communities. Implementation of these recommendations can, over a period of time, greatly relieve the pressure on building sites in the central cities, and the rapidly expanding fringes in the outlying metropolitan area. For the immediate future, however, it seems certain that the overwhelming amount of new housing construction must take place on a limited amount of vacant land available in the existing metropolitan areas.

Implementation by State and local governments to whom they are directed, of recommendations dealing with taxation of land contained in the report of the National Commission on Urban problems might bring vacant land in metropolitan areas on the market at more reasonable prices. But, for the immediate future, there seems to be no reasonable prospect that the cost of suitable residential sites will decline in the face of the demand for such sites generated by the increased housing production contemplated.

The shortage of suitable sites, and the high cost of those sites which can be obtained has particularly ominous implications for achieving production of the six million low and moderate income units projected as part of the total production goal. Suburban jurisdictions which ring the central city often adopt land use regulations which effectively prevent construction of low and moderate income housing on the relatively cheap land available in the outlying metropolitan areas. Since there is little vacant land left in most older cities, construction of low and moderate income units there often requires utilization of land on which there are existing slum properties which must be demolished and cleared. The costs of demolition and clearance, and the high value of the alternative non-residential uses of this land makes it extremely expensive. As a result, unless the land is used more intensively (for high rise) than is practicable -- considering that families with children are to be housed, and very few of the facilities offered in luxury high rise units can be provided -- it is not possible to put on the land dwelling units which can be amortized with a monthly payment that low and moderate income families can afford.

In addition the very act of demolishing the existing slum properties on the land tends to increase the cost of the remaining low and moderate income housing available in the city, as well as imposing specific burdens on the families displaced by the clearance.

The Task Force, therefore, recommends:

Buy at 100 - sell at 20
US pays 80
Buy at 100
Sell at -0-

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-- Elimination of those administrative rules and practices in the urban renewal program which preclude writing-down the cost of land sold for low or moderate income housing projects to zero when that sales price is the land valuation necessary to achieve the rent schedule ~~which~~ the "target population" can afford.

-- Relocation assistance and payments (equal to those provided in the urban renewal program) to persons and families displaced by the construction of federally subsidized low and moderate income housing projects.

-- Federal grants to cover the cost of writing-down land (wherever situated) acquired by State or local governments and sold at its value for use as a site for low and moderate income housing.

-- Sale of excess Federal land to developers of subsidized housing at its value for use as a site for such housing.

Expanding and Improving the Work Force

Studies made for the Kaiser Committee indicate the need for substantial increases in the size and efficiency of the work force available to the residential construction industry if it is to construct 26 million housing units over the next ten years.

Much of the necessary increase in the size of the work force could be provided by facilitating the entry of minority groups into all segments of residential construction, and providing adequate training in the necessary skills.

In addition, action must be taken to utilize more efficiently the manpower available for residential construction.

In a study for the Kaiser Committee, it was found that in the construction industry, 1.8 men are required to fill every average yearly job, a higher ratio than in any other industry. To a great extent, this is due to the seasonal character of construction. For example, while a full work year in construction is considered to be about 1800 hours, many workmen are employed on the job only between 1100 to 1400 hours a year. This pattern is wasteful of skilled manpower and hampers recruitment of new workers.

Specifically, the Task Force recommends the following Federal actions:

-- Developing uniform "performance" standards governing admission, recruiting, and training which would be utilized by all Federal agencies to judge compliance with requirements of equal opportunity in construction employment.

-- Implementing Section 3 of the Housing Act of 1968 to require that, to the maximum extent feasible, workers employed in connection with the construction, rehabilitation and operation of housing assisted under the Federal subsidized housing programs be lower income persons residing in the area in which such housing is located.

-- Requiring that persons employed pursuant to the implementation of Section 3 of the 1968 Act be given training in construction skills with Manpower Development and Training Act funds available for the cost of such training.

-- Substantially increasing the percentage of MDTA resources allocated to training programs for construction workers.

-- Substantially increasing the amount of Federal vocational education funds allocated to provide training in construction trades.

-- Substantially expanding the pre-apprenticeship training program.

-- Establishing a non-skilled trainee Davis-Bacon rate applicable to the construction industry.

-- Vigorous action by the Bureau of the Budget to secure active government incentives to, and promotion of, techniques to offset seasonality in construction and to assure that Federal construction is spread throughout the year.

More Effective Administration and Utilization of Housing Subsidy Programs

The 6 million low and moderate income units projected as part of the national production goal can not be constructed unless existing housing subsidy programs are adequately funded, and existing mechanisms for delivering the subsidies authorized are improved.

At the present time all Federal housing subsidies are project oriented -- that is the payment of the subsidy is tied to a specific housing project with respect to which the Federal subsidy is made available. Experience in the public housing program, in the 221(d)(3) Below Market Interest Rate program, in the 202 Elderly Direct Loan program, and in the Rent Supplement program has made clear that the development of such a specific project involves lengthy and expensive processing and that it is extremely difficult to achieve volume production.

A number of reasons for the difficulties that have been encountered are now well known. In public housing (and to a lesser, but still considerable, extent in all subsidized housing) the problem of securing local approval of available sites slows down production. The nonprofit organizations so heavily relied on to develop housing in the 202 Elderly Direct Loan, 221(d)(3), and Rent Supplement programs, have been a notoriously weak reed -- largely lacking in the entrepreneurial talents necessary to develop and construct housing projects.

The 1968 legislation authorized several programs which should do much to improve the ability of nongovernmental sponsors to develop and construct subsidized housing projects. The partnership provisions should bring not only equity money but technical competence to the field. The assistance to nonprofit sponsors authorized by Section 106 should be invaluable in developing more knowledgeable sponsors and improving their ability to operate. The National Homeownership Foundation authorized by Section 107 can also be helpful.

The Task Force recommends vigorous implementation of these programs and particularly urges full funding of the amounts authorized to assist nonprofit sponsors by Section 106 of the 1968 legislation.

The Task Force believes that additional steps can be taken. First, the Federal delivery system must be improved. Second, State and local governments must be induced to take greater initiative in developing low and moderate income housing and in utilizing, or facilitating the utilization of, the existing subsidized housing programs.

Both the Kaiser Committee and the National Commission on Urban Problems have recommended that all housing programs administered by HUD be placed under one assistant secretary. Organizational changes are not always the only, or even the optimum, method of achieving improvement in administration. The Task Force believes that the annual report required by Section 5 of the 1968 Act on areas of program administration and management which require improvement can generate meaningful improvements in the administration of the Federal housing subsidy programs. Any organizational changes ought to be deferred until after the first report -- which must be filed "as early as practicable in calendar year 1969" -- has been prepared and analyzed.

Recommendations made later in this report would establish Federal programs to assist State and local governments to participate more fully in the development of low and moderate income housing.

Adequate Funding

Nothing has happened since enactment of the 1968 legislation which would permit the assumption that the housing production goals can be achieved without operation of existing Federal housing subsidy programs at the full authorization levels provided by the Congress.

The Task Force strongly recommends that appropriations up to the full level of authorization available be requested for HUD housing programs, including

-- rent supplements

-- low-rent public housing, including tenant services

-- section 235 homeownership

-- section 236 rental housing

-- rehabilitation grants and loans

-- loans to nonprofit sponsors

-- homeowner counseling services

Experimental housing allowances -- use of existing housing

There are two threads that run through the existing Federal housing subsidy programs. First, the programs provide project subsidies -- that is to say the subsidy provided is tied to a specific dwelling. If the recipient of the subsidy leaves the specified dwelling he loses the subsidy. Second, with some notable and recent exceptions, the major housing subsidy program have been used primarily to promote new construction and substantial rehabilitation.

The emphasis in existing Federal subsidy programs on project subsidies, and the production of new or rehabilitated units is easily explained. Tying the subsidy to a specific dwelling unit, and insisting that the subsidy programs generally add to the stock of available housing units serves two purposes. It establishes a manageable universe to which subsidy payments can be related, and it assures that the additional effective demand for housing created by the subsidy payments does not simply drive up the rents on units in the existing housing stock.

The advantages of using housing allowances, rather than project subsidies, as a method of permitting low income families to obtain decent housing, was carefully examined by the Kaiser Committee. A housing allowance program would make available to families -- according to their needs -- cash allowances which could be utilized only for the purchase of standard housing.

There are several advantages in a program of housing allowances. Since subsidy payments are not tied to specific units, there is much greater liklihood of avoiding the concentration -- which plagues the public housing program -- of poor families in one location. It permits those receiving housing subsidy dollars to make their own decisions on housing quality, style, and management -- to exercise some market power in determining where their housing dollars are best spent.

The project subsidy programs are now largely insulated from the healthy influences that would be provided by the availability of options to their consumers. A housing allowance program can be fully implemented much more quickly than a project subsidy program. (There is no need to process applications to construct or acquire units, etc.) Finally, it is possible, though not certain, that a program of housing allowances would involve lower administrative expenses than do the present project subsidies.

The immediately ascertainable disadvantages of a housing allowance program are (1) the great difficulty of delimiting a universe of eligible recipients small enough to be manageable, (2) the liklihood that any large infusion of new purchasing power (without an immediately offsetting increase in the housing stock) would result in a bidding up of prices for the existing housing inventory, and (3) the possibility that the recipients of housing allowances could not make intelligent use of the allowance without strong programs of consumer education and the elimination of patterns of racial discrimination which deny to some access to available housing.

The Task Force believes that the potential value of a housing allowance program in enabling low income families to obtain standard housing warrents undertaking immediately a small experimental program. The Task Force, therefore, recommends that in a selected number of housing market areas, in which there are adequate vacancy rates, HUD be authorized to:

-- Initiate an experimental housing allowance program which would permit rent supplement or 236 rental payments on behalf of the displaced, the elderly, and large families (more than three minors) for any existing standard housing suitable to their needs. The housing allowance would be equal to the difference between 20 percent of the recipients monthly income and the monthly rental for any existing standard housing within the rental range established for equivalent units in the rent supplement program.

The Task Force also recommends that:

-- In housing market areas, in which there are adequate vacancy rates HUD be authorized to utilize up to 25 percent of the funds authorized for the rent supplement program for payments with respect to existing housing leased to families eligible to receive assistance under the rent supplement program.

-- A portion of the appropriations for the Section 235 Homeownership Program authorized by the 1968 legislation are available to assist eligible families who purchase existing single family homes. The portion of appropriated funds authorized to be used in connection with existing homes is scheduled to decline from 25 to 10 percent over the first 3 years of the life of the Section 235 program, and none of the funds could be used for existing homes thereafter. The Task Force recommends that up to 25 percent of the funds appropriated for the Section 235 program continue to be available for use in connection with existing homes.

Improvements In Existing Housing Subsidy Programs

The work of the Kaiser Committee has once more called attention to the fact that existing Federal housing subsidy programs are not designed to serve the neediest families. Even public housing -- the program with the deepest subsidy -- operates generally on the premise that the rents collected from all the tenants of a specific public housing project will cover the operating cost of the project.

As a result tenants who can not afford to pay that portion of the operating costs of a project allocated to the unit they occupy can be admitted to a public housing project only to the extent that the project includes tenants whose incomes permit them to pay more than the operating cost of the unit they occupy.

Over the years, Congress has authorized additional subsidy payments of up to $120.00 per annum per dwelling unit on behalf of the elderly, and those displaced by urban renewal or public housing projects, and, in 1968 large families (four or more minors) and families of unusually low income. But these are, at best, inadequate piecemeal attempts to permit public housing to serve some additional poor families it could not otherwise serve. The additional

$120.00 per annum per dwelling unit provided is often not enough additional subsidy, and the patch work of enumerated classes on whose behalf the additional subsidy may be paid is, at least, confusing and may be discriminatory.

The Task Force, therefore, recommends that in the public housing program sufficient subsidy be permitted per project to make up the difference between the total rents generated by the rentals the occupants can afford to pay and the total cost of operating the project.

The Task Force believes that a number of additional steps can be taken to make public housing more responsive to the needs of its occupants. The Task Force recommends that:

-- Local housing authorities be required to encourage the development of tenant councils which will participate in the management of the projects.

-- Members of these tenant councils and other tenants be trained to manage and operate low income housing projects, and that funds be authorized to finance such training.

-- Residents of the projects be utilized, to the greatest extent feasible, in the maintenance and management of the projects.

-- Local housing authorities be required, during the planning of projects, and in developing general operating policies for these projects, to consult with the residents of the area in which the projects will be located.

In addition, to make a greater percentage of the total number of federally subsidized dwelling units available to the lower part of the income spectrum served by these programs, and to obtain a broader mix of families of different incomes living together in units which are subsidized, the Task Force recommends that:

-- Sponsors of 221(d)(3), 202 and 236 projects be required to offer 10 percent of the units in these projects for lease to local housing authorities in connection with their Section 23 leasing program -- or to tenants receiving subsidy under the Rent Supplement Program.

-- HUD be authorized to provide management assistance and tenant services grants to sponsors of low and moderate income housing projects financed under the 202 Direct Loan program, the 221(d)(3) program, the 221(h) program, and the 236 program.

MODEL CITIES

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Part II - Description of Housing Proposals

The housing recommendations of the Task Force essentially fall within two broad areas -- those designed to relieve the effect of constraints which could preclude achievement of the ten-year housing production goals and those designed to increase the responsiveness of existing housing programs to the needs of lower income families. Relatively little in the way of new budgetary expenditures would be required with respect to these proposals. No significant new subsidy program is recommended. Somewhat less than one-third of the proposals could be implemented without additional legislation.

Our proposal to deepen the amount of subsidy provided by public housing was promoted in large measure by the inadequacy of existing welfare programs. They often do not provide sufficient income to the very poor to enable them to participate in the existing program. Since, adequate income maintenance programs are not available, an expansion in the depth of governmental assistance in the area of housing was considered necessary as partial support for our lowest income levels.

I. Attaining Ten-Year Housing Production Goals

A. Attracting Enough Financing at Reasonable Interest Rates.

1. Policy Proposal: Less use of restrictive monetary policies that curb housing production and greater emphasis on fiscal measures and selective monetary policies which put less of the burden of credit restraint on the homebuilding industry. In recognition of the national priority accorded housing production and in view of the disproportionately severe effect general restrictive monetary policies have had on housing relative to other industries in the past, The Task Force recommends that those

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responsible for determining the mix of monetary and fiscal policies assign greater weight to the need for housing production. We believe action in this area can have more bearing on the fulfillment of housing goals than any other of the proposals of the Task Force.

2. Legislative Proposal: Elimination of permanent statutory ceilings on interest rates on FHA and VA housing loans. The Secretary of HUD has authority under Public Law 90-301 to waive statutory interest rate ceilings, but this authority expires October 1, 1969. Although Public Law 90-301 established a commission to study mortgage interest rates and to report to the Congress by April 1, 1969, the Task Force believes that the importance to the housing subsidy programs of competitive yields in government-backed mortgages without excessive discounts requires an emphatic policy statement against unrealistic interest rate ceilings.

3. Legislative Proposal: Require the Federal Reserve Board to purchase, through its open market operations, obligations issued or guaranteed by Federal housing agencies. The Federal Reserve Board under present law is empowered but not required to make such purchases. The Task Force believes that in periods of severe credit shortages the full beneficial impact on housing of such open market purchases can best be assured through a statutory requirement.

4. Legislative Proposal: Authorize the Government National Mortgage Association to borrow funds on the private market (through issuing mortgage-backed securities) to finance housing subsidy programs (except low-rent public housing). The Task Force recommends that GNMA be authorized to buy unlimited quantities of subsidized federally insured mortgages, the authority to be used only to the extent that private credit is unavailable at reasonable costs. The costs to the Government will be lower under this approach with respect to mortgages subject to interest reduction grants

because of the liklihood that GNMA will be able to lend at lower interest rates than private lenders. The major drawback to this proposal is its budgetary impact. The Task Force recommends that more realistic budgetary concepts be adopted with respect to such operations in recognition of the high priority assigned to housing. Administrative Policy: Only nonrecoverable costs of GNMA to be counted as budget expenditures.

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5. Administrative Proposal: Implement as quickly and fully as possible the authority of the Government National Mortgage Association to guarantee private obligations secured by federally insured or guaranteed mortgages. This promising form of increasing housing credit was part of the 1968 legislation and is expected to attract additional pension and other trust fund investment into housing. Both the Federal National Mortgage Association and other acceptable private issuers are eligible for the guarantee. Little or no additional potential cost to the government is involved in the GNMA guarantee since the mortgages securing the obligations are also guaranteed or insured by the Federal Government.

B. Improving the Efficiency of the Homebuilding Industry.

1. Legislative Proposals to increase the Federal Government's role in supporting and conducting research into new housing technologies and more efficient utilization of construction resources:

a. Establish a Building Standards and Testing Institute (possibly as an independent government institute). The advantage of the proposed Institute would be the centralization of research on uniform construction standards and the greater chance of the acceptance of these standards because of the prestige strong governmental backing would give to the Institute. Laboratory testing and standards preparation would largely be contracted out with the Institute acting as a central focus for these activities. Specifically, the Institute would be responsible for (1) development of national standards for measuring the quality of building products and construction systems; (2) promotion of voluntary industry coordination of the dimensions of building products and subsystems; (3) central coordination of the testing of building products and subsystems; and (4) drafting of more uniform Federal standards for construction.

b. Establish within the Urban Institute an Association for Urban Technology. The purpose of the Association is to promote professionalism in the urban development field and to facilitate research and development. The Association could be sponsored and supported by private industry, trade associations, foundations, universities, and government. Specifically, the Association would (1) publish technical journals on housing; (2) serve as a professional association for urban technologists; (3) oversee administration of training and fellowship programs in urban technology; (4) assemble an information bank on housing research and development; (5) carry out an "extension service" to those in need of technical help; and (6) maintain systematic contracts with foreign institutes concerned with housing research.

c. Increase the annual level of Federal funds for housing research and development to $100 million a year, gradually over a three-year period; establish a technical advisory body to help HUD select the research activities to be supported by Federal funds. While this is a substantial increase of present funding levels (about $10 million annually), the general lack of a research and development capacity and willingness in the construction industry puts the responsibility of encouraging research onto the government if meaningful technological advances are to be made. Like other research and development efforts short-run costs can often be converted into long-run savings.

d. Establish within HUD a testing facility which would evaluate the technical suitability of new building products and materials. This "in-house" capability is necessary to assure optimum use of Federal housing subsidy programs to further acceptance of technological advances.

2. Administrative Proposal: To the extent feasible, establish a single set of Federal construction standards applicable to all Federal or federally assisted residential construction. Such a uniform set of standards would not only facilitate construction of projects but would also encourage economies of scale and technical innovations.

3. Administrative and Legislative Proposals to encourage large-scale production of housing and its components:

a. The Department of Defense should contract substantial portions of its housing requirements to be produced by large firms to specified performance standards; and

b. HUD should be authorized to do the same with respect to public housing units when requested to do so by local housing authorities.

C. Providing Adequate Sites

1. Legislative Proposal: Federal grants to cover the entire cost of writing-down land acquired by State or local governments and sold at its value for use as a site for low and moderate income housing. Federal grants would reimburse the locality's net costs -- namely, the costs of acquisition, relocation, and demolition, less ~~the resale~~ price of the property. The program could be used for areas as small as one block and in non-slum as well as slum areas. It thus is a broader program, with respect to the one aspect of acquiring sites, than the urban renewal and neighborhood development programs. The program would be useful in assisting localities which may own numerous scattered

building sites to package a large parcel of land that can be sold for redevelopment. The Task Force recommends that $ be authorized for the first year, $ for the second year, and $ for the third year.

2. Legislative Proposal: Authorize sale of excess Federal land to developers of low and moderate income housing at its value for use as a site for such housing. Existing Federal law governing the sale of excess land permits a sale at a reduced price if the land is to be used for parks, hospitals, or schools, but does not permit sale at less than "market value" if the land is to be developed for housing. We recommend that national housing goals be given equal recognition with respect to the sale of excess Federal land.

3. Legislative Proposal: Federal grants to cover the cost of relocation assistance and payments (equal to those provided in the urban renewal program) to persons and families displaced by the construction of federally subsidized low and moderate income housing projects. Persons and families displaced by such housing projects ought to be on a par with those displaced by public housing and urban renewal. An essentially similar purpose is served by the acquisitions that make their displacement necessary. To those displaced there is no difference that in the case of urban renewal and public housing eminent domain proceedings were available to the acquiring agency while in other housing programs they were not. The Task Force recommends that $ be authorized for the first year, $ for the second year, and $ for the third year.

4. Administrative Proposal: Elimination of those administrative rules and practices in the urban renewal program which preclude writing-down the cost of land sold for low or moderate income housing projects to zero

$$\begin{array}{r} 400 \\ 120 \\ \hline 620 \end{array}$$

F769 168,000

$$\begin{array}{r} 400,000 \\ \hline 568,000 \end{array}$$

$\boxed{\text{F769}}$

168,000
58,000 FARMERS
______
226,000

~~746,000~~
~~568~~
~~122~~
~~570~~
~~742~~

226,000
400
______
626
~~120~~
______
~~746~~

F770

$$\begin{array}{r} 226 \\ 400 \\ \hline 626 \end{array}$$

400,000 - CITY
~~160,000~~ - FARMERS
______
~~410~~

$$\begin{array}{r} 746. \\ 626 \\ \hline 60,000 \end{array}$$

$$\begin{array}{r} 570 \\ 226 \\ \hline 796 \end{array}$$

$$\begin{array}{r} 746 \\ 726 \\ \hline 60 \end{array}$$

168,000 | F7 69
58,000 |
______
226,000

$$\begin{array}{r} 226,000 \\ 400,000 \\ \hline 626 \end{array}$$

when that sales price is the land evaluation necessary to achieve the rent schedule which the "target population" can afford. The additional cost to the Federal Government is estimated at   and will be absorbed within existing authorizations for urban renewal.

D. Expanding and Improving the Work Force

1. Legislative and Administrative Proposals expanding Federal training assistance for construction-related occupations.

a. Increase percentage of funds for vocational education in the construction trades and improve the curriculum. The Federal Government spends about $260 million annually on vocational education, with about seven million persons currently enrolled in such courses. Very little of use in the construction or building trades, however, is being taught. The Task Force recommends that a more appropriate balance in the program be instituted, giving recognition to the importance of the need for increased skilled labor in the construction industry and the benefits to trainees in acquiring skills in this area.

b. Higher priority in Federal manpower training programs for training in construction-related occupations and greater use of on-the-job training. Statistics covering 1966 indicate that only about 2 percent of all enrollees in institutional training programs and around 5 percent of all enrollees in on-the-job training programs were being trained in construction-related careers.

c. Expand pre-apprenticeship training programs by increasing Federal funding by $75 to $100 million for each of the next three years. Although pre-apprenticeship training can be extremely useful in the construction area, only a little more than $11 million a year is spent on such programs.

2. Administrative Proposal: Vigorous action by the Bureau of the Budget to secure active government incentives to, and promotion of, techniques to offset seasonality in construction and to assure that Federal construction is spread throughout the year. One of the major reasons for the low productivity rate in the construction industry is the seasonal character of building, with a substantial slowdown in the winter months. Technically such a slowdown is not necessary. The Federal Government can exercise a strong influence here since it accounts for about a third of all construction. About three-fourths of its contract awards, however, are made during the summer months. Although an outstanding Executive Order requires wintertime construction for all work that can be done during winter months, Federal contract awards continue to be seasonal in nature.

3. Administrative Proposal: Establish a trainee classification for Davis-Bacon purposes as part of approved training programs for preparing workmen to enter regular employment in the building trades. This is necessary if on-the-job training programs in the construction trades are to be effectively conducted.

4. Administrative Proposal: Establishment of a uniform set of Federal performance standards for judging the construction industry's accomplishments in the area of equal employment opportunities. The direction for Federal enforcement of equal employment opportunity has stemmed from two sources -- Executive Order 11246 and title VII of the Civil Rights Act of 1964 -- and enforcement has been spread among the Equal Employment Opportunities Commission, the Justice Department's Civil Rights Division and the Office of Federal Contract Compliance established in each Federal agency or department. The resulting diversity in enforcement approaches has hampered the effective encouragement of minority hiring in the construction fields and should be rectified.

5. Administrative Proposal: Implement fully Section 3 of the Housing and Urban Development Act of 1968 which requires to the greatest extent feasible that lower income residents be given employment opportunities with respect to the development of federally subsidized housing in their areas; utilize Federal training programs to assist these workers. The statutory requirement enacted in 1968 offers a useful handle to add new skilled workers to the construction labor force and to assist lower income persons to attain skilled work.

ACC
CAPITAL COSTS
50 TO OPERATING COSTS

II. Expanding Benefits of Federal Housing Subsidy Programs

A. Increasing Depth of Subsidy

1. Legislative Proposal: Sufficient Federal subsidy to make up the difference between the total rentals public housing tenants can afford to pay and the total cost of operating the project. The Task Force has found that the very poor cannot afford to live in low-rent public housing projects. $10 month Congress has authorized an additional annual subsidy of $120 per dwelling unit for families of unusually low income but this often will not be enough. The full low-rent public housing subsidy needed should be provided. The additional costs are estimated at .

Elderly

2. Legislative Proposal: Require sponsors of 221(d)(3), 202 and 236 projects to offer 10 percent of the units in these projects for lease to local housing authorities in connection with their Section 23 leasing program or to tenants receiving subsidy under the rent supplement program. The great advantage of this proposal would be the resulting broader mix of families of different incomes living together in subsidized projects. Combining subsidies to achieve this goal is now authorized and encouraged but there is no systematic way to assure its occurence with regularity. The proposal requires only an

offer by the sponsor and does not require that each project actually contain 10 percent rent supplemented or leased units. Should the sponsor's offers not be fully accepted or not accepted in time he would be free to rent the units as he otherwise would.

B. Increasing Coverage of Subsidy Programs

1. Legislative Proposal: Initiate an experimental housing allowance program which would permit rent supplement or 236 rental assistance payments on behalf of the displaced, the elderly, and large families (more than three minors) for any existing standard housing suitable to their need. The housing allowance would be equal to the difference between 20 percent of the recipient's monthly income and the monthly rental for any existing standard housing within the rental range established for equivalent units in the subsidy programs. The advantages and disadvantages of a housing allowance program are discussed in Part I (pp 19-21). The program will be limited to a selected number of housing market areas in which there are adequate vacancy rates. No additional costs.

DISPLACIES ;

2. Legislative Proposal: Utilize up to 25 percent of rent supplement contract authority for payments with respect to existing housing, in housing market areas in which there are adequate vacancy rates. While the rent supplement program is properly oriented toward production of new units, the Task Force believes the limited use of existing housing proposed can not only speed up the program, but also lead to a more desirable economic mix than has hitherto been obtained in rent supplement projects.

3. Legislative Proposal: Permanently retain the 25 percent use of contract authority for existing housing in the 235 homeownership program. Under present law 25 percent of 235 contract authority is available for existing housing but this percentage declines to 10 percent by the third year and to zero after the third year, with certain specific exceptions. Again, the Task Force recommends that some balance be maintained between new production and use of existing housing, with the emphasis remaining on the former, however.

C. Tenant Involvement in Subsidized Housing

1. Legislative and Administrative Proposals to increase role of tenants in development and management of public housing projects:

a. Local housing authorities be required to encourage the development of tenant councils which will participate in the management of the projects.

b. Members of these tenant councils and other tenants be trained to manage and operate low income housing projects, and that funds be authorized to finance such training.

c. Residents of the projects be utilized, to the greatest extent feasible, in the maintenance and management of the projects.

d. Local housing authorities be required, during the planning of projects, and in developing general operating policies for these projects, to consult with the residents of the area in which the projects will be located.

2. Legislative Proposal: HUD be authorized to provide management assistance and tenant services grants to sponsors of low and moderate income housing projects financed under the 202 direct loan program, the 221(d)(3) program, the 221(h) program, and the 236 program. A similar grant program

was enacted in 1968 for the benefit of public housing tenants. The same benefits should be available to tenants in other subsidized projects. The Task Force recommends that $ be authorized for the first year, $ for the second year, and $ for the third year.

DEVELOPING AN URBAN LAND POLICY

If present trends continue, the United States population will grow by over 100 million people in the next three decades. Projections indicate that close to 40 percent of this increase will be concentrated in eight great metropolitan areas each of which, by the year 2000, will have a population of 5 million or more; 30 percent will be added to 35 areas each of which, by the year 2000, will have a population in excess of one million. Other urbanized areas each of which, by the year 2000, will have a population in excess of 100,000 will absorb 20 percent of the total national increase. All of the lightly urbanized and rural areas of the nation will account for about 10 percent of population growth in the next three decades.

The physcial space needed to accommodate population expansion is being met largely by haphazard conversion to urban uses of raw land adjacent to existing urban areas. Because such fringe development requires proportionately more land per person than central city living does, the ratio of land required for a given urban population is growing.

America has put more land to urban use since 1950 than in all its previous history. Approximately one-fifth of New Jersey is covered by development, one-fifth of Massachusetts, one-seventh of Rhode Island, one-seventh of Connecticut. Americans are using up rural land for urbanization at the rate of one-half million acres a year.

The rapid use of raw land in areas surrounding the urban core is paralleled by a dramatic decline in the amount of vacant land available in the central cities. Personal transportation alone has devoured vast tracts. Between 60 and 70 percent of land in the centers of some cities is given over to automobile needs.

Studies show that few large vacant parcels of land in urban centers now remain. The Rand study indicates vacant land within Washington, D.C., dropped from 22 percent in 1928 to four percent in 1955. In Detroit, the supply of vacant land dropped from 22 percent in 1943 to 8 percent in 1954. Even in the newer cities like Los Angeles, vacant land had declined from 64 percent in 1940 to 31 percent in 1960. There is also some evidence that land is most scarce in high density areas inhabited by low income populations.

Constant competition of users of limited quantities of land in metropolitan areas has had the inevitable consequence of escalating land values. Though prices for raw land vary, studies by McGraw-Hill, the National Association of Home Builders, and others demonstrate the sharp increase of raw land prices in strong market areas.

Land prices around Chicago have been rising at a rate of 10 percent annually. In Los Angeles, prices of better located properties have increased 300 percent in the last five years. Since 1960, in Baltimore acreage prices increased 64 percent, in Indianapolis, eighty percent, in Dallas, 92 percent, and in Washington, D.C., 74 percent. A national survey conducted in 1964 indicates that prices of raw land increased 15 percent per year between 1960 and 1964 accounting for nearly all increase in prices of prepared lots.

The situation in central cities is particularly difficult. A recent study by the Kaiser Committee shows land prices in central city renewal areas have been rising even more rapidly than have suburban land prices. Indeed, the level of land prices in renewal areas is significantly higher than the level of land prices in suburban areas -- and this is true not only of acquisition values but also of reuse or resale values. The cost of acquiring land per acre in renewal projects begun after 1964 is significantly higher than in those begun before 1964. In Boston, average prices paid per acre went from $103,000 before 1960 to $247,000 after 1964. In Cleveland comparable figures are $65,000 versus $160,000; in Louisville, $35,000 versus $102,000; in New York City, $560,000 versus $955,000; in Philadelphia, $43,000 versus $430,000. Similar trends can be shown for average site acquisition and improvement costs for public housing.

Increasing land prices contribute significantly to more expensive housing. The average cost of building a house has gone up less than the price of acquiring the land. The average FHA single-family home constructed in 1951 would cost 66 percent more if built today, but the site alone would be 205 percent higher. Although larger lot sizes and higher development standards account for some of this increase, the upward thrust of land prices is the chief component.

Rising land costs are a major factor in reducing the number of units available to low income families.

More and more cities are being forced to use marginal land for development of housing. Filling operations and use of air rights are becoming common. Since much low income housing is built in the inner city, the result has been to raise the cost of this housing. Across the country federally aided low and moderate income housing programs face development problems due to mounting site costs.

Up to the present, urban growth, has for the most part, been haphazard, characterized by leapfrogging patterns of sprawl and by low density housing and strip commercial development. The traditional determinants of urban land use have been unable to structure rational large scale development.

Most of the land use stimulated by population growth and movement in this centry has been unplanned. The absence of planning evidences a lack of understanding of the economic necessity to conserve land and to minimize the social cost of urban growth. Unplanned growth adds unnecessarily to the public expense. In the new subdivisions of the Northwest, conservative estimates indicate each time a new home is built the local jurisdiction is committed to as much as $17,000 in public expense.

Unplanned growth tends to maximize short run gains for land owners while ignoring the related community commitment to heavy long run tax burdens. The determination of highest and best use is dictated by local market conditions and not the needs of the metropolitan community. Consideration is rarely given to welfare and other non-monetary factors.

An Urban Land and Development Policy

In the eighteenth and nineteenth centuries, public ownership of much of the land in the path of the nation's westward expansion made the implementation of a national policy with respect to the social and economic consequences of land allocation relatively simple. Gifts of public land structured the movement of population, financed the development of transportation systems, the creation of an educational system, and the construction of much of the infra-structure of the communities that grew out of the migration to the west.

In the twentieth century, absent the fortuitous accident of public ownership of much of the land in the path of development, there has been no visible public asset the disposal of which could both require, and occasion, the development of a public policy for converting from rural to urban uses the land in the path of urban development.

In his January 11, 1968 lecture at the Great Issues Symposium at Oklahoma State University, Robert C. Weaver said:

> "The truth of the matter is that although we have long been an urban Nation, we do not have an urban land policy...
> "As a consequence of this, urban land use is haphazard and usually unplanned. The price of land for urban use often reflects little input on the part of the owner but rather the presence of people and expenditures for public improvements and services. Standards of design for urban development depend upon decisions of thousands of entrepremeurs who act independently. They are often motivated by an urge to maximize profits as quickly as possible. Universally they face zoning ordinances that too often inhibit good design and efficient land use...
> "We lack public bodies willing and capable of determining urban land policy or administering urban land programs.
> "We must have an urban land policy. Its roots are the requirements of an urban society. It must recognize the key role of planning, and it will have to initiate new instruments..."

The bases of such a policy are four generally accepted goals:

-- Land should be used so as to promote equal access and choice in basic living patterns.

-- Land should be used so as to assure space, facilities and opportunities for present and future populations.

-- Land should be used so as to promote a quality environment.

-- Land should be brought into development in a way that minimizes the social and economic costs of urban growth to the community.

There are a wide variety of programs and strategies that could be defined to support these goals. In selecting viable alternatives among them, it is well to recognize that both our long standing traditions as to the individual's right to develop and dispose of land, and the division of powers between Federal, State and local governments will make much recent foreign experience irrelevant to us.

The creation of an urban land policy in America will come in evolutionary not revolutionary ways. It will be built incrementally on the basis of our tradition, attitudes, experiences, and programs. The Constitution and tradition make the states the best instrument now available for implementing an urban land policy.

The contribution the Federal Government can make to an urban land policy lies in its ability to (1) formulate and articulate as national policy the four generally accepted goals suggested as the bases of an urban land policy, (2) stimulate the establishment of State, regional and local institutions which can formulate, develop, and implement local programs that are compatible with national policies, (3) formulate broad criteria for development activities, and assist and induce local institutions to undertake programs consistent with regional and national objectives, and (4) allocate national resources to the implementation of an urban land policy.

Recommendations

The Task Force recommends that the goals of an urban land policy be met initially through widespread development of balanced "new towns", most of which would be located on the perimeter of existing metropolitan cores and capable of absorbing a significant percentage of the increased population projected to be living in urban areas by the year 2000. Specifically, the Task Force recommends:

-- A National Conference on New Towns and Communities for America. The principal purpose of the conference would be to educate a cross section of leaders about the need to diffuse population concentration by building new communities. Though national and international authorities on new towns and urban development would be invited, the conference would review the problems of new town development, and would seek to discover ways of resolving these. Conference recommendations would become the basis for part of the President's 1970 legislative program. The conference would be used to generate political support and stimulate public discussion for a national program of new town development.

-- Administrative and legislative steps to stimulate the creation of State development agencies, or State chartered public or private corporations, to plan, develop the infra-structure, operate for limited periods and guide the growth of new towns. The recommended program would complement the New Communities legislation enacted in 1968 which would still be available for wholly private developments.

Participation of the States in new town development has the advantage of (1) facilitating land assembly through eminent domain proceedings; (2) encouraging more efficient and coordinated planning of new towns, and (3) assuring State sharing of costs and responsibilities in development of a sound land policy.

The program would consist of the following elements:

a. Establishment within HUD of an office to prepare, assemble, evaluate, and make available to State and local governments studies and data pertaining to land use and development, the establishment of new communities, and matters affecting the environment of these communities.

b. Federal assistance to encourage States to create agencies to develop and implement State and local plans for land uses and programs to assure a healthy physical environment. Assistance would be in the form of grants to cover up to two-thirds of the administrative costs of the State agencies.

c. Federal assistance to development bodies for land acquisition, site development, and the construction of public facilities including low-income housing. Assistance could involve combinations of matching grants, low interest loans, and loan guarantees. To be eligible for this assistance the State or a private body (private new town developers would also be eligible under the program if their development conformed to a State plan and received State approval.) would submit to a single Federal agency a complete plan and development program for a new town project that would meet standards and requirements set by the Federal administration. The plan would contain a general development strategy, a program of financial support using State and private sources and other pertinent data. The Federal agency would review and approve the plan and make all the necessary disbursements and arrangements.

d. Incentives to encourage employment generating industries to relocate to or develop in new towns. Such incentives could be in several forms: special Federal and State tax deductions or credits, loans for plant construction and the purchase of equipment, long-term leases with low ground rents or rent-free premises for specified terms, special support for training new workers, and grants to cover relocation assistance. The development of industry in new towns would be in accord with the development scheme worked out by the planning body.

TAX CHANGES TO ASSIST LOW AND MODERATE INCOME HOUSING

We now have a costly and inefficient system of tax subsidies for buildings and structures generally. The present system costs the treasury some $750 million in revenue annually.

Of this $750 million annual "tax expenditure":

-- some $500 million is used to provide tax advantages for motels, office buildings, shopping centers, and commercial and industrial construction of all kinds

-- as much as another $100 million is used for continued tax advantages for older housing which is undergoing its second, third, or fourth round of depreciation write-offs at rates above straight line

-- probably another $100 million goes for relatively recent new housing construction in the semi-luxury or luxury high-rise category

-- only about $50 million feeds directly into the process of rewarding investors who currently or recently have made commitments increasing the low and moderate income housing supply.

Possible Realignment of Tax Subsidies and Declared National Policy Objectives

Any kind of tax expenditure should be subject to reasonably rigorous cost-benefit testing.

In examining the extent to which the present $750 million annual "tax expenditure" occasioned by the subsidies for buildings and structures generally may be justified by national policy objectives, the Task Force noted that while there is an urgent and explicitly recognized national policy to stimulate the construction of low-income housing

-- there is no declared national policy of urgently stimulating non-housing construction

-- there is no recognized national objective of supporting the market for older real estate of all kinds with the hope, for example, that a higher tax-supported value for a 45-year old hotel will somehow affect the construction of new hotels or motels where investors consider the resale value of their property after the 8 or 10 years required to complete the optimum first tax shelter cycle

-- there is no declared national policy of subsidizing luxury apartment development.

If, therefore, an urgent national goal in the low-income housing field is to be achieved by the use of tax subsidies as well as by front door or direct expenditure subsidies, this does not preclude a substantial and indeed predominant element of correction of the present situation with respect to tax subsidies for buildings and structures generally. In the case of what is by far the largest part of the "tax expenditure", not only is there no collision between eliminating the present loss of revenue and furthering national housing goals, but indeed there is an opportunity to reduce pressures on available construction, promotional, and financial resources, making it easier for them to shift into needed housing activity.

A. Recommendations (for immediate implementation)

The following related lines of policy action are recommended in both tax and non-tax areas:

Withdraw accelerated depreciation methods for buildings and structures other than new low and moderate income residential properties

This proposal would take the essential immediate step of limiting tax depreciation to straight line for all future acquisitions and construction on (1) all buildings and structures outside the residential rental field, (2) on all future acquisitions of used housing more than 10 years old, except substantial rehabilitation expenditures on substandard housing units which the Secretary of HUD finds to be rehabilitated to a standard condition (the Secretary could make advance commitments to certify rehabilitation of units, which upon their completion in accordance with previously approved plans, meet HUD standards) and (3) on new rental residential building with unit rentals in excess of $250 a month. The exclusion of low and moderate income housing from this immediate change is designed to avoid disruption in a critical housing area but is not intended to prejudge the result of a longer-range study of alternative incentive measures -- both tax and non-tax -- for low and moderate income housing.

The exception in (2) above would apply only to cases of "substantial" rehabilitation of substandard units, and not to cases of deferred maintenance. This exception would allow accelerated depreciation methods only on the rehabilitation expenditures and would not affect the depreciation method(s) otherwise applicable to the other cost of the property.

To avoid unfair treatment of building projects on which commitments have already been made, some leeway might be appropriate in setting the effective date, similar to the rules adopted in connection with the 1966 temporary suspension of accelerated depreciation on buildings.

This proposal would gradually increase revenues beginning at once and eventually by roughly $700 million (calculated at current 1968 economic levels).

It would eliminate the bulk of unnecessary revenue losses and tax shelter problems in the real estate field. It would continue present advantages in residential construction for other than luxury apartments pending the recanvass of housing incentives outlined below. The effectiveness of the present treatment in generating low and moderate income housing would be greatly enhanced by the curtailment of tax benefits in other real estate areas, thus creating a powerful differential. Confining tax incentives to forms of housing where supply needs are urgent would shift resources to this area; the possibly temporary character of the surviving housing tax provisions could also act as an immediate spur to low and moderate income housing starts.

B. Recommendations (to be perfected and implemented as a package)

1. Provide for full recapture (taxation as ordinary income rather than capital gain) of gains on future sales or exchanges of all buildings, residential and nonresidential, to the extent of prior depreciation deductions

This recommendation would provide for full recapture of depreciation claimed on buildings and structures for the period beginning with the year of adoption of the suggested legislation, applicable to all dispositions during subsequent taxable years (the method followed in applying recapture to machinery and equipment in 1962).

It would provide gradually increasing revenues as the years go by, depending in part on the volume of real estate turnover, probably in the order of $100 million annually after 10 years.

Recapture provisions would eliminate a major source of inequity in real estate tax shelter operations, involving the conversion of ordinary income into capital gain. The recapture provisions would make the (at least temporary) continuation of accelerated depreciation methods on new low and moderate income housing tolerable pending a longer-range review of tax incentives for construction. If shorter depreciable lives are adopted for use with the straight-line method, as suggested for consideration below, such recapture would be an essential safeguard.

To prevent inequity and undue lock-in effects, the recapture would apply only to gains reflecting prior unrealistic depreciation on buildings. Separate calculation of land and building portions of the gain would thus prevent taxation of appreciation of land values in the guise of excess depreciation at rates above the generally applicable capital gains tax.

The adoption of full recapture should be designed to take effect only with the package revision to be developed under Recommendation 2 below.

2. Develop provisions for adequate long-range incentives for new housing as a substitute for present unfair and inefficient tax provisions

With the retention of present accelerated depreciation for eligible housing only low and moderate income housing activity should be sustained and encouraged while a more comprehensive program is developed on the basis of cost-effectiveness principles. Such a plan would comprise the best possible package of changes based on careful exploration of such alternatives as:

-- interest subsidies through Urbank or other means for housing beyond the present HUD subsidized programs
-- liberalized loan-to-value ratios
-- capital grants on per housing unit basis

-- package tax revision in the entire building field, such as depreciation guideline revision (for application with the straight-line method) and investment tax credits designed (1) to place construction generally on an appropriate tax footing relative to industrial machinery and equipment and (2) to provide a rational, economical method of selective tax support for housing if that is desired.

With the development and adoption of this program the remaining accelerated depreciation methods for low and moderate income housing could then be phased out entirely. With the full recapture provision in effect, liberalized tax lives for buildings would result only in tax timing changes; no conversion of ordinary income into capital gain would be involved.

3. Develop specific features to encourage housing rehabilitation and improvement and to combat urban decay

As one aspect of the broad incentive approach outlined in Recommendation 2 above, it seems desirable to consider the development of specific features to (1) combat the present neighborhood or externality effects which militate against good maintenance and improvement of the existing older housing supplies and (2) set in motion some incentive for upgrading older low-cost housing so that the "filtered down" units will better contribute to meeting the Nation's housing goals.

To do so, the Task Force endorses recommendations similar to those of the Douglas Commission in its recent Report:

-- to allow expensing of "major repairs" or rehabilitation outlays an older properties (30-40 years) which bring these units up to a specified minimum Federal standard

-- to accomplish some tie-in of depreciation and repair-improvement expenditures which would furnish a positive incentive or rewards for landlords who keep their property up and cut back depreciation for those who continue to "milk" deteriorated housing properties.

The positive encouragement afforded by this plan would involve little or no net revenue loss because of the revenue-gaining feature included.

* * *

The program outlined here should achieve the following:

-- immediate elimination of the real estate tax shelter abuse for nonresidential and luxury housing construction

-- replacement at an early date of the present accelerated tax depreciation system for housing with a more rational and neutral tax treatment for construction generally, with whatever selective support seems appropriate for low and moderate income housing, as part of a package of tax and non-tax measures

-- recapture of gains attributable to prior depreciation when a more rational and neutral tax treatment for construction generally is adopted

-- elimination of possible tax unneutralities which in combination with market mechanisms encourage urban blight, plus encouragement to conversion of more of the supply of "filtered down" older housing into units acceptable in meeting national housing goals

-- additional revenues in the order of half a billion dollars for possible use in more affirmative ways to cope with urban housing problems

-- development of new non-tax incentives which would provide stronger incentives for new housing construction for the budgetary resources used

-- a shift of such budgetary resources from the current special tax provisions which are relatively inefficient and not subject to review into non-tax incentives which would meet cost-effectiveness tests

-- a better, fairer tax system.

IMPROVING CAPACITY OF STATE AND LOCAL GOVERNMENTS

The last decade has seen the emergence of many new programs to deal with the problems of the urban environment. The great majority of these programs while financed at the Federal level must be implemented at the State and local level. Their implementation has often been hampered by the lack of fiscal and administrative capacity of State and local governments to deal with the problems of the urban environment. It is clear to the Task Force that resolution of major urban problems requires that the Federal Government provide substantial assistance to help State and local governments modify, improve and where necessary, create institutions able to plan for efficient and orderly growth and development, achieve better allocation of State and local resources, develop more rational decision making processes, and establish more efficient administration of public activities.

Proposals for improving the capacity of State and local governments put before the Task Force can be arranged in three broad categories: First, were those designed to improve the financial condition of State and local governments; Second, were those designed to achieve better allocation of State and local resources, more rational decision making, and more efficient administration, by using Federal cost-sharing of strategically selected public activities to encourage the shifting of responsibility for areawide functions to larger governmental units; and Third, were those to provide direct assistance to improve State and local resource allocation and decision making capacity.

Improved State and Local Finances

The Task Force considered a number of proposals which would bolster State and local financial capacity by tapping the Federal Governments's greater revenue raising capacity. Unlike existing Federal assistance programs, which are limited to specific uses, these proposals are directed to improving the capacity of local governments to devise and carry out their own programs for urban betterment as well as to more effectively participate in Federal assistance programs.

Three categories of proposals were considered: (1) alternative methods of providing block grants; (2) inducing (by means of Federal tax credits or other forms of tax sharing) greater reliance on income and less on property and sales taxes to finance State and local expenditures; and (3) shifting the responsibility for financing State and local services, such as education and welfare, to the Federal Government.

While we are impressed with the need and desirability of some form of reallocation of revenues or expenditures between Federal, State and local governments, we feel the choice of any particular proposal is beyond the competence of the Task Force. We recommend that a comprehensive study of alternative methods of improving the fiscal capacity of State and local governments be made with full consideration given to the views of representatives of these governments.

Improved Administration of Areawide Functions

It is now well recognized that efficient public development of urban areas is hampered by the fragmentation of governmental units involved in planning and implementing large-scale development policies.

Section 205 of the Demonstration Cities and Metropolitan Development Act of 1968 provides incentive grants to assist planned metropolitan development. These 20 percent incentive grants can be made for a number of development projects eligible for Federal categorical grant assistance, if the project is related to, and in conformance with, a comprehensive plan for the development of the metropolitan area. But, though section 205 can be useful in providing an incentive for coordination of local activities with a metropolitan development plan, it does not provide any incentive for shifting areawide functions to larger governmental units. The financing and administration of areawide functions remains fragmented.

The Task Force recommends Federal cost-sharing to provide the incentive for shifting the responsibility for <u>some</u> public activities to larger governmental units.

Specifically, the Task Force recommends:

-- <u>Federal supplemental incentive grants, administered by HUD, of up to one-half of the non-Federal share of the cost of specified public activities that are financed on an areawide basis and administered by a metropolitan, or regional body</u>. These grants would be supplemental to categorical grants for the activity. The grants would be made to a metropolitan or regional body that is responsible for financing and administering the activity. Eligible functions would be limited to those that can best be performed by large jurisdictional units, that is, where the service area crosses existing jurisdictional lines, such as open space, transportation, sewer and water facilities, air and water pollution control. Authorization of $ million over a three-year period is recommended.

While there are some functions (transportation, water and sewer, air and water pollution, etc.) for which it is appropriate to shift the financing and administrative responsibilities to larger jurisdictions, there are other functions, (housing subsidy programs, housing and building codes inspection and enforcement, social services to occupants of low-income housing, technical assistance in the management and administration of local government, etc.), which are localized but which can be handled most effectively through the combined efforts of local jurisdictions and the State. To encourage greater State participation in these activities, the Task Force recommends

-- Federal incentive grants of up to one-half of the cost of annually approved State programs which initiate or assist projects or activities that broaden existing public and private efforts to solve the problems of the urban environment. State activities would be in areas where the State is particularly and uniquely well qualified because of its legal and geographic relationship to units of local government and its greater ability to commit both financial and personal resources. State programs would be designed to augment, complement, and fill gaps in Federal and local housing and community efforts. State programs would be flexible and designed to meet the particular needs of each State within the range of activity options authorized by enabling legislation for this proposal. Authorization of $ million over a three-year period is recommended.

Improved State and Local Administrative Capacity

Our cities are faced with a number of fundamental and interlocking problems which require both immediate and long-range attention -- the problems of the ghetto, of schooling, job training, housing, health care, transportation, and many others. If these difficult areas of State and local concern are to be handled effectively, our public administrators must have available to them superior analytical and creative resources.

The Task Force recommends two approaches to making these resources more available to our public officials. The first is by tapping the great reservoir of talent in our cities which is primarily engaged in other pursuits, such as our scholars and business leaders. This is a ready source of ideas and know-how which can be put to immediate use. The second is by improving the quality of persons in the State and local public service. This is a more long-range approach but one which is essential to sound local government. It involves more emphasis on urban studies in our schools, more scholarships and other incentives for promising students to enter public service, advanced training for persons already in public service who wish to improve their abilities, and greater interchange of employees between the Federal Government and State and local governments.

The Task Force recommends:

-- Federal funding of 75 percent of the cost of Urban Extension Centers. These centers would be staffed by university, governmental and other personnel. They would provide mayors with assistance in innovating, planning, and coordinating policies and would act as the Mayor's special arm working with local community efforts to attack urban problems.

-- Full funding of the Federal-State training programs authorized by Title VIII of the Housing Act of 1964 and the Urban Information and Technical Assistance Services authorized by Title IX of the Demonstration Cities and

Metropolitan Development Act of 1966.

-- Resubmission to the Congress of the Intergovernmental Manpower Act.

-- Broadening of the National Defense Education Act to permit forgiveness of loans to those entering State and local government service, to the same extent now provided teachers.

FNMA ~~TYP~~ COMMUNITY

C.D.P. * Technical Assistance Agency
* TYPE

- ✓ Hospitals
- ✓ Schools
- ✓ Sewer
- ✓ Pollution
- ✓ Roads

$ 330 billion needed

- Mostly through tax-exempts now.
- Inefficient subsidy
  - Cities poor ratings
  - Not enough capitol
  - Longer term loans

- ✓ Woods
- ✓ Black
- ✓ Meyer

COMMUNITY DEVELOPMENT BANK

Recent studies have shown that our State and local governments will require approximately $328 billion to finance essential public facilities such as roads, schools, and hospitals through 1975. About half of this investment will be financed through the ~~capital~~ market in the form of State and local bond issues. The annual volume of bond issues is expected to increase from about $14.5 billion in 1970 to over $22 billion in 1975.

Capital, of course, is a scarce resource and has many competing uses. If State and local governments are to increase their rate of spending, they must be prepared to pay higher interest rates in order to bid the necessary funds away from other potential uses. Over the past 18 years, for example, the interest rate on high-grade municipal securities has more than doubled.

Because of rising interest costs, many hard-pressed municipalities cannot afford to finance the needed public facilities required for a growing population. The high cost of borrowing affects the number of schools and new classrooms which can be constructed each year. It limits the number of hospital beds which can become available. It limits badly needed local expenditures for roads and highways, libraries, and parks. It slows down the fight against air and water pollution.

The tax exemption accorded securities of State and local governments has provided a form of Federal subsidy to help finance needed public facilities, while according to State and local governments the greatest possible autonomy in selecting the public facilities to be financed in the capital markets.

However, the steadily growing volume of tax exempt financing has turned the tax exemption feature into an increasingly inefficient means of subsidizing public facilities constructed by State and local governments.

This is true because as the volume of tax exempt securities grows larger, investors in lower and lower income tax brackets have to be attracted into the market in order to provide a large enough supply of funds to meet the demand. Of course, the value of the tax exemption is less for taxpayers in lower income tax brackets and an increasingly higher yield must be provided as it becomes necessary to obtain the funds of these lower income investors. As this process accelerates, the tax exemption accorded the securities of State and local governments tends to cost the Federal Treasury more and more, while benefiting State and local governments less and less.

In the face of the erosion of the value of tax exemption to State and local governments, and a growing awareness of its cost to the Treasury, serious consideration has begun to be accorded proposals which would enable State and local governments to tap other sectors of the capital market for loan funds to finance their public facilities needs.

It is not a necessary condition of these proposals that they be viewed as a substitute for the present tax exempt status accorded the securities of State and local governments. Any one of these proposals could be adopted while the alternative provided by the benefits of tax exemption remain open to State and local governments.

The broad purposes that an acceptable proposal must meet are these:

-- First, and foremost, it should make possible a greater allocation of capital to the development of public facilities necessary to deal with the problems of the urban environment.

-- Second, it should stimulate the construction of public facilities which will contribute to the economy, efficiency and comprehensively planned development of the area in which the facility is to be located.

-- Third, it should alleviate the potential disruption of the capital markets occasioned by the un-coordinated actions of State and local governments seeking to borrow funds to finance the large increase in public facilities expenditures which will take place in the next decade.

-- Finally, it should reduce the excessive revenue loss resulting from the present tax exempt status accorded State and municipal securities.

The Task Force gave careful consideration to the establishment of a Community Development Bank that would accomplish these purposes in part directly, by its own borrowing and lending activities, and in part indirectly, by reducing the inordinate burden that now rests upon the market for tax-exempt securities.

In addition, the Bank might eventually take over and expand some of the direct Federal lending programs related to community divelopment, thereby simultaneously removing a burden from the Federal budget and relaxing the constraint on the availability of funds for these programs that results from their presence in the budget.

There are many reasons why the proposed new institution should be more efficient than existing arrangements in raising funds for the burgeoning needs of community development. Much of the financing that is now undertaken for such purposes takes place in narrow markets, is adversely affected by the small size, large number, and differential acceptability of issues, and leads to frequent market congestion because of inadequate coordination of issues. The new Bank, by contrast, would tap a much wider market; would borrow on a large scale and in a unified fashion, relying on an efficient marketing instrument -- or family of instruments -- with broad appeal to various investor classes; and would have ample flexibility in going to the market at the most favorable times. Moreover, as is discussed in further detail below, the Bank would provide a more efficient means than is now available of passing the maximum benefits of Federal subsidies on to States and localities.

In evaluating the financial conditions of borrowers and the economic feasibility of proposed projects, the Bank might, in its initial stages, rely on loan guarantees or other appraisals by Federal agencies or on essentially the same procedures, including the use of outside consultants, that are now used by municipal bond underwriters. However, decisions on such matters should be left to the Bank's management. In any case, as its activities expanded, it would consciously attempt to build up its own expertise in financial analysis, community planning, and project evaluation. Indeed, an objective would be to develop the Bank into a positive instrument for promoting orderly community planning in the financial and economic fields.

I. Organization and Management

The Bank would be organized as a quasi-public corporation, receiving its charter from the Federal Government. Its Board of Directors would consist partly of Federal Government officials and partly of representatives of governmental units eligible to use its lending facilities. For example, the Bank might have a Board of 13 members, including five Federal officials, one of whom would serve as chairman, and eight members appointed by the President of the United States with the advice and consent of the Senate to represent State and local governments and the private financial community. These members would represent States, counties, large cities, and smaller cities. The term of appointment might be 4 years with initial appointments staggered to provide continuity.

The Board of Directors would select qualified persons to serve as president and vice president of the Bank and to fill such other offices as might be provided in the bylaws, with executive powers and duties as prescribed by the bylaws or by the Board of Directors.

The above procedure for appointing the Board would assure State and local governments of adequate representation on the Board. In appointing members, the President of the United States might consult with various State and local interest groups, such as the League of Cities, Association of Counties, Council of State Governments, Governors' Conference, and the Council of Mayors.

As soon as feasible, it would be desirable for the Bank to establish regional or metropolitan subunits, which would seek to foster integrated regional development efforts and examine loan requests in the light of their consistency with such efforts. The existence of regional banks would be of special importance in promoting active participation of State and local units in the activities of the Bank and in allowing it ot serve as a vehicle for innovative and creative activities in the field of urban development. All market borrowings would, however, be carried out by the national Community Development Bank.

II. Financing the Bank

The Bank would raise the bulk of its funds by borrowing in the private capital market through the issuance of bonds or other debt instruments. The Bank's issues would have to receive the prior approval of the Secretary of the Treasury in order to assure that the Bank's extensive borrowings in the capital market were properly coordinated with Treasury debt management, and to facilitate the orderly marketing of the Bank's securities. The Bank itself would be exempt from all taxes except State and local property taxes. However, interest on the Bank's obligations would be subject to Federal, State, and local taxation to the same extent as the obligations of private corporations.

It would be necessary to protect holders of the Bank's debt obligations against possible losses of principal or interest in order to assure the Bank adequate access to the capital market at reasonable interest rates. Such protection could be provided in either or both of two ways:

1. The Bank's securities could be directly guaranteed as to principal and interest by the Federal Government.

2. Provision could be made for an indirect guarantee by authorizing the Bank to borrow from the Treasury up to $1 billion initially and $5 billion over a five-year period. This borrowing authority would not be used except in times of emergency or unsettled market conditions. However, the Bank would be permitted to borrow up to $10 for each one dollar of its capital, and its authorization to borrow from the Treasury would be treated as a part of its capital for purposes of computing this ten-to-one debt capital ratio. Either a direct or an indirect Federal guarantee would enable the Bank to borrow at favorable rates of interest.

Equity capital could also be accumulated by voluntary subscription and by requiring each borrower from the Bank to purchase its stock to the extent of 1 percent or 2 percent of the amount of the loan. This stock would be of the nonvoting preferred variety, which would pay a limited dividend of perhaps 5 percent per year. While not necessary, the issuance of stock by the Bank might expand its lending ability and perhaps create a desirable financial stake in the success of the Bank on the part of State and local governments.

III. Lending Activities of the Bank

The statute establishing the Bank might provide that its loans to State and local governments be limited to certain specified purposes, such as mass transit, public housing, other housing assisted by Federal or State governments, academic facilities, hospitals, municipal airports, sewage treatment systems, air and water pollution control, Model Cities, etc. The Bank might also be permitted to lend to private nonprofit organizations for specified purposes, such as the construction of college housing, academic facilities or hospitals. In making its loans, the Bank should be required to make certain that all Federal, State, and local laws are adhered to and that due attention is given to Federal standards that have been established with respect to the kinds of activities it is supporting.

Although the interest rate charged by the Bank might vary according to the maturity of the loan, the rate charged at any given time for a specified maturity would be the same to all borrowers. Of course, rates charged would vary over time as the Bank's own borrowing rates changed according to general credit conditions and Federal Reserve monetary policy.

The Bank would be provided with ~~a subsidy by~~ the Federal Government, which would enable it to lend at interest rates below its own borrowing rates. This subsidy might be handled in various ways. One way would be to provide the Bank with an open-ended subsidy which would enable it to lend to State and local governments (and other specified borrowers) at an interest rate equal to two-thirds of its borrowing rate. If the Bank was able to borrow at an interest rate of 6 percent, for example, this would enable it to lend at a rate of 4 percent. The Bank would be required to adhere to sound financial principles in making loans, and it would add to its lending rate a premium which would cover its administrative expenses and enable it to build up an appropriate reserve against losses. If this premium were 1/4 percent (and assuming no stock purchase requirement by borrowers), the effective rate to the borrowers would be 4-1/4 percent. The Bank's lending standards, together with the limitations provided in the statute on the purposes for which it would lend, would determine the demand for funds that would be forthcoming at a rate of 4-1/4 percent, and this would set a limit on the Bank's (net) lending and borrowing. If the Bank was not able to meet the demand for loans at 4-1/4 percent by selling 6 percent bonds, Bank lending would have to be curtailed, either by raising the lending rate or by establishing other priorities as a basis for rationing loans.

In practice, the Congress might not be willing to provide the Bank with a wholly open-ended subsidy. Instead, it might set an annual limit on the subsidy, and the appropriateness of the formula for computing the subsidy could be reviewed at the time of the renewal of the appropriation.

Federal subsidy to the Bank would not need to involve a net cost to the Federal budget as long as it did not exceed the savings of the Federal Government stemming from the substitution of taxable financing of State and local needs for potential tax-exempt financing. These savings presumably would be very substantial since, at the present yield spread between taxables and tax-exempts, it is estimated that a significant portion of the tax-exemption subsidy goes to private investors rather than to the issuing State and local governmental units.

To cite a (somewhat oversimplified) example of the amount of subsidy that can be channeled to the Bank without involving a net cost to the Federal Government: Assume that the average rate on new issues of nonguaranteed tax-exempts by municipalities is 5 percent, the rate on guaranteed taxable bonds issued by the Bank is 6 percent, and the effective marginal Federal tax rate for investors in the Bank's securities is 40 percent. The Bank would then market its bonds at 6 percent; 40 percent of the interest would be recaptured by the Federal Government and paid over to the Bank, so that its net rate could be 3.6 percent. The Bank could then lend to local governments at 3.6 percent (plus a nominal amount for reserves and expenses) instead of the 5 percent they would have had to pay in the tax-exempt market.

If the Federal Government wished to provide additional interest or other debt-service subsidies to promote certain types of investments eligible for Bank financing, it could reimburse the borrower directly or through the Bank for some portion of the debt service charged by the Bank on the loan.

IV. Relation of the Bank to Tax-Exempt Bond Market

The tax-exempt market would continue to be available to State and local governments as a source of financing after the establishment of the Community Development Bank. Indeed, in no case should there be any coercion or legal requirements for State and local governments to use the facilities of the Bank in lieu of the tax-exempt market. However, the establishment of the Bank would help to correct three serious defects in the tax-exempt market and make it into a more efficient financial instrumentality.

1. The steadily growing volume of tax-exempt financing has turned the tax exemption feature into an exceedingly costly means of subsidizing State and local governments. As the volume of tax-exempt securities grows larger, investors in lower and lower income tax brackets will have to be attracted into the market in order to provide a large enough supply of funds to meet the demand. As this happens, a smaller share of the subsidy provided

by the tax exemption will go to State and local governments and a larger share will go to taxpayers in higher income tax brackets. Suppose, for example, that the interest rate on securities of equivalent risk which do not have the tax exemption is 6 percent and that tax-exempt securities are bought by investors subject to marginal tax rates as low as 50 percent. In this case, the interest rate on tax-exempt securities should theoretically be 3.00 percent, because this interest rate would equalize the returns on tax-exempt and taxable securities for investors in the 50 percent tax bracket; however, taxpayers in brackets above 50 percent would get subsidies in the form of higher rates on tax-exempt securities than they could earn on taxable securities of equivalent risk. That is, only a portion of the tax exemption would to to State and local governments, the remainder being garnered by taxpayers in brackets above 50 percent.

Under present conditions, most tax-exempt securities are purchased by commercial banks, which are subject to a tax rate of approximately 50 percent. With the increase in State and local borrowing that is anticipated in the next few years, however, it will be necessary -- in the absence of a Community Development Bank -- to tap supplies of funds from investors who are subject to a rate lower than that applicable to commercial banks. As this happens, the differential between taxable and tax-exempt securities will have to narrow, thereby reducing still further the benefit of the tax exemption to State and local governments and increasing the proportion of the subsidy provided to high income taxpayers.

2. Because of the tax-exempt feature, municipalities are dependent largely on bank investors and are thus required to compete for funds with businesses and others borrowing directly from banks at interest rates substantially in excess of the rates on corporate bonds. As a result,

municipal borrowing rates are substantially higher than 50 percent of the rate on taxable bonds of comparable risk. In fact, tax-exempt rates are currently about 70 percent as high as corporate bond rates and about 80 percent of the rates on Federal agency issues.

To the extent that the payment of a direct subsidy to State and local governments on their borrowings through the Community Development Bank induced them to borrow from the Bank rather than in the tax-exempt market, the Treasury would gain revenue from the replacement of tax-exempt securities by the taxable securities of the Bank which would offset the cost of the subsidy. The subsidy going to wealthy taxpayers would be reduced, and the Treasury could, at no net cost in tax revenues, provide a larger amount of subsidy to State and local governments than they now receive through the tax exemption. Moreover, there would be a benefit to those State and local governments that continued to use the tax-exempt market, since, as the pressure on that market was reduced, the interest differential between taxable and tax-exempt securities should begin to widen.

3. At the present time, there are also wide disparities among the interest rates paid by different State and local governments. In part, these disparities may be related to the varying degrees of risk attaching to their securities. Largely, however, they arise from geographical differences in interest rates, from the large number and small size of issues, and from the lack of flexibility available to many communities in timing their borrowings.

The resources and procedures of the security-rating services that serve to determine the risk differentials among different State and local government security offerings are notoriously inadequate. Not only do some issues receive low rating and have to pay unjustifiably high interest rates, but, in addition, some governmental units are unable to obtain ratings and have no recourse to funds other than those of local financial institutions or well-to-do investors. The fact is that there have been no recorded defaults of principal or interest on State and local general revenue bonds for many years -- which clearly indicates that no significant risk attaches to these securities. By lending at a uniform interest rate, the Community Development Bank should do a great deal to correct these manifest inequities. Those governmental units subject to low ratings would have the greatest incentive to use the Bank, thereby leaving the tax-exempt market to those units receiving high ratings who consequently benefit most from the exemption.

The high rates charged some municipalities in the tax-exempt market may conceivably be a result of poor planning and financial imprudence on the part of these municipalities. The Community Development Bank could refuse to lend to a community whose financial practices were objectionable or could require that the bad practices be corrected as a condition for the loan. Indeed, once it was in full operation, the Bank would presumably be able to provide technical assistance to help a community institute sound financial procedures.

V. Growth of the Bank

The speed with which the Bank would be able to expand and its success in making additional capital available for community development would depend primarily on its success in developing a market for its own securities, on the aggressiveness of its management in pushing its objectives, including the development of its facilities for assisting communities in financial and economic planning, and on the amount of funds made available for interest subsidies. With an effective management and strong financial support from the Congress, the Bank should be able to make a major contribution within a few years of its establishment.

VI. Recommendation

The Task Force believes the establishment of a Community Development Bank to be both feasible and desirable. Accordingly, we recommend that the President appoint a commission immediately to formulate a detailed proposal, including a draft charter and bylaws and the necessary enabling legislation. The commission should include representatives of State and local governments, and of agencies of the Federal Government concerned with finance and with problems of community development, and should draw extensively on the advice of the private financial community. The commission should be asked to submit its report to the new President within three months of its establishment in order to ensure that the Community Development Bank would become an operating reality within a relatively short time.