Real Estate Issues

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AMERICAN SOCIETY OF REAL ESTATE COUNSELORS

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Real Estate Issues

About REAL ESTATE ISSUES

by Neil J. King, C.R.E.

The American Society of Real Estate Counselors is pleased and proud to offer this first volume of ***Real Estate Issues*** to the real estate and academic fraternities. The scope of the topics herein reflects the wide-ranging pursuits of ASREC's 441 members in the United States, Canada, and Puerto Rico, whose interests include yet transcend brokerage, appraising, management, real estate securities, land development, and mortgage banking.

Although their attention focuses primarily on real estate and the solving of often fascinating and complex problems in specific areas, Counselors are sought to paint a broader picture for both public and private clients. In terms of time, expense, public impact, and sheer magnitude, the C.R.E.'s work involves not only attention to detail, but consideration of the governmental trends and long-term effects that a development will have on the surrounding neighborhood and community.

While ***Real Estate Issues*** addresses macro and micro matters related to real estate, articles will also appeal to those in allied fields: planners, architects, developers, economists, politicians, scientists, and sociologists. Hopefully, the perpetration of a common language based on experience and theory will benefit all who put real estate to use.

On behalf of the American Society of Real Estate Counselors, special thanks is extended to Jim McMullin, C.R.E., of Arlington, Virginia for spearheading this effort and to Jean Felts, C.R.E., of New Orleans for her able assistance. Jim's foresight and perseverance have culminated in a valuable contribution to real estate literature.

I hope that you find the articles in ***Real Estate Issues*** thought-provoking and informative. We're most interested in your reaction and urge you to send comments and suggestions to the ASREC editorial office, 430 North Michigan Avenue, Chicago, Illinois 60611.

Neil J. King, C.R.E., 1976 president of the American Society of Real Estate Counselors, is president of Armond D. King, Inc., Skokie, Illinois.

Foreign Investment in U.S. Real Estate

by Gene Wunderlich

WHO SHOULD OWN THE LAND?

The American's possessiveness of territory against outsiders has a long history. "As early as 1635 Watertown passed its order that no 'forreiner' coming into town should benefit by the commonage . . . "[1] Prior to 1659, Connecticut forbade sales to outsiders unless the town gave permission.[2] Even dower rights to land were denied a widow who had not joined her husband in American citizenship at the time of the Revolution.[3] The existence today of 29 state laws[4] of varying severity and effectiveness which limit land holding by aliens is evidence of the latent opposition to ownership of land by outsiders.

Despite such delitescent discrimination against outsiders, land holding in the United States has a history of liberal settlement and sales.[5] Questions about the legitimacy of past European claims to North America[6] have never been a serious bar to the free marketing of America's land. Nor has concern for future patterns of land use or land ownership in the United States been of much public concern until recently. Therefore, this inquiry into the basis for differential treatment of citizens and aliens in land holding was made in the context of a tradition of relatively unrestricted possession and transfer of land. Subsurface sentiments against outsiders have generally been suppressed in favor of perceived economic advantages of an unrestricted market for land.[7]

Although the impetus of this inquiry was an examination of foreign investment practices and policies, land in these chapters has been accorded a broader base of analysis. The foreign ownership of land in the United States is part of a larger question: Who should own the land? Correlatively, what benefits and responsibilities should ownership entail? Is citizenship a basis for special benefits and special responsibilities?

This article was originally part of a report submitted by the U.S. Department of Agriculture to the U.S. Department of Commerce, as a result of the Foreign Investment Study Act of 1974 (P.L. 93-479). In public domain.

1. For this and subsequent footnotes, see "References" at end of article.

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LAND, CITIZENS, INFORMATION

Three critical features of the foreign investment issues are land, citizens, and information. Let us first examine the meaning of these features as they bear on foreign investment policy, summarize the authored sections, and then arrive at some conclusions.

Land

Land has physical, economic, and institutional qualities sufficiently unique to require separate attention in direct investment policy. We need only say about the physical quality of land that it is scarce in relation to the total potential uses. Each unit of land has but one location; it absorbs, stores, or emits energy; it defines activity; and it limits the existence of man absolutely. Without space there would be no circumstance.

Land in this report, however, is defined as a resource; its more relevant qualities are economic and institutional.

The economic value of land[8] follows directly from physical scarcity; there are simply more wants from the land than can be supplied without cost (even if the cost is only that of deciding). If land cannot supply man his wants, then man must apply labor (work) or capital (save). From the product created by a combination of labor, capital, and land are paid wages, interest, and a remainder—rent. This elementary restatement of distribution principles is intended to distinguish land, the resource, from real estate, the paper claim to land often merged with capital.

The institutional features of land follow from the physical and economic qualities. However, the rules about land access, use, and benefit, i.e., the institution of property, are determined also by the level of sophistication of society—its capability to manage symbols.

In simple societies it is possible for an economy to function through single, unique transactions for goods or services. Complexity and size require rules for categories of things and processes. Thus, livery of seisin gave way to modern conveyancing—the volume of land trading was too much for a simple direct system.

But each degree of sophistication requires standardization and classifying—so the progress of society calls for homogenization—the physical (and to a great extent economic) qualities of land are lost to the exigencies of a classifying and refining market. The land market, still primitive by the standards of the household goods market, is moving rapidly to the point of pure manipulation of symbols.

The greater the volume of real estate transactions, the greater the need for mass marketing techniques, grades, standards, forms, regulations, and controls. "Paper" is replacing territory. One consequence is that policies are designed in terms of paper and symbols which do not fully take into account the territory and uses they represent. The nature of land as a resource in economic processes may be forgotten. Policies to affect the real estate trade may not be effective policies for land. Policies to affect international investments may not be effective policies for real estate.

Citizens

The request by Congress for the study of alien investment implies that citizenship is a crucial ingredient in the national policy of investment. Especially must this be true about land, for citizenship is defined, in part, by land. McDougal, Lasswell, and Chen refer to "membership in a territorial community"[9] and Bickel adopts Holmes' definition of citizenship as "a territorial club."[10] The concept of exclusion at the heart of property is also the essence of citizenship.

Citizenship connotes an interest in the common property of a nation.[11] The cliché of owning stock in a nation is not without substance. But is owning stock in a nation to be one of the exclusive privileges of being a citizen? The question underlies investment policy. Obviously the answer must extend beyond the simple economics of resource control and international finance.

Why does a citizen of one country invest in the territory of another? Are there motivations beyond the monetary return and security of asset? Citizenship is an investment of allegiance.[12] Citizenship provides "protection against other territorial communities and of securing richer participation in the value processes of his chosen community . . ."[13] Does investment provide some of the amenities (and burdens) of citizenship? Is equity equivalent to patriotism?

The attractive aspect of citizenship to an individual is gaining some advantage, or avoiding some disadvantage—that is, acquiring some benefit as a member of a nation.[14] Presumably, then, a policy of investment in the land of a nation can be viewed in terms of the benefits of citizens vis-a-vis others. Even the 18th century liberal arguments for free trade were not based on a one-world philosophy but on the idea that free trade was good for the nation and its citizens.

Citizenship ***jus soli*** grows directly out of the land, and even citizenship ***jus sanguinis*** merely employs a blood step to territory. Citizenship may be termed land's investment in, and claim on, people. "Patriotism is the demand of the territorial club for priority . . ."[15]

A policy on international investment in land must at least imply some vision of the benefits and burdens of citizenship. This inquiry on international real estate investments recognizes that nations can and do discriminate on the basis of citizenship.

All of the sections of this report, one way or another, touched the issue of benefits and burdens of membership in the territorial club. We have not treated the topic of citizens, subjects, and nations exhaustively. Perhaps this inquiry into alien land ownership, however, may be a useful entry into other inquiries about the nature of man and state.

Information

The Foreign Investment Study Act of 1974 is itself a testimony to the significance of information. Congress passed the Act because it felt that information on foreign investment was inadequate. This report on investment in real estate provides an entry into some basic policy issues of the rights of citizens and governments to know, the nature of property and privacy, and the privileges and responsibilities of foreigners to supply information to members of the "territorial club."

Most recently the policy issue relating to information has been framed in terms of personal privacy[16] and federal[17] and other institutional[18] records related to specific persons. However, the information issue goes beyond personal privacy and into commerce, industry, finance, and intergovernment relations. What are government's duties to obtain information in support of commerce, national security, and economic prosperity? What are government's duties to inform its citizens? What is a public record?

Aside from regulation or restriction of foreign holding of real estate, the major policy issue relates directly to information: Who should report what to whom about real estate transactions, holdings, and interests? What information about real estate transactions, intentions of transactions, financing, ownership, and lesser interests should be made available to other parties, to government, or to the public at large? Some of the policies relating to information may pertain to any investment, portfolio or direct; other policies may distinguish the economic and institutional qualities of land. Our principal concern is information about property in land.

The concept of information is a root of property.[19] The entitlement to a property object such as land is a proclamation of interest to and against the world. To the extent the claim is honored and enforced, the world acknowledges the proclamation.

Muniments of title or registration certificates are written forms of communication essentially between the rights holder and all other persons. They are public documents; they must be public to serve their purpose. Even unwritten evidences of entitlement, such as "open and notorious possession" or preliterate public exchanges of wealth, are communications to the world—publicity.

Public though they may be in a legal sense, the public land records are not in fact a generally accessible display of land, interests, and interest holders.[20] The character of public records of landholding has been shaped by requirements of parcel conveyancing.[21] Public records are suited to assurance of individual interests on a transaction-by-transaction basis. They are generally not suitable for a cross-section display of ownership status, say, of a whole jurisdiction.

Ownership status is further obscured by trusts, nominees, and other devices which veil the beneficial owners of property.

The economic function of information is to reduce uncertainty in the processes of resource allocation or exchange.[22] By reducing uncertainty in the assignment of benefits and costs to people, information also plays a role in the distributive process.[23] From a public or economic point of view the arguments for information may be summarized as strongly in favor of the maximum amount of accurate information that cost will allow. From an individual point of view, however, withholding information can provide private advantage. Much of the world's commerce is conducted on the basis of private advantage of secrecy or misinformation. A substantial portion of the real estate trade, for example, is conducted with privileged (restricted) information. Secrecy is clearly to the advantage of the traders; the advantages to the public at large are less obvious. From an economic or social standpoint of information, the

use of a nominee to obscure beneficial ownership is a lie. Whether such lying has overriding advantages to an economy and society should be a matter of public policy discussion.

With the possible exception of the essentially untested law of Iowa,[24] no state has a system of record keeping that identifies the actual owner of land by his citizenship. Iowa's modest entry into ownership disclosure provides an interesting prelude to the inquiry of individual and national rights to wealth encouraged but not ventured by Alfred Marshall 85 years ago:

> "Individual and national rights to wealth rest on the basis of civil and international law, or at least of custom that has the force of law. An exhaustive investigation of the economic conditions of any time and place requires therefore an inquiry into law and custom; and economics owes much to those who have worked in this direction. But its boundries are already wide and the historical and juridical bases of the conceptions of property are vast subjects which may best be discussed in separate treatises."[25]

AN INQUIRY INTO THE OWNERSHIP OF U.S. LAND

Recitation of facts, such as 4.9 million acres owned by foreigners and 62.8 million acres leased by foreigners,[26] is a sterile exercise without an understanding of the processes by which land ownership changes, the forces that have affected and will affect ownership distribution, and the effects of investments in land. This report provides the ingredients of a policy-oriented inquiry into U.S. landholdings.

In their most general form the issues can be summarized simply into one: there is lack of knowledge not only about land ownership facts but about their causes and consequences. These causes and consequences are digested and combined below under four topics: 1) the real estate institution and investor behavior within the institution, 2) impacts of foreign investment on the economy in general and on particular sectors and regions, 3) formation and administration of federal, state, and local law, and 4) needs and technology for, and limits on, the disclosure of land ownership information.

The Real Estate Institution

The author has not premised his analysis on a large volume of foreign investment in land. Nevertheless, his inquiry provides useful insights for policy if a large volume of foreign investing in U.S. land were to take place. A growing familiarity with American brokerage, financing, and transfer institutions will tend to encourage real estate investment by foreigners. Therefore according to the reasoning by Burke, Harris/Hampel, Dovring and others, even if the proportion of all real estate owned by foreigners is small now, the quantity will probably increase.

Public policy on foreign investment in U.S. real estate needs research on a continuing basis, not only to monitor the facts but to understand and project the public's intentions and interests. Timmons, in his overview of the relation between policy and research, emphasizes that data and reliable analysis are needed so that policies will not be fashioned from emotion, myths, and fragments of information.

Research questions arise as much from perspective as from situation. One perspective of foreign investment is the flow of capital over time. This flow of capital into the country began long before the United States achieved nationhood. Anderson, in his historical review reminds us that large tracts of West Virginia land were purchased by British investors to sell to immigrants. The story of European investment in U.S. land was repeated across the whole country. Much of the European investment, however, was not channeled into land exclusively. Our historical data must combine time series of total investment with fragments of information on real estate. Often the type of investment would obscure the element of land. Investments by Europeans in American railroads, for example, was a ***de facto*** investment in railroad lands, granted by the government and, in turn, sold to settlers.

It would be easy enough to associate the developmental capital which flowed into America in the 19th century with speculations and investments in land. As Anderson points out, rarely are capital accounts sufficiently refined in historical data to distinguish the land element.[27] Benefits stemming from the development of transportation, manufacturing, and construction could be mistakenly attributed to land purchase, sale, and lease. Before an accurate assessment of the economic effects of foreign investment can be made, the purposes of the investment must be known.

In the mid-20th century the locally oriented U.S. real estate market extended itself to a national trade. Then in the early 1970's the American real estate establishment internationalized its perspective. Not only are foreign buyers now undergoing an educational process, American financial organizations, brokers, finders, attorneys, and insurers are learning the international land game. Early in this inquiry we asked: Is there an international real estate institution? Burke, in his article on transnational conveyancing, concludes "yes," but it is still taking shape. The lack of uniformity in state land law combined with possibly overriding federal law creates a complex web of doctrines and rules that are difficult enough for those familiar with American conveyancing. To the foreign investor the rules are even more perplexing. Furthermore, as Brown states ***infra,*** laws and ordinances are not always applied equally to outsiders and locals.

The unique and complicated features of the law may account for some of the conservative approaches to real estate investing in these early stages of the internationalization of the institution. The uncertainty of investors and advisors creates a "herd instinct" and causes them to follow regional or sector patterns with which they are familiar. The lack of large-scale, smoothly functioning markets probably affords an opportunity for the one-person, small-firm finders to trade profitably in limited information.

The foreign investor is likely to have a large equity in real estate, purchased not only because of his financial capability but because he is apprehensive about the information requirements of American lending institutions. Unless the foreign investor abandons his traditional reticence about disclosing information, it is likely that effective reporting requirements would tend to discourage foreign purchases.

The complex rules comprising the real estate investment and finance institu-

tions are rooted in, and are implemented in the presence of, an equally complex collection of attitudes and beliefs of citizens about foreigners. The alien land laws are but reflections of attitudes of exclusion from the territorial club. Lack of experience, explains Summers, is no bar to expression of an attitude. Attitudes may be built from complexes of beliefs, and so the attitude toward Arab purchase of a neighboring farm may have nothing to do with a farmer's experience (or lack thereof) with Arabs. Furthermore, his attitude about farm land may differ completely from his attitude about an industrial site. An informed position on public reaction to foreign investment in real estate requires more than ascertaining surface opinions. Thus, informed public policy will require an examination of basic attitudes held by those who influence the content of the policy.

At the other end of the policy chain are the issues related to the uses of power. Ownership and control of land is a means for distributing and exercising power; the rules governing the acquisition of title, the application of regulation, the distribution of income, and the incidence of tax all are subject to the political process. Rule-making and rule enforcement are political processes, and as Loveman points out, ownership is actually defined in terms of the location of decision-making about the use of land or about the distribution of benefits and costs of land holding.

The relatively few restrictions on foreign ownership of U.S. land is a reflection of the decentralized power of numerically strong landowners and the real estate establishment—brokers, attorneys, financial institutions, and others associated with the transfer and management of real estate. This strong position is not unique to the United States. The political power of land ownership explains why there have been virtually no successful land reforms in the world that did not involve shifts of political power.

The basic political question is, according to Loveman: Do citizens in general have a right to know who owns America's land? His question recognizes directly that information is not only economically valuable but politically powerful. The answer to the question is by no means simple because it inquires into the nature of commercial security, privacy of wealth, and relationship between government and citizen. In the case of foreign ownership of land the answer extends to relationships among nations. Hopefully the answer will express more than textbook cliches on free trade.

Three papers by Paulsen, by Harris and Hampel, and by Currie, Boehlje, Harl, and Harris, examine the real estate institution from the point of view of those participating in the investment process. Paulsen's comparison of German and Iranian investors makes the simple, direct point that investment motivations differ, and these differences will be reflected not only in the type of investment but the manner in which the investment is undertaken. His observations about investment motivations are borne out, partly at least, by the study of real property transfers in Iowa reported by Currie and others. The Iowa study not only found that the number of completed sales to foreign investors was small, but also that the sales were predominately to Germans. The study confirms, to some extent, what Burke refers to as a herd instinct of investors, what Summers suggests about discriminatory attitudes, and what Paulsen says about the pref-

erences of types of foreign investors. The Iowa study incidentally indicates the difficulty of documenting sales to foreign investors.

The investment model by Harris and Hampel rigorously defines the elements of the investor's bidding potential. Their equations state the relationship between the bid prices and the characteristics of the investor, including his risk preferences, value of his portfolio, his tax rate, and his expectations about income. From the model it is possible *a priori* to indicate the sources of bidding advantages to a domestic farm operator or to a foreign investor. The biggest advantage to the domestic operator is greater income per acre. Included in other advantages are the lower transaction costs to domestic bidders. The advantage to the foreign investor is diversification of the investment portfolio so that marginal riskiness is lower than for the domestic bidder. The relative riskiness of investments due to political conditions in other countries may cause the foreign investor to be less risk averse to American property.

From all of the examinations of investor behavior, it seems that improved information could lower transaction costs and encourage better investment decisions as a whole. That is not to say, of course, that it is to the advantage of any particular investor or broker for any particular transaction to reveal anything about his investment intentions or actions.

Economic Impacts

Having examined the character of the real estate institution and the behavior of investors within that institution, we turn now to the economic impact of foreign investment in land. Dovring and Gaffney seek to answer the question: Do purchase and possession of land have the same impact as other direct investments?

Notwithstanding a U.S. policy that generally encourages the inflow of capital, we should be circumspect about foreign ownership and control of land. According to Dovring, the long-run benefits to the United States of foreign investment in land are doubtful. Dovring argues that the society and a private entity differ in their perceived discount or interest rate. Individuals, compared to society, have a high time preference for present income. This difference is particularly significant in calculating the value of a non-depreciating asset such as land. Society can afford to accept a lower rate of return on the value of an asset.

The social account value of land to the United States as a nation is greater than the private market indicates. Therefore, transfers in the private market will not reflect this public interest. According to several authors, foreign and domestic purchasers differ in their perception of land as an investment asset. Some of these differences are attributable to tax laws of various nations. The real property tax is payable by all foreign and domestic owners, but other taxes on income from land, capital gains, or inheritance may not be the same for the foreign as the domestic owner.

Dovring and others note the relatively low value of real estate in the United States compared to comparable real estate in other countries. Dovring notes that long-term investors, especially institutional or governmental, can sustain relatively low current returns because of contemplated longer term capital gains. Expectations of such capital gains are supported by the experience in

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other countries and the probable policy of the U.S. government to continue programs whose effect is to enhance land values. Given the relative states of management and technology in the United States and abroad, there is small likelihood that foreign investment in land, farmland at least, will result in intensification of use or increased productivity.

In summary, Dovring sees few positive impacts resulting from foreign investment in farmland or forest land. Presumably, one could extend some of his arguments also to open land suitable for development. A similar case against foreign investment in real estate which results in construction, development, employment, formation of joint-venture capital, and transfer of technology would be less convincing.

Sales of land to foreign investors, according to Gaffney, are equivalent to borrowing abroad. The real issues are the impacts of real property investment which are conditioned in large part by domestic institutions. Presumably, therefore, problems associated with international land transactions are manageable as domestic policies.

Gaffney enumerates advantages of foreigners purchasing land, such as a transfer of capital in time of need, the stability of land sales over flights of "hot money," the economic and political stake of foreigners in the United States, the balance of U.S. investment abroad, the infusion of new management, and obviation of policing a restriction. The disadvantages include loss of control of resource use by U.S. citizens, the preference for less intensive land use associated with foreign investor preference for minimum management, loss of sovereignty associated with land, less concern of foreign investor for community well-being, loss of tax base through income and consumption taxes, loss of secondary demand because of absenteeism, and increased ownership concentration.

The net advantage or disadvantage to a nation of direct foreign investment, according to Gaffney, depends on the structure and operation of domestic institutions. In particular, he notes that the tax structure generally favors the foreign investor. The exception is the property tax; Gaffney suggests real property taxes as a way to offset disadvantages associated either with foreign investment, or with traditional preferences land and landowners have enjoyed in the economic system. He and others note that foreign investment in real estate is not in itself a problem but is, instead, a symptom of lower domestic capacity for capital accumulation.

The general analyses by Dovring and Gaffney pertain to the abstract qualities of land. However, the impacts of foreign investment will differ widely among land uses and regions. Several analyses were directed to specific uses—namely, farmland in Iowa discussed above; forest land; minerals, especially in West Virginia; recreation and other uses in Hawaii; and land ownership in Texas and Colorado.

Both Irland and Labys, in examining respectively timber and mineral resources, stress the importance to foreign investors of assuring supplies of natural resources for their homeland. They note that land ownership is only one of the ways of assuring supply. Land use and income may be controlled by

leasing, contracting, and even marketing practices. Commonly, control is obtained by a combination of ownership, leasing, and contracting—often through complex systems of subsidiaries and affiliates.

Although land prices are low and growth rates are high in the United States in relation to the rest of the world, foreign investment in timberland has been small—one third of one percent of U.S. commercial forest land. Irland explains that timberland, with its management requirements and cash flow delay, is unattractive to the foreign investor. In Alaska, forest production of interest to the Japanese is on state and federally owned land. Japanese investment, therefore, has gone into processing logs and pulp. Except for Alaska, most of the foreign investment in American timber serves the U.S. market. The economic effects of foreign investment in timberland, according to Irland, have not been negative. This may be accounted for in part by joint ventures with American investors.

Foreign investment in coal has been heaviest in coking coal; mines with foreign investment produced 16% of the U.S. coking coal. Labys estimates that West Virginia mines with foreign interests would produce 18% of the state's production by 1978, a doubling in five years. Labys judges that foreign investment in mining processes has a favorable impact on the balance payments, employment, and income. He indicates that the predominant investment is in extraction and processing rather than in mineral land ownership. He does not assign any particular economic benefit to foreign ownership of mineral rights or mineral land ownership. He points out the inadequacy of available data, and recommends "considerable further work."

Gertel, in his study of foreign, largely Japanese, investment in Hawaiian real estate, noted that ownership of nearly 40% of the hotel units in Waikiki and a substantial portion of the condominiums was of the structures while land remained in Hawaiian ownership. About one-fourth of the $517 million of foreign real estate investment in Hawaii in 1975 was new construction, estimated to have increased income to Hawaii households by some $178 million. Foreign real estate investment expanded the economy of Hawaii but also added to problems of congestion, traffic, the oversupply of condominiums, and high land prices. Some two-thirds of the foreign real estate investment were takeovers of existing resort facilities, sugar plantations and purchase of land tracts. The national impact of these takeovers could not be fully traced; they depend, among other uncertainties, on whether sellers invested funds received in the American economy. Gertel joins Gaffney in stressing land use and tax policies as basic defenses against adverse impacts of foreign as well as domestic real estate activities. Citing citizens' concerns he calls for authoritative information on foreign-owned real estate supported by an adequate data base.

The Colorado real estate market examined by Waples reveals a familiar problem in identifying current or prospective foreign investors. Colorado law, for example, requires assessors to file annually a list of nonresident taxpayers, but does not require that the beneficial owner be identified. Through personal interviews with real estate brokers and counselors, Waples was able to identify some urban, recreation, and development action in the real estate market. Although some farm and ranch land has been sold and many more inquiries

have been made, the amount of land is small; Waples could verify only 1,780 acres and rumors of about 38,000 additional acres. Inquiries apparently are numerous; transactions are few.

The Colorado survey of bankers, brokers, extension agents, recorders, and assessors revealed no strong opposition to foreign investment by Coloradans. According to Waples they favorably regard the import of capital. Two reasons are given for opposing foreign investment—absentee owners have no interest in community affairs, and outside investment causes land prices to rise.

Schmedemann divides the real estate market into separate submarkets in terms of the types and objectives of buyers. He found that most foreign investment was disadvantageous to communities and agriculture. In addition to two traditional markets based on 1) production income and 2) consumption utility, he identifies 3) an inflation market for foreign and domestic buyers. Particularly under the conditions existing in Texas and the Southwest, an absentee foreign investor will have little incentive to invest in rural communities. Typical expenditures associated with foreign investment will have low multipliers and high leakages. Community consolidations and shifts of economic activities to larger centers will result not only in economic changes but changes in political outlook. Because the proportion of land changing hands is small—probably less than 2%—a relatively small number of transactions can affect land values. An increase in foreign investment in agricultural real estate will increase land prices and thus increase the cost of agricultural production. Schmedemann sees a number of reasons for an increasing trend in foreign investment in Texas and Southwest rural real estate, but little advantage of such investments to communities or to the area's agriculture.

Law of the Land

Law—its foundations, structure, and administration—will have a significant bearing on real estate as an investment. American law has a number of features, not well understood by foreigners, that could influence investor behavior. Some legal issues have yet to be completely resolved. One such issue is the strength of state laws prohibiting foreign holding in light of the treaty powers of the federal government.

Law affecting land use and development has been more prominent in urban areas. Zoning, subdivision controls, building codes, and health regulations are found in both rural and urban areas, but they are of greater significance in urban areas. Thus Brown, in his review of land law impacting foreign investment, focuses his analysis on urban land. He notes that the number, complexity, and divergency in local applications of land use regulations reduce the attractiveness of real estate as a foreign investment. For development particularly, the intricacies and inconsistencies of local land laws are a deterrent to investment.

Zoning law does not differentiate between foreign and domestic land owners. The alien investor will not be affected *per se* by his alien status. Within broad guidelines, however, there remain wide areas of discretion by local officials. Brown emphasizes that the zoning game is sometimes played with favoritism; "outsiders," foreign or domestic, are at a disadvantage. Foreign investors may be advised to joint-venture with those who are locally favored.

Subdivision regulations have increased, and subdividers have been required to accept more of the costs of installing utilities. Community management and control has expanded and, as in the case of zoning, approval and monitoring of subdivision regulations can be exercised in discriminatory ways. Housing and building codes, too, vary widely, not only in the provisions of the ordinances but in their application.

One possible source of misunderstanding is the power of eminent domain held by most levels of government. Its significance is lessened somewhat by its infrequency of use. Nevertheless, foreign investors may be unaware of the ease with which land can be condemned, not only by federal or state governments but by the delegation of this power to private entities. Of course, just compensation must be paid, but presumably courts could, even if now they do not, compensate at considerably less than market value.

Brown also reviews management and control processes exercised by property owners' associations, condominia associations, Realtors, builders, and other trade associations which impact on development either through their role under statutes and ordinances or through contracts and covenants. At the other end of the government scale are state, regional, and federal agencies. Environmental and consumer protection legislation will affect not only the ease with which real estate is marketed but the uses to which the land may be put. Alien investors could overemphasize the American constitutional protection against expropriation of private property unless they are carefully advised of the exercise of eminent domain powers or the effects of other controls and taxes.

At the other end of a legal spectrum affecting foreign investment is international law including customary law, multilateral treaties and bilateral treaties. Morse concludes that treaties, coupled with most-favored nation clauses, severely limit federal or state laws attempting to restrict alien ownership. However, a registration requirement, either of state or federal government, would not be superseded by a previous treaty or be in violation of a treaty.

With the possible exception of land under the sea neither customary law nor multinational treaties have any important bearing on foreign land holding. Bilateral treaties, however, do affect directly the alien ownership of land. Citizens of Denmark and Ireland may own land for almost all uses except agriculture and mining. Six other treaties provide most-favored nation treatment as to acquiring and possessing land. Most countries allow time for disposing of land if alien status is a bar to possession.

Most bilateral agreements are the treaties of friendship, commerce, and navigation which contain provisions granting persons or corporations specific rights to own or use land in the United States. Usually the treatment grants a level of treatment pertaining to the specific right. National treatment guarantees that the national government will not discriminate between aliens and citizens and states will afford the same treatment as citizens of other states. Most-favored nation status assures the alien that he will be treated the same as a citizen of any other foreign country. The supremacy of treaties and most-favored nation provisions severely limit state laws restricting inheritance and possession of land. Of the 43 treaties currently in force about half have granted

national or most-favored nation treatment to aliens for ownership or lease of land for residential, industrial and commercial purposes. Agriculture and mining are excluded. This means that state laws which confine their restrictions to agricultural or mineral land are less likely to be superseded by treaty.

Morse also reviewed the laws of Yugoslavia, Mexico and Canada, three countries which have recently examined their alien ownership policies and which represent widely differing political perspectives. Yugoslavia, which permits private ownership of only residences and small plots by its citizens, does not permit any direct alien ownership of land. Its imports of capital are through joint ventures with the alien retaining title to his assets but not acquiring an interest in the enterprise. Some modifications of law relating to use are resulting from the Yugoslav desire to encourage capital investment from abroad.

An alien wishing to acquire ownership or control over Mexican land is subject to that country's Foreign Investment Law. The law prevents foreign ownership of coastal and border land. It also reserves some land uses to the Mexican government or Mexican companies, usually mining or forestry. Registration is required of alien investors with penalties for failing to register.

In Canada restrictions on alien ownership differ by provinces. Restrictions by the federal government under the Foreign Investment Review Act (1973) also will have a bearing on alien ownership but the division between federal and provincial responsibility is still not entirely clear. Purpose of the FIRA is to screen foreign investments generally and as yet has had little to do with real estate. Older authority, the British North America Act, delegates to the provinces the power to regulate, manage and sell real property to the public. In some provinces there are no important restrictions even on state owned land and in others, such as Prince Edward Island and Saskatchewan, alien ownership above a specified amount is prohibited.

In Alberta, Nova Scotia and Ontario, alien investors are required to register. The Nova Scotia Land Holdings Disclosure Act requires all non-permanent residents who acquire land holdings, and anyone acquiring on their behalf, to register. The Nova Scotia law was recently upheld in court. Ontario not only registers alien land investors but charges a 20 percent transfer tax. The Ontario Law has the effect of making up some of the disparity between private and public value of real estate.

The law of the land as it affects foreign investment in U.S. real estate extends much beyond the state restrictions on alien investment. Brown shows how zoning and subdivision law—the discriminatory manner in which it may be administered—may influence investor decisions. Morse shows that treaties and federal supremacy nullifies much of the state limitation if, in fact, it were effective. Both writers indicate the need for better information and recommend a policy of reporting or registering alien interests in land.

Information

From the outset of this inquiry the author has been perplexed by the absence of aggregative statistics on alien investment in land. The lack of land ownership information is not unique to alien investment. On any but the local level we do not know who, domestic or foreign, owns the land. Universities, pri-

vate organizations, and federal agencies are attempting to obtain better information, but a national system for data collection has yet to be developed. The final section of this report focuses on what may be the only fundamental policy issue—information. Who gets what from whom, how, when, and where.

Most of the studies in some way touched the information question, but Zumbach, Harl, and Cook made it the central focus of their investigative efforts.

The two most logical sources of land ownership data are the conveyancing and tax assessment processes; these are within the authority of the states and are administered by localities. We therefore look first to these governments. However, it appears that an adequate land ownership system will require some federal action or a coordinated federal-state-local undertaking.

From the standpoint of data on alien ownership, the most advanced state reporting procedure appears to have been designed by the 1975 Iowa General Assembly. Iowa has had restrictions on alien ownership since the 19th century but without monitoring. As described by Harl, the procedures under the new act (House File 215) call for corporations, partnerships, and nonresident aliens who own or lease agricultural land for farming to report annually to the Iowa Secretary of State. The report includes the identity of beneficial owners. County assessors are required to submit lists of names and addresses of aliens, corporations, trusts, and other entities shown on the assessment rolls. Data from the first year's reports are expected in mid-1976. Experience with the Iowa reporting law will indicate what can be done at the state level.

Zumbach and Harl review the implications of state and federal reporting, assuming certain ownership information needs. State recording acts, as presently written, do not provide a basis for adequate reporting of alien ownership because 1) alien status of the owner is not required during the recording process, 2) the holder of legal title is not necessarily the beneficial owner, and 3) although there are some risks associated with not recording title, it is not a legal requirement. The problem of beneficial ownership, as Zumbach and Harl write, is likely to be a problem in any reporting procedure, not just in title recording. Artificial entities—trusts, corporations, partnerships—may obscure the identity of owners even if there is no attempt to maintain secrecy. Artificial entities may have no idea who the holders of equity interests may be at any one time. Although collection of the information is possible, it is likely to be costly and resisted by large firms. Even if all beneficial ownership were identified the reporting system would not reveal control.

If the reporting requirements were to rest solely with the states, there would be little likelihood of consistency of concepts or procedures among them. Further, because of the full faith and credit relationships among states, a state that wanted to become an anonymity haven would probably not have to report investor information to other states. Zumbach and Harl therefore conclude the need for some federal involvement. They rely on the commerce clause for federal authority to create a reporting system. They also might have included the "general welfare" clause. Their analysis points to a need for some combination of 1) existing state and local responsibilities for real property taxation and title recordations, and 2) federal standards, coordination, and collection of data.

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Although some federal, state, and local government involvement may be assumed, professional and private associations could take an important—perhaps a primary—role. The titles of the Uniform Simplification of Land Transfers Act (USOLTA), dealing with recording for example, might be so worded as to provide suitable information reporting. Research departments of organizations such as the National Association of Realtors® or the American Land Title Association might generate aggregative data from their members.

The technical issue of information on alien land ownership is that the data sources are local, subject to avoidance and evasion, and oriented to a single transaction such as paying a tax or conveying an interest. In contrast, data needs are national or state, aggregative, and unambiguous. Any continuous monitoring procedure by the federal government will require a new program and new authorities. A single-purpose monitoring program probably would be too costly except on sample of such small a size as to be dubious reliability. A proposal for a specific system may be premature but some features of an adequate system can be identified.

The land data system should be:

1) Oriented to ongoing local functions such as planning, zoning, conveyancing and tax paying.
2) Updated regularly and frequently (no less than annually).
3) Comprised of data not only of alien status of land owners, but by type of owner (government, corporation, individual, and so forth) and area and value of the property.
4) Oriented about a universal system of identifiers.
5) Designed to provide adequate security for data considered to be outside the scope of public information.

Such features are being discussed by a number of professionals and organizations. The section prepared by Cook discusses a 13-year review of organized efforts in land record improvement that lead to the North American Institute for Modernization of Land Data Systems (MOLDS).

The MOLDS Institute, incorporated in the District of Columbia in 1974, is an association of 16 Canadian, Mexican, and U.S. governmental and professional organizations seeking to design compatible land data systems. The general objective of the association is the coordination of land recording functions from the national to the community level, with the view to design a national cadastre. U.S. involvement in the Institute is heavily influenced by over a decade of work by one of the committees of the American Bar Association. This committee is seeking to improve the archaic state of title records and recording. The Institute places emphasis on systems that could yield aggregative information while performing regular government functions. In concept the national cadastre could provide information on alien (or any other) ownership while satisfying the needs for conveyancing, assessing, planning, and other local and community functions. The national cadastre would eliminate duplicative data gathering, lower the system overhead, provide better security of information, and coordinate public and private land requirements. Although the cadastre may not be the only or the ideal solution to the problems of missing data on alien land ownership, it is a concept with promise.

The design of efficient information systems implies more than technical issues. Systems which provide easy, inexpensive access to ownership information also imply value issues—that is, public disclosure. Should the quantity, value, and location of real estate owned by aliens be public? Should the owners' names and characteristics be related to types, quantities, and location of land? Those supporting a negative answer to the two questions refer or allude to privacy. They associate ownership of land with personal anonymity and, therefore, disclosure is an infringement on personal rights of privacy. Ownership information is also regarded as valuable stock in trade, and to publicize is to expropriate. Another argument against disclosure is that reporting takes the time of property owners, is a nuisance, and serves no useful purpose.

Those supporting the reporting and disclosure of real estate ownership (including alien status) argue that the transactions of transfer of real estate are already a matter of public record; indeed, the act of conveyance and possession are public for the protection of the owner. Disclosure therefore is a matter of efficiency in information handling, not a change in intent or purpose. A fundamental premise of the operation of a free market is complete, accurate, and ever-present information; and in an exchange economy, what can be more basic than knowing who the exchangers are? Monopoly (whether of use or information) is inimical to the operation of a free market. Reporting of information, its assembly, and analysis require time and resources it is true, but these transaction costs are characteristic of an organized economy or society. The real issue is, how can these costs be minimized? The present system of small, duplicative, sometimes counter-productive enterprises seeking to acquire, monopolize, and market information is quite likely, in the aggregate at least, to be far more costly than a single, open system providing unlimited access to ownership information. A completely open system of ownership information would serve not only private commercial interests but also public bodies that need information on national and international capital flows, fiscal and developmental planning, and the management of government services.

The value issue must be resolved in forums other than in this report because the authors represent a very small, and by no means representative, cross section of the American society. On the basis of the analyses thus far, however, we can reach some conclusions.

CONCLUSIONS

Alien investment in U.S. real estate as a policy issue can be reduced to two questions: Should the opportunity to own U.S. land be conditioned in any way by citizenship status? Should information on the ownership of land, nominal and beneficial, be readily accessible to the public?

This report has dealt with many refinements and ramifications of the questions. We now attempt to answer them as simply and directly as possible, even with qualifications.

Ownership Restrictions and Conditions

There is an economic basis for restricting foreign ownership of at least some types of land under some economic circumstances, particularly from a long-range point of view. Under some circumstances, foreign

investment may overcome shortages of capital brought about by an unwillingness or inability of domestic savers to invest. If capital shortages are impeding development, foreign injections may boost employment and income, and stimulate growth. An important issue, beyond the scope of this study, is how foreign investment replaces or stimulates domestic savings and investment. The purchase of raw land is purely an economic transfer, with no increase in the quantity of available resource. The exchange of money for land, of course, may have the secondary effect of providing funds to the previous owner who either 1) hoards, 2) invests, or 3) purchases consumer goods. The impact of foreign investment in raw land depends on the economic behavior of such previous owners and the follow-up behavior of the new owners.

The initial impact that foreign investment in real estate has on employment, income, and growth appears positive on net but subject to some negative effects such as increased land prices. In the long run, real estate investment yields interest or rent with a reverse effect on the balance of payments. Both the initial and long-run impacts of real estate investments are affected by general economic conditions.

Perhaps the economic issue is best stated as a converse question: If the U.S. economy is in need of foreign investment, might there be places to invest that would be more advantageous to Americans than their land?

There appear to be social, political, and legal bases for restricting foreign ownership of land. These bases exist as facts, however, and they do not necessarily provide a guide for what ought to be. Policies must be decided on examination of fundamental values. Values pertaining to foreign ownership of land are often influenced by beliefs about community, sovereignty, and independence as well as economic well-being.

In place of outright restrictions on foreign ownership of land, there are other policies applied to all owners that could lead to preferred outcomes. For example, the United States or the states could discriminate in price to foreign purchasers, perhaps by surcharges such as Ontario's 20 per cent transfer tax. Guiding land use and dvelopment, sharing of returns from land (through no-escape income and transfer taxes), and improving the structure of *ad valorem* property taxes offer greater promise as land policies.

Information on Land Ownership

From the standpoint of existing treaties and domestic law there appears to be a much stronger basis for improving reporting systems which reveal foreign ownership than for restricting foreign ownership. The bulk of land ownership information is now in public records. It fails to be of public use only because of the system's awkwardness and inability to aggregate. Relatively few changes in law, such as those in Iowa, could start to draw back the curtains of ownership secrecy.

In an economic system premised on private property and a free market, the efficient allocation of resources calls for complete information. Economically rational allocations rest on accurate assignment of benefits

and costs to owners of resources. High costs associated with the assembly of information or the monopolistic control of information tend to produce bad economic decisions.

Information assembly and organization is not without cost, however. Economic decisions often must be made without complete information because the expected benefits from the additional information are less than its cost. Nationwide data on land ownership appear collectable only from local government sources. Thus, unless there is federal involvement, data would be inconsistent and irregular. But the cost of a single-purpose data system would be excessive. Therefore, the preferred information system will be based on state authority for property assessment and title recording, operated by local governments, and standardized through the federal government.

Recommendations

Recommendations correspond to the two basic issues stated above:

Continue the current policy of limited federal restrictions on the alien ownership of land, without preemption of state restrictions, pending the completion of a comprehensive empirical study of the long-run economic, social, and political impacts of foreign real property investments.

Develop sources and procedures for the reporting of completed investment transactions to a federal agency or agencies, with regard to the extent, location, values, and uses of all real property conveyed or under contract to foreign individuals and entities, whether nominal or beneficial owners.

Encourage states to adopt legislation requiring local officials to identify alien interests in real property and to make such interests items of public record systematically reported to the state for collection and analysis by an agency or agencies of the federal government.

Promote the design of systems to collect and process information on real property more efficiently and at reduced cost. Create a commission with representation from Congress, selected federal agencies, organizations of state and local officials, professional societies, and private industry to recommend system standards.

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1. S. Livermore, *Early American Land Companies* (1968), p. 25.
2. *Ibid,* p. 27.
3. Discussed with other aspects of the history of citizenship in J. Kettner, "The Development of American Citizenship in the Revolutionary Era: The Idea of Volitional Allegiance," 18 *American Journal of Legal History* 230 (1974).

4. F. Morrison, "Legal Regulation of Alien Land Ownership in the United States, in U.S. Dept. Commerce, Foreign Direct Investment in the United States," Interim Report to Commerce, appendix II (1975); F. Morrison and K. Krause, "State and Federal Legal Regulation of Alien and Corporate Land Ownership and Farm Operation," Agricultural Economic Research Report 284 (May 1975); Council on International Economic Policy, Summary of State Legislation affecting Alien Investment in Land and Related Resources, prepared by Washington and Lee Law School, unpublished 1974; and Economic Research Service, Memorandum on State Legislation Affecting Alien Investment, summarizing material from Martindale-Hubbell, November 16, 1973.
5. P. Gates, *History of Public Land Law Development* (1968); A. Chandler, *Land Title Origins: A Tale of Force and Fraud* (1945).
6. See for example, M. Price, "Law and the American Indian" in *Readings and Cases* (1973); "... the Anglo-Saxon commitment to private property obviously yielded in important ways to the rapacity of the European settlers and the frontier expansionists ..." Origin and legal reasoning pertaining to European claims may be found in Chief Justice Marshall's opinion in *Johnson v. McIntosh*, 21 U.S. 98, *Wheaton's United States Supreme Court Reports* 543 (1823).
7. Land schemes appeared before the Revolution, and the annals of real estate speculators contain the names of many of the nation's founding fathers. Land promoters such as Robert Morris, Patrick Henry, and Sam Blodgett, first supervisor of the city of Washington, D.C., flourished in the early days of the Republic, and appear in America's land legends. George Washington wrote to his friend William Crawford, "Any person who neglects the present opportunity of hunting out good lands ... will never regain it ... my plan is to secure a good deal of land." See A. Chandler supra, p. 71. M. Harris describes real estate machinations of an earlier time: "... Andrew Craig was a dummy owner who immediately reassigned his part of the Burlington Company venture to Cooper. Also Washington's share in the Dismal Swamp venture was sold to a dummy owner in Alexandria. He immediately reconveyed it to Bushrod Washington, one of the executors." See Harris, *Origin of the Land Tenure System in the United States* (1953), p. 291.
8. The market approach to real estate shows a 1975 asset value of $3,361.5 billion for all U.S. real estate. Another approach, more closely related to national wealth, would put the value at $4,361.5 billion. Land represents about one-third of the value of real estate. See *Appendix I.*
9. M. McDougal, H. Lasswell, and L. Chen, "Nationality and Human Rights: The Protection of the Individual in External Arenas," 83 *Yale Law Journal* 901 (1974).
10. A. Bickel, "Citizenship in the American Constitution," 15 *Arizona Law Review* 369-387 (1973).
11. Mason Gaffney points out, however, that some citizens have a greater interest in the common property than others, and, in the extreme, some of the common property is not altogether common. Gaffney also describes the process by which beneficial citizenship is conferred on foreign nationals (casiques) through military spending. See Mason Gaffney, "Benefits of Military Spending," *Proceedings of 10th Annual Conference, Committee on Taxation Resource and Economic Development* (Madison, Wisconsin, October 25, 1971).
12. Bickel supra, p. 383.
13. McDougal supra.
14. Individual advantage is consistent with the notion of citizenship and benefit. The benefits to members of the multinational corporation are extraterritorial to a particular country. Nevertheless, national policies do influence the multinationals, hence its members; so the ultimate effect of a policy may be determined by the direction of allegiance of the "dual citizens" of a country and a multinational.
15. Bickel supra.
16. See for example the issue of standard universal identifier extensively treated in U.S. Department of Health, Education, and Welfare, *Records Computers and the Rights of Citizens* (July 1973).
17. *Ibid*, and the Privacy Act of 1974 (P.L. 93-579), 93rd Congress, December 31 (1974).
18. See for example: "Note, Government Access to Bank Records," 83 *Yale Law Journal* 1439 (1974); R. Block, "Of Records and Reports: Bank Secrecy Under the Fourth Amendment," 15 *Arizona Law Review* 39 (1973); and J. Rule, "Private Lives and Public Surveillance" (1974).
19. This view of property is examined in G. Wunderlich, "Property Rights and Information," 412 *The Annals* 80 (1974).

20. B. Burke, "Governmental Intervention in the Conveyancing Process," 22 *American Law Review* 240 (1973).
21. F. Leary Jr. and D. Blake, "Twentieth Century Real Estate Business and Eighteenth Century Recording," 22 *American Law Review* 275 (1973); also P. Basye, "A Uniform Land Parcel Identifier—Its Potential for All Our Land Records," 22 *American Law Review* 251 (1973); and D. Moyer and K. Fisher, "Land Parcel Identifiers for Information Systems" (1973).
22. D. Lamberton, ed., *Economics of Information and Knowledge* (1971) contains a number of now classic articles on the economics of information.
23. One form of uncertainty that has received attention of economists in recent years has been in the assignment of liability and appropriation of benefit—the so-called externalities problem—which has dominated the "economics of property rights." As a broad generality, one can say there has been a confusion by economists of an assignment of value problem with an assignment of rights problem.
24. Other states, such as Arizona and Nebraska, have made some progress toward more complete reporting by trusts and corporations, but, as of this writing, Iowa seems to have the most complete disclosure measure.
25. A. Marshall, *Principles of Economics*, p. 51 (8th ed. 1920; 1st ed. 1890).
26. For details, see *Appendix I*.
27. There are few data on private landownership, even on current status. With the exception of the Census of Agriculture of 1900 and a farmland survey in 1945, there are no national statistics on landownership in the U.S. See, for example, U.S. Bureau of Census, Historical Statistics of the United States, Colonial Times to 1957 (Washington, D.C.: U.S. Government Printing Office, 1960). The 1900 Census of Agriculture reported, incidentally, in Table 23 that 1,097 of the 1.9 million rented farms were owned by foreign owners. The 1945 study did not identify the nationality of owners.

APPENDIX I

Land: Something of Value

Symbols, ideas and concepts are the essence of civilized intercourse, and land investment policy has its own semantic. The importance of a concept or conception may be illustrated in the way or ways we think about the value of land.

According to the market view of "real estate," the 1975 value of private real estate as a stock asset is $2,655.6 billion.[1] This value is the market price of privately traded real estate, representing the sum of productive returns or consumptive worth of real property less taxes. Real property taxes projected to 1975 are approximately $52 billion annually.[2]

Publicly owned real estate may be similarly valued at $705.9 billion. The total value of real estate traded in the private market plus the value of public real estate is $3,361.5 billion in 1975.[3]

Is the total above a full accounting of values? We counted the value of publicly owned real estate and the market value of privately held real estate. Real property owned by private holders yields benefits (less taxes) to owners and is so capitalized. But the revenues collected through taxes also are measures of value; they simply accrue to government rather than the private owners. Thus, real property taxes represent partner government's share of "privately held" real property. If the $52 billion annual taxes were capitalized, say, at 5%, the total value of American real estate would be increased by $1,040 billion. This $1,040 billion added to the private value of privately held real property plus the publicly held real property yields a total of $4,401.5 billion.[4]

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1. The estimate of 1973 real property assessed value of $679.4 billion and the 1973 assessed value excluded from taxes of $27.6 billion are taken from U.S. Bureau of Census, Census of Government, Property Values Subject to Local General Property Taxation in the United States, 1973 Special Studies No. 69, December 1974, pp. 10-11. The comparable values for 1975 are projections of the 22.8% change from 1971-73, multiplied by a sales/assessment ratio of 1/.327.
2. The real estate property taxes were derived from U.S. Bureau of Census, Census of Government, Governmental Finances in 1972-73, table 4, 1974, p. 20, for all property taxes. The ratio of .85 real property as a proportion of all property taxes is from Advisory Commission on Intergovernmental Relations, The Property Tax in a Changing Environment M-83, March 1974, p. 267.
3. The public land estimates are based on the ratio of values private and public in U.S. Securities and Exchange Commission, ***Institutional Investor Study Report***, supp. vol. 1 (March 10, 1971), House Document 92-64, part 6, 92nd Congress, 1st session; see also Appendix 2 by Grace Milgram, and a projection of the ratios of 1952, 1960, and 1968 to 21% of total value, i.e., $705.9 billion.
4. The estimates of real estate values, while based on the data available, are dependent on projections and interest rate assumptions, so they should be regarded as illustrative only. A further refinement in the idea of real estate could distinguish land from capital embodied in land. Land is about one-third of the value of real estate. See *Statistical Abstract* of 1973, table 564 (1973), p. 343.

Real Estate Values Are Made in the Money Market

by James E. Gibbons, C.R.E.

Over a great many years, real estate appraisers have employed the "Three Approach" procedure, looking at value from the viewpoints of cost, market activities, and income attributes. At various times, any one of these yardsticks may be more useful or persuasive than the other two; but if it was necessary to select the one most extensively employed, the nod would go to the market data procedure. It always seemed prudent to look to the latest and most relevant market transactions, seeking in them the clues to and evidences of value. There can be no doubt that such efforts will always be an important part of an appraisal, but recent economic and monetary trends point to a need to shift major emphasis to income or money conditions. This position is strongly supported when one studies the concept of value and considers the nature of a real estate investment.

A widely held view today is that value is best described as the present worth of future benefits of ownership. It is a function of futures and the benefits, both income and proceeds of sale, are generally expressed in dollars. Valuation is, therefore, a projection of such benefits and their discounting to express present worth or value. Obviously, key considerations are selection and application of discounting rates.

Consider then the nature of a realty investment. It is not land, bricks, and mortar; rather, it is the capital invested to secure the enjoyment of the benefits accruing to the property rights involved. In a single word, the investment is capital.

Traditionally, two types of funds have been used to purchase real estate, namely, a substantial amount of debt capital provided by a lending institution, and a smaller amount of risk money from the investor. Of course, there have been occasions where the investments have consisted entirely of one or the other of these types of capital. In any event, the realty investment is clearly a money situation. Therefore, the price and availability of this commodity will influence and regulate the value of the situation.

Consider some features of the commodity money. Like all others, its pricing is influenced by laws of supply and demand. In periods of excess supply and

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slack demand, the price is low, whereas, in periods of limited supply and heavy demand, the price is high. It would appear, therefore, that money does not differ greatly from other economic commodities. Its price, however, is generally not expressed in dollars and cents, but as a rate of interest to be paid for the use of the funds. A most significant difference between money and other commodities is found in the supply side of the pricing formula. While demand for funds is a product of natural economic forces, supply of money is a mechanically regulated element. It follows, therefore, that whoever manages supply can regulate general interest rates (prices) which, in turn, set the discounting rates used in valuing real estate. Because of this process, it is valid to assert that realty values are made in the money market, not in the real estate market.

CREDIT REGULATION

It is interesting to examine the monetary supply regulation devices that exist in today's economy. Since 1913 when Congress created it, the Federal Reserve System has had the mission of managing money and credit with a view to promoting orderly growth of the national economy. In order to discharge this duty, the Fed has been given a group of credit regulation tools.

Reserve Requirement

First, there is the Reserve requirement. As a requirement for membership in the System, the nation's banks must agree to keep varying amounts of their deposits frozen in accounts at the Federal Reserve banks, thereby eliminating these funds from availability for loans. The magnitude of this requirement can be changed from time to time; and by such changes, the volume of money and credit is expanded or contracted. If the Fed wishes to restrict money supply, they can increase the deposit reserve obligation. On the other hand, should monetary ease be the objective they can lower the limitation. Over recent years, demand deposit funds have carried an approximate 15% requirement, and time funds have been frozen to the extent of 3% to 5%.

Fed Discount Rate

A second credit regulation tool is the Fed discount rate. One of the great privileges of membership in the Reserve System is the right of member banks to borrow from Fed. This ability makes it possible for them to secure funds and accommodate their customers during periods of great demand. It is clear, therefore, that this privilege is a means of expanding monetary supply, and a limitation on the privilege is a restrictive factor. The cost to member banks acquiring funds is an interest item which is called the Fed Reserve discount rate. If it is very cheap to borrow, member banks will be encouraged to acquire funds and make them available to customers. On the other hand, if it is expensive there will be a disinclination to use the device. The regulation of the discount rate is quite obviously an effective credit management tool.

A further word should be said about member bank borrowings from the Fed. Even though membership in the System purportedly makes this privilege available, the actual operation of the arrangement involves very significant limitations and restrictions. Fed is not always willing to extend credit, particularly when the System feels that it is not in the best interests of the U.S. economy. When that is the case, it is said that the "discount window is closed."

In this way, it is not just the pricing that limits credit expansion but non-availability of funds, as well.

Open Market Committee

A third credit management tool is operation of the Open Market Committee. This is probably the most intensely used, and certainly the most potent of Fed's arsenal of weapons. The Committee is composed of the president of the New York Federal Reserve Bank, a few fixed members, and a group of rotating members. This body buys and sells U.S. government securities in the open market. By so doing, they exert a powerful influence on interest rates. In fact, by reason of their operations being conducted on a daily basis, they can maintain short-term money rates at target levels selected by the Committee. Without going deeply into the mechanics of operations, the impact of a purchase of securities by the Open Market Committee is to infuse into the general money market an amount of credit equal to approximately six times the amount of the purchase. On the other hand, a sale by the System results in withdrawal from supply of money and credit of an amount equal to approximately six times the sale. When one considers that on a daily basis the transactions of the Committee run in hundreds of millions of dollars, it is apparent that the supply side of the money market is in reality manipulated by the Fed. In this connection, it should be noted that the Fed has the duty to use these great influences in a manner likely to promote orderly growth in the U.S. economy. Whether over the years of their operations they have, in fact, moved effectively toward this goal is a matter for debate; and there are as many who will vote "no," as those who will vote "yes."

FED FUNDS RATE

Since real estate valuation is a discounting procedure, and its key is the selection of a discounting rate, the issue of money rates is a central consideration. Federal Reserve operations impact most directly and immediately on the so-called "Federal Funds Rate." This rate is the amount banks pay each other for short-term loans made back and forth to enable the institutions to meet their deposit reserve requirements. If a bank is falling short of the amount necessary to be kept in its reserve account, it will, on its own or through a broker, canvas the banking system to find another member bank that has excess reserves. The needy bank will borrow on a short-term basis from the surplus bank, and the rate paid is called the Fed Funds Rate. It is obvious that if through Open Market Committee operations the Reserve is infusing large amounts of excess reserves throughout the monetary market, the price for Fed Funds, or the Fed Funds Rate, will be quite low. On the other hand, if reserves are tight the rate will go up. This Fed Funds Rate is a key consideration because it is directly influenced by the Open Market Committee operations. It is also important because it is a foundational type rate, representing top quality credit and the shortest loan term. From such a base, poorer credit risks are assigned increments of additional rates, thus forming composite rates from the Fed Funds level. The amount banks must pay customers for longer term deposits in the Certificate of Deposit market will generally be something in excess of the Fed Funds Rate. Similar adjustments will appear throughout the whole array of credits, such as commercial paper, U.S. Treasury bills, U.S.

agencies, U.S. bonds, municipal securities, corporate borrowings, and so forth. Through a process of risk rating, each of these is assigned some level above or below the key Fed Funds Rate. Through this process, it can be seen that, as the Fed Rate fluctuates, there are sympathetic adjustments throughout the entire credit market. Of course, where longer term credits are involved, daily movements in the Fed Rate will not produce instantaneous and precisely duplicate changes throughout the bond markets. It is clear, however, that the changing trends, policies, and views of the Federal Reserve System will and do limit both the availability and price of money.

ECONOMIC RECAP

So much for the mechanics of the market; and, of course, it should be emphasized that this discourse is intended to illuminate only the highest spots in the very complicated terrain of credit operations. Of more importance to the real estate counselor, appraiser, or investor should be a review of recent economic experience in order to judge the validity of the assertion that realty values are made in the money market. During the late 1960s, as a result of pursuing the Viet Nam War in an expansive economic climate, the government operated on large deficit budgets which resulted in accelerated rates of inflation. As the decade of the 1970s arrived, the Federal Reserve was most concerned, and remains so, about the damaging effects of continued inflation. The number of dollars in circulation proliferated throughout the world, and there were serious doubts about the continued durability of this currency's value.

In such a situation, the Fed consciously embarked upon a program of restrictive credit intended to slow down the economic tempo and ease inflationary pressures. By 1973, the Fed's program had gathered momentum, and we witnessed an unparalleled climb in interest rate levels. Commercial banks' prime lending rates went from approximately 5% to 12% and remained at such levels well into 1974. It should also be noted that during the latter part of said period and as a result of political pressures, the prime rate was held constant. Commercial paper rates, which were free of political influence, soared into the 14% to 15% area. High quality corporate bond issues rose to the 9-10% level and, in many instances, even higher.

During this period of restrictive credit and high interest rates, there was little or no long-term debt capital available. Money managers found conditions changing so rapidly that they were reluctant to do anything but place their funds in the shortest term situations so that they could be rolled over at the increasing interest rates that were constantly emerging. This phenomenon is of tremendous significance to the field of real estate, where investments are of a long-term nature and where, for many years, the key part of the investment was long-term debt capital, otherwise known as mortgage money. Venture capital, or equity money, became extremely scarce because the managers of these funds were also reluctant to take a position involving intermediate to long-term commitments. Conditions were changing so rapidly that investors' anticipations of further rate changes kept everyone on the fence, and available capital went only into high quality short-term debt situations.

Consider the impact of these credit conditions on real estate investments. In the construction area it became the rule that building funds had to be borrowed on the basis of floating rates. A construction loan would be pegged at 4% or 5% above commercial banks' prime rate or commercial paper rate, whichever was the greater. With the prime rate moving in a very short period of time from 5% to 12%, and the commercial paper rate moving from 5% to 14% or 15%, the cost of construction money escalated from about 9% to close to 20%. The cost of such funds is a critical element in the so-called cost approach to value. Costs are both direct and indirect, and the construction loan interest is one of the largest indirect elements. With such a serious price distortion, there was no way a construction project could have been rationally budgeted. In just about every instance, these ventures ran out of funds and fell into foreclosure. But above all, their costs had escalated beyond any previously anticipated level.

COMPONENT PRICE LEVELS

Of equal importance in the cost approach to value are the price levels of the components that go into the makeup of building ventures. Each element of a building is manufactured by an organization that operates its affairs by using some equity money and a significant amount of borrowed funds. As interest rates escalated, manufacturers passed such additional costs through to customers by pricing their products at higher levels. In this matter, builders were forced to stand not only increased direct interest costs, but higher prices for all the materials utilized in their ventures.

In the situations where real estate developers were fortunate enough to have completed the construction phase of their investments and were facing the problem of marketing their products, the monetary problem became equally difficult. If a project was of the rental variety, the owner would have to establish rents that would be sufficient to pay all operating expenses (including the huge increases generated by the energy crisis and real estate taxes) and the very steep requirements for mortgage money (if any at all was available) and show something beyond that as a return on equity capital invested. Looking at the operating expense elements and considering mortgage constants in the 12% to 14% range, it was clear that rents had to be raised to levels far beyond the ability of the market to pay. In other words, in these real estate ventures value was destroyed and there was no economic feasibility.

From the viewpoint of a market data approach to value, how does one identify and measure a market when market activity is stifled and killed by oppressive money costs? If the project was a sales venture, such as a condominium apartment, the same general maladies existed. Either there was no mortgage money available to the prospective purchasers of apartments or, if there was mortgage money available, the terms were exceptionally onerous. Mortgages would be quoted at low ratios of loan to value, high interest rates, short amortization terms, and, generally, some substantial fees to the lender. Only a very few purchasers could stand these conditions. Market activity halted and it has only recently shown signs of a broad-based recovery.

IMPACT OF DISINTERMEDIATION

While discoursing on mortgage funds, it would be well to touch on another money market factor which proved to have a powerful influence on real estate markets. This is the activity which has acquired the very fancy label of "disintermediation." In simplest terms, this was the withdrawal, by savers, of funds from thrift institutions (paying relatively low interest rates) for the purpose of investing them in short-term money market instruments (where rates had escalated to 10, 11 and 12%). This activity sharply curtailed the availability of long-term mortgage funds which had traditionally been supplied by the thrift industry and life insurance companies.

The pervasiveness of difficult conditions in the money market is fascinating to contemplate. When one complains about the high level of real estate taxes, he normally thinks of the cost of building and operating schools, sewer systems, water supply, and so forth. It is true that these constitute major increments of the tax package, but not far behind is the interest rate cost to municipalities of the funds borrowed for these projects. Witnessing the surge upward in municipal bond rates, it was clear that local governments were being compelled to pay very high rates for the funds they needed for projects of necessity. High interest costs are passed through to the citizenry as increased real estate taxes. The escalating tax item thus destroys the bottom line of rental real estate and at the same time pushes the cost of home ownership beyond the market's ability to pay.

When one also considers the increased costs stemming from the energy crisis, he naturally thinks of the huge increase in oil prices forced on the world by the Middle East oil-producing nations. Not far behind in importance, however, is the fact that utility companies had to acquire from the money market the funds they needed for their necessary operations. These companies had to face substantial increases in money costs which in turn were passed on to the customer in the form of higher utility prices. Again, an adverse impact on real estate bottom-line earnings occurred and more value was destroyed.

In recent months, Fed has pursued a substantially easier monetary policy, and the price of short-term funds has declined. As a result, there has been an inflow of money to the thrift industry which in the past always signaled a new wave of building operations and mortgage activity. To date, the recovery of the housing industry developed slowly. It is interesting to speculate about the causes of this situation. Probably, "the once burned—twice shy" attitude is holding back builders and mortgage lenders. There is still a very large overhang of real estate disaster situations remaining from the 1973-75 period. They will have to be absorbed before large new efforts will start in the housing construction market.

The price of long-term capital and equity funds has been slow to yield to recent downward trends in short-term interest rates. In the back of the minds of money managers, there must be a fear of returning to the restrictive credit conditions of 1973-75, causing a reluctance to drop prices. These people seem to be trying to avoid the roller coaster effects experienced in short-term money markets.

VALUE DESTRUCTION

Perhaps the most damaging aspect of recent monetary policy has been the destruction of values and economic feasibility throughout the real estate investment field. The very serious increases in construction costs, operating expenses, real estate taxes and mortgage money rates have occurred without corresponding increases in the market's ability to pay. These factors all contribute to the reduction, if not total elimination of any net earnings from many real estate ventures. In the appraisers' eyes, therefore, is the unhappy prospect of newly-constructed projects that are not worth the cost needed to create them. This has its most serious implications throughout the housing field. Younger people in the family formation phase of their lives are now confronted with a median home price of $42,000 or $43,000. By most rules of thumb, this would mean a monthly housing cost of about $450. A quick glance at earnings statistics throughout the nation will reveal that the people who most need housing are economically eliminated from the market. This is not a happy or healthy condition for the real estate industry or, more particularly, for the country.

Value is best described as being the present worth of future benefits, and valuation is the discounting procedure employed to calculate such worth. In this article, the impact of monetary conditions on many economic elements related to real estate has been indicated. Two major trends emerge. The increased construction, operating, and monetary cost levels generated by a restrictive monetary policy have destroyed net earnings, or what we have described as the future benefits of ownership. The remains of these benefits, if any, must be discounted at rates which in a historical perspective are startlingly high. The appraiser's so called capitalization rate is nothing but a weighted average of the cost of mortgage money and equity funds.

The purpose of this article has been to indicate that the cost or rates of these types of capital stems from money market operations which, in turn, are manifestations of the economic thinking and regulation of the Federal Reserve System. Throughout a large segment of the economy, the laws of supply and demand represent the results of free market activity. But with the supply of money we have a somewhat different situation. It seems clear, therefore, that the obligation of real estate valuators and counselors is to be thoroughly aware and informed on monetary conditions. It has been said that the real estate counselor is an economic generalist, and this is just one more demonstration of the accuracy of such a statement. Since real estate values are made in the money market, real estate people must now be money market students.

Landmark Issues in American Cities

by Jared Shlaes, C.R.E.

Controversies associated with landmark preservation are reaching the boiling point in more and more of America's towns and cities. Should the old town hall be razed to make room for a new municipal center, or the old church to make room for a parking lot? Are attractive old houses worth saving if they stand in the way of needed institutional expansion, or of high-rise apartment development? Can an old office building or theater be allowed to interfere with a major civic improvement scheme? When should a new hotel be allowed to disrupt the cornice line of a cherished old street? How much can taxpayers be asked to spend on the preservation of privately owned structures?

Questions like these are not always easily answered. The emotions they provoke can reach high levels of intensity, while the economic and social issues involved are not always easy to identify or to assess. We know how to handle the easy cases: Monticello, the Old North Church, Georgetown, Fort Ticonderoga, the Water Tower, Independence Hall. We have been less successful in dealing with the hard cases: Carnegie Hall, Villard Houses, Penn Station, Chicago's Old Stock Exchange. It is such cases that will be dealt with in this article. Our purpose is not to catalog all the issues, since new ones crop up every day in every important city, but rather to discuss in some depth a few cases with broad implications, in the hope that the issues raised and the analytical methods employed will improve our understanding of preservation problems and point toward new solutions.

The cases described here arise from conflicts among those who support and those who oppose specific preservation efforts. Each case is based upon a recent study done by the writer's firm, in most instances with financial assistance from the National Trust for Historic Preservation. The rapid evolution of public attitudes and of the legal framework within which preservation controversies must be resolved forces an examination of cases not yet closed, since yesterday's cases as often as not are too old to be useful.

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The issues raised fall into interrelated categories:

The taking issue. As used by Bosselman and Callies in their famous study[1] this term is shorthand for the whole complex of legal and administrative questions raised by the increasing public involvement in private land use decisions. As government seeks to assert an increasing degree of control over the use of real property through its eminent domain, taxation,[2] and police powers—as it promulgates new devices[3] to protect the natural and the built environments, to maintain and restore landmark buildings and districts, to compensate for private damages arising out of public improvements, to secure the tax base, to channel and limit growth, and to enhance the visual and functional aspects of urban life—the private interest sees its traditional rights eliminated or modified in new, unforeseen, and sometimes drastic ways. The right of a property owner to demolish, remodel, expand, or alter an existing structure or to build as he sees fit on land he owns has been drastically limited since colonial times. Have we gone too far? Is landmark designation an unwarranted intrusion on property rights and personal freedom? Do new zoning schemes calculated to preserve neighborhoods attack private rights unfairly? How deep is the economic damage arising out of these new public intrusions, and how is it to be measured? Questions of this nature have rightly preoccupied the courts, the government agencies concerned with land use control, and those private citizens who own, operate, use, finance, plan, and build upon real property. Few of them have been satisfactorily resolved. The uncertainty they provoke begins to constitute a problem of its own. Not having a firm understanding of their respective rights, both private owners and public agencies involved in landmark questions are often ill able to reach acceptable compromises.

Progress vs. preservation. Many American cities were built on the striving of their citizens for progress and growth. In any conflict between the old and the new, most people had little trouble reaching the right answer. Is the city to sacrifice its image as a progressive, dynamic urban center in order to preserve its monuments and older neighborhoods? In many places this question is still seen as a symbol of the struggle between the forces of reaction and those of progress. Whose side are you on? The answer is no longer clear.

Political philosophy. To what extent can the public assert its rights over private property without impairing those rights in fundamentally destructive ways? The libertarian[4] will argue against public intrusion in all but the most obviously necessary areas; the social activist will argue for

1. Fred Bosselman, David Callies, and John Banta, ***The Taking Issue*** (Washington, D.C.: U.S. Government Printing Office, 1973).
2. See, for example, International Association of Assessing Officers, "Property Tax Incentives for Preservation," ***Proceedings of the 1975 Property Tax Forum.***
3. See, for example, ***Transfer of Development Rights,*** ed. Jerome G. Rose (New Brunswick, N.J.: Rutgers University Center for Urban Policy Research, 1975).
4. See especially Friedrich A. Hayek's classic, ***The Road to Serfdom*** (Chicago: University of Chicago Press, 1944).

complete public control over land use decisions. Which is right? How far may we compromise political principle for the sake of local planning concerns or loyalty to historic and architectural landmarks? To what extent will increased public involvement inhibit desirable future development by discouraging builders and entrepreneurs? How will property owners react to new legislation affecting their rights and privileges?

The tax base. What are we doing to ourselves when we halt major new real estate development to save a landmark? Will we shift development outside community boundaries and lose the associated tax revenue forever? How much does the landmark itself contribute to the economic value of the community or the neighborhood? Will its loss reduce tourism, or so impair civic pride that the community will decline?

Impact considerations. Will a new structure overload the community's schools, parks, transit facilities, streets, utility systems, or will it add needed students to an underpopulated school and needed riders to the transit system? Will it raise population densities above acceptable limits, or change the character of the population in undesirable ways? What will its visual impact be? Its economic impact? What will happen if the new development is blocked and the existing structure does not remain viable?

Costs and feasibility of preservation. Who will pay what it takes to acquire and maintain an obsolete landmark structure? Where is the money to be found for major restoration? What resources are available for preservation, and how much will they cost? Can private owners support the maintenance burden associated with landmark structures? Are public uses needed and available for obsolescent buildings that must be preserved? Is public ownership practicable? Is real estate tax abatement an available tool? What subsidies can be justified?[5]

Administrative and political concerns. Not every city or state has an active agency directly concerned with landmark preservation, nor is every such agency effective and adequately financed. Who will administer the necessary programs? Will they conflict with other existing and equally important programs? Is the political environment generally sympathetic to the agency's objectives? Can the agency's viability be assured over the relevant period of time? How effectively is it organized? Is it big enough to do the job? How well is it motivated? Can it muster strong support at times of crisis? To what extent must its decisions reflect the current political structure? How much experience has it had in conflict situations? What is its track record in preserving key monuments?

In many cities preservation objectives conflict with other public goals: the construction of a highway system, a rapid transit network, a renewal project; the administration of a zoning ordinance that does not take preservation concerns into account; the operation of a real estate tax assessment system that is firmly entrenched and generally perceived to be

5. See *Economic Benefits of Preserving Old Buildings* (Washington, D.C.: The Preservation Press for the National Trust for Historic Preservation, 1976).

fair but that makes no allowance for special treatment of landmark properties; the desire to minimize public outlays or public interference with property rights. How are these goals to be reconciled?

Cost/benefit issues. These involve a largely unscientific weighting of often incommensurable variables. Which is more important: preserving the valued local monument or adding the jobs and real estate tax revenue produced by a larger replacement structure? Conserving the integrity of a streetscape or adding needed housing and other facilities? Restoring a local landmark or providing a catalyst for further development in the area? Almost any landmark-related issue can be viewed in these terms. Constructive public discussion requires their use. The difficulty lies in selecting the issues, establishing appropriate units of comparison and allocating weights. Much will have to be learned before this process becomes anything other than the grossest kind of intuitive comparison, but the learning effort is both unavoidable and justified.

THE ALBEE THEATER

On July 24, 1972, the Albee Theater in Cincinnati, Ohio, was entered on the National Register of Historic Places with the statement that it "is one of the few surviving opulent cinema palaces in the United States and the only one in Cincinnati." The city of Cincinnati plans to demolish the Albee together with the vacant Sheraton-Gibson Hotel and other adjacent structures now occupying a site of approximately 83,000 square feet known as Fountain Square South. It is prepared to enter into agreements with a well-known developer requiring that the city construct at its expense a three-level substructure upon which the developers are to build an office tower of approximately 575,000 square feet and a 450-room luxury hotel, in addition to approximately 80,000 square feet of retail space and other public facilities.

The vacant and underutilized state of the existing buildings at Fountain Square South is viewed by local officials as detrimental to the well-being of Fountain Square Plaza, which adjoins to the north. Clearance of the entire half block upon which the Albee stands is viewed as essential. The local urban renewal authority is eager to encourage development of a luxury hotel on the site, apparently in the belief that Cincinnati's entire economy would benefit from the addition of such a facility to a city which at present lacks a world class hotel. The agency also appears to feel that the hotel should precede the new office building also contemplated for the site, or be built together with it, but should not follow the proposed office building in the development sequence.

The city expects to spend $12.1 million on the acquisition and clearance of the site and on partial construction of the three-level substructure. An additional $3 million will have to be added to the parking revenue bond indenture, and another $2.5 million will be required to complete construction of a second-level walkway to extend utilities and to upgrade streets and sidewalks. Total municipal outlays will thus be in the order of $17.6 million for the project. Annual revenues to be derived from Fountain Square South as redeveloped are estimated at $1,514,216 by the municipality. This figure, judged adequate by local authorities, includes real estate taxes, ground rent, hotel room tax, and payroll

tax. It does not allow for all revenues lost elsewhere due to shifts of business into the new project.

A local committee interested in saving the Albee questioned the rationale for this plan, which has the support of leading business and political interests in Cincinnati, and sought our assistance in evaluating its components. Upon investigation, we found that the hotel portion of the project was economically not feasible and that the projected office building was only marginally feasible and was made so only by the heavy public subsidy contemplated. Our analysis of revenue projections indicated that the city's estimates were overoptimistic and that only $1,070,000 in annual revenue was likely even if the hotel were feasible. Applying a discount rate based upon the city's general obligation bond yield expectations and known parking revenue bond yields to the city's projected investment and returns, we found that for the 67-year period of the city investment the net present value to the city of the anticipated cash flows was *minus* $4,647,000, indicating that the city's return on the investment was less than its bond interest costs. In effect the city would suffer a loss in total wealth of $4,647,000 at the moment it undertook the project, a loss which would be significantly greater if current real estate taxes derived from the property were taken into account and if proper consideration were given to the nonfeasibility of the hotel.

The Albee seats approximately 3,100 and has facilities which permit a wide variety of performing arts uses. It is reputed to have outstanding acoustical qualities as well as unimpeded sight lines from all levels. Made obsolete as a movie palace by industry trends, it would serve well as a supplementary facility to existing concert halls and auditoriums in the area if made available for such purposes. Theatrical and concert producers and booking agencies have indicated a willingness to rent the theater on terms which would provide a net income adequate to support the property, although some tax abatement or subsidy might be required. We estimated that total subsidies required including real estate tax concessions would cost the city substantially less than that portion of the Fountain Square South subsidy reasonably allocable to the Albee.

Our suggestion was that the city consider proceeding with the office portion of Fountain Square South on an adjacent site, deferring for the time being the clearance of remaining buildings, including the Albee, while further investigation was undertaken. The city's response has been to accelerate actions tending toward completion of its contractual arrangements with the developer and the demolition of the Albee. At this writing, the outcome is unknown.

Many conflicting interests are apparent in this case. The city is anxious for monumental new central business district development, specifically including a luxury hotel which on its face does not appear feasible but which if built would add prestige to Cincinnati and enhance its attractiveness as a tourist center. The developer has his own reasons for desiring to press on, particularly so since his contract offers him considerable freedom of movement. Property owners in the block are variously affected; some are anxious for the project to go ahead; others have their own development plans. Taxpayers would be adversely affected by the development, but industry and commerce might be expected to benefit if the development does indeed proceed. A cloud is cast over all

these questions by the uncertainties attaching to the project: Can the hotel indeed be built? Will it, if built, be economically viable? What will the addition of a new office building at this location do to occupancy rates elsewhere in downtown Cincinnati?

There appears to have been little opportunity for serious public discussion of these issues. Details of the proposed development contracts and of such feasibility studies as may have been prepared in support of the project were not made public, and indeed were refused to interested citizen groups. An important question here is the degree to which preservationists and citizens at large are entitled to knowledge of undertakings such as this: Can municipalities negotiate workable renewal agreements in public? Will preservationists behave reasonably? Can developers be persuaded to take preservation objectives into account? These questions must remain unanswered here, but should provide food for thought in other cities confronted by similar problems.

UNION STATION

Union Station in Denver, Colorado, constructed in several portions over the period 1880-1914, has a gross area of approximately 174,000 square feet, of which approximately 130,000 is usable. It is located in a preservation district west of the Skyline Project, on the fringes of downtown Denver, and beyond the active development area. Still used for railroad purposes, the building is threatened by proposed changes in Denver's transportation network as well as by its own functional and economic obsolescence.

We were asked by Historic Denver and by the Regional Transportation District to investigate the feasibility of retaining the station either as a multi-modal transit facility or as a nontransit facility devoted to other uses. We found that conversion to other uses was relatively unlikely for both structural and locational reasons, and that its adaptability for use as a multi-modal transit facility depended upon a network of interrelated decisions by a variety of public and private agencies for which the groundwork had not yet been laid. The Burlington Northern Railroad, a principal owner of the station, has announced an extensive new-town-in-town on a 550-acre site adjacent to the station and extending to the South Platte River in an area now used for mainline trackage and railroad sitings; we judged this development to be essentially impracticable for the foreseeable future. However, the railroad's planning apparently reflects the belief that the proposed new town will proceed in some form. Realignment of mainline trackage according to current Burlington Northern plans may hamper the desires of the city to utilize the banks of the Platte River for public purposes. Similarly, a proposed realignment of two traffic arteries through the adjacent preservation district would hamper restoration within the district, thus reducing the utility of Union Station for commercial and other nontransit uses. The Burlington's plans call for a consolidated transportation and utility corridor along the bank of the Platte River in a realignment which would require relocation of the railroad yards, reconstruction of several highway interchanges, and provision of a number of utility extensions and civic improvements including bridge, road, and viaduct relocations or eliminations. These in turn would require significant public outlays and the sacrifice of conflicting public objectives.

The Regional Transportation District has proposed three different transit alignments to serve downtown Denver in the first phase of its rapid transit plan, which links communities to the north and south of Denver by way of the downtown area. These three schemes have varying impacts on Union Station and have varying chances of approval by the United States Urban Mass Transit Agency and by local authorities. Other transit considerations likely to have an impact on Union Station are two proposed street realignments, the possible elimination of two viaducts and bridges, the potential relocation of Amtrak trains to a new station nearby, the possibility of inducing two bus companies serving Denver to regroup near the Union Station, and the long-term prospect of satellite collector stations to serve Stapleton International Airport. All of these considerations have consequences for the continued use of Union Station which have not been fully analyzed.

It was apparent from our study that communication among the various agencies involved was poor and in some cases nonexistent. We accordingly recommended to the mayor of the city and county of Denver that he assume a leadership role in establishing the structures needed to coordinate the activities of those agencies in terms of the general desire to preserve Union Station. We further suggested that the Regional Transportation District focus its attention on a possible modification of its transit plans which would simplify the system, reduce costs, and enhance Union Station and its surroundings. A computer-assisted cost-benefit model was suggested to formulate the critical path required to attain specified planning goals, to quantify courses of action, and to test the financial implications of a variety of possible solutions.

The mayor evinced a willingness to assume a coordinating role but did not appear ready to take the strong lead which will be necessary if the conflicting interests of public and private agencies concerned are to be reconciled constructively. As in the previous case, the jury is still out.

ROBERT W. PATTERSON HOUSE

Originally built in 1892 to plans by Stanford White, the Patterson House is the only remaining structure in Chicago by that architect. A 1927 addition added enough space to permit its conversion in 1950 for the use of the Bateman School, a private institution which closed a few years ago, leaving the structure unoccupied.

The building occupies a corner site of 16,890 square feet zoned for high-density residential use on Astor Street in Chicago's Gold Coast area. It falls within the Astor Street District, designated a Chicago landmark by city ordinance in December 1975. Under this ordinance, new construction, additions, alterations, and total or partial demolition are subject to written approval of the Commission on Chicago Historical and Architectural Landmarks. The Bateman School had been seeking to sell or develop the property for some time prior to the enactment of the ordinance, and following enactment sought a permit to demolish the structure which was referred to the Commission, as were various proposals for the development of the property and its conversion into a condominium development and other adaptive uses.

We were retained by the Commission in connection with this matter and asked to investigate the economic feasibility of converting the property to condominium or other adaptive use. Our investigation of physical condition disclosed that the interior had been poorly maintained and clumsily remodelled for school purposes, but that the structure was sound and well adapted for restoration as a single-family dwelling or institutional headquarters. Its excellent location would justify purchase and renovation for such uses. We also found that condominium conversion would be at least marginally feasible, although unlikely to prove highly profitable, and that interested parties were available to undertake such conversion. Although the site is physically suited for high-rise apartment development and is located in a prime area, the condition of the apartment market in Chicago is such that no such development appears likely on this site for some time. High-rise development projects submitted by the owner were carefully examined and judged not feasible, but a number of proposals entailing conversion of the existing structure and the construction of a modest number of additional units on the site were judged at least marginally feasible. Other adaptive uses were examined and judged not feasible. The property was encumbered by at least two mortgages, one of which was in default, with legal proceedings aiming at foreclosure already underway. The property owner alleged that the financial condition of the property was at least partly the result of delays encountered because of landmark designation, and offered to sell the property to the city at a price significantly in excess of its market value.

We recommended that the financial condition of the property be continuously monitored, and that owners and lenders be urged to seek out a purchaser willing to retain the existing structure in substantially its present form. Developers now in view, including the property owner, were to be encouraged to refine their condominium conversion programs and carry them forward. The Commission was also advised to consider ways and means of funding the relatively small subsidy which might be required to encourage such conversion, and of funding the acquisition of the property on an interim basis if circumstances should so require.

Following completion of our report, the foreclosure sale was scheduled but was deferred when the owner filed for protection from creditors. At this writing the house remains vacant. The city has stood firm in its refusal to issue a demolition permit, triggering protests by the owner, even though it is by no means evident that the property would be worth more cleared than it is in its present form. The property has been tax exempt while in school use and is still not paying taxes.

Some of the issues raised in this case amounted to red herrings. The owner's claim that only landmark designation prevented the high-rise development of the property was false, and the owner's plans to develop the property were unrealistic. The interference by the public in the owner's rights was nonetheless quite real. The position of the lenders has not yet been spelled out with any clarity, and the outcome remains uncertain. There is, however, a general feeling that the city will acquire the property at its market value if no better way to save the building can be found, and that some write-down upon resale would be justified if the preservation of the building would be assured thereby.

THE AUDITORIUM BUILDING

Designed by Adler and Sullivan at the peak of their powers, the Auditorium building is widely recognized as a structure of great historical and architectural importance. Originally built in 1887-1890 as a combined hotel, auditorium and office structure, the building occupies a half-block site at the corner of Michigan Avenue and Congress Parkway near the Conrad Hilton and other important Chicago hotels and near Orchestra Hall and the Art Institute of Chicago. It is owned and occupied by Roosevelt University, a commuter university which offers extensive adult education programs and graduate degrees in a variety of fields.

Before Roosevelt University acquired the property in 1946 it had been used in its original configuration until 1940 and as a servicemen's center during World War II. Roosevelt University, then a new institution, undertook extensive renovation and reconstruction for classroom and administrative use. During the 1950s the construction of the Congress Street (now Eisenhower) Expressway sliced sixteen feet off the south end of the first floor, replacing it with a recessed arcade. Renewal of the theater, a magnificent auditorium of some 4,200 seats, was undertaken in 1960 when the University created the Auditorium Theater Council, which in turn retained architect Harry Weese and raised funds for a rehabilitation costing $1.75 million. Both theater and school portions of the structure are still intensively used.

The building is listed in the National Register of Historic Places, the Historic American Building Survey, and the Illinois Plan for Historic Preservation. In 1958 the Commission on Chicago Historical Landmarks, predecessor of the present Commission on Chicago Historical and Architectural Landmarks, designated the building under an ordinance now superseded. The United States Department of the Interior designated the building a national historic landmark in 1975. It had not, however, been designated a landmark under the current Chicago landmark ordinance. Trustees of the University felt that such a designation would unreasonably interfere with their freedom to use and remodel the space for University purposes and might also impair the mortgageability of the property, which was their principal asset.

The Commission retained us to study the impact of landmark designation under the Chicago ordinance on the Auditorium building. The ordinance itself was an important factor in any such assessment. A careful review of its language disclosed that from the viewpoint of the property owner, the ordinance imposes at a minimum the risk of delays and uncertainties in connection with any proposed construction, alteration, or demolition of the improvements on his property. Delays may add up to as much as 252 days from the time the permit application is filed, during which efforts at accommodation are made. At the expiration of the 252 days the owner will presumably have been granted his permit or have reached a suitable accommodation; if not, he will likely be considering litigation to force issuance of a permit. Throughout this period he will have been afflicted by the uncertainties associated with the review process and will find his freedom of action impaired. These delays and uncertainties may combine to inhibit the effective operation of the property as an economic

unit, to inhibit its free salability, and to cause the loss of opportunities to profit from offers to lease, to purchase, or to finance the property which might arise.

When the time period specified has expired, one of three situations will present itself: 1) the permit will be granted; 2) the permit will have been refused, leaving the owner no remedies except such as litigation might yield; or 3) some accommodation will have been reached. In the first two cases, no compensable damage appears to arise. In the third, the owner will presumably be satisfied with whatever accommodation has been reached and will, therefore, be entitled to no further damages.

If the owner's permit is rejected, he can look forward to problems in the area of rentability, operating efficiency, mortgageability, and salability. On the other hand, the fact of landmark designation may confer certain benefits on the property, including a reduction in its real estate tax assessment to reflect any loss in market value resulting from designation, an increase in prestige, and a stabilization of tenancy as a result of the greater security tenants will experience in a designated building.

Roosevelt University is a non-profit institution, so that the building and land are presently exempt from real estate taxes. The University itself is in reasonably good financial condition, although facing increasing competition from a state university campus located nearby. It is able to operate relatively well in the building, despite significant functional deficiencies and maintenance burdens. The building is thus not immediately endangered, although the city is interested in adding such additional protection as designation under the ordinance would confer.

Our investigation disclosed the building to be sturdy in construction and still in good structural condition, although some settling has occurred. It was reasonably useable as an educational facility and quite useable as a theater. Its neighborhood was good and well adapted for such uses, although the site is unlikely to be needed for new construction of either office or hotel space in the foreseeable future.

Alternate uses such as office, hotel, apartment, retail, and warehousing were considered and rejected as not feasible on both economic and physical grounds. The cost of demolishing the existing building was estimated at $4,520,000, or approximately $71/square foot of land area. Because in our judgment $125/square foot represented the highest price which the land might bring under current conditions, maximum net realizable land value after demolition is approximately $3,500,000 or $55/square foot. Value added by the structure based on an analysis of replacement cost and depreciation was estimated at $17,500,000. It thus seemed unreasonable to anticipate that the structure would be demolished for economic reasons, particularly in view of the high demolition costs. We accordingly concluded that the highest and best use of the property was its present educational and cultural use, and judged that even if both Roosevelt University and the Auditorium Theater Council were to discontinue operations, replacement tenants could be found at a price substantially in excess of net land value after demolition.

Applying the ordinance to the specific situation, we found that the uncertainties and delays possible as part of the administrative review process were un-

important in terms of the existing use or in terms of the practices and policies of current or potential users. The Auditorium is not subject to many of the concerns which confront the owner of an operating office building, hotel, or apartment house. A delay of a few weeks or months in the implementation of some alteration program will not affect its economics significantly, nor is it likely that the building will lose acceptability in the marketplace by virtue of its old design. The property in question is not salable as a land speculation or for demolition and redevelopment, and it enjoys the advantage of real estate tax exemption, which both enhances the economic viability of the present uses and deters conversion to other profit-making uses. The present users are institutions inclined to move slowly and subject to their own administrative processes which appear to be fully as time-consuming and uncertain as those of the Commission, so that the red tape inherent in designation does not unduly constrict the owners of the property.

The owners are concerned about interference by the city with interior and structural changes routinely required in connection with their operation of the University. City practice in the past has not interfered with such operations, and it is considered unlikely that this policy will change; indeed, the Commission expressed a willingness to exempt interior remodelling of spaces without particular architectural significance from its review processes. In one area, however, the University's concern seemed more justified: its fear that designation might interfere with the free salability and mortgageability of the property. We found that designation would have no apparent effect on existing mortgage arrangements or on the salability of the property, which for practical purposes is so widely recognized as a landmark that any purchaser desiring to demolish it or to alter it destructively would meet a solid wall of public opposition. Future mortgageability, however, was a more serious problem. The trustees of the University and several of their friends appeared at public hearings to testify that designation would create real difficulties in this area.

We recognized that prospective mortgagees would tend to shy away from designated buildings in general and might urge resistance to the designation of the Auditorium building, but pointed out that they would also shy away from theater and campus loans in general, and particularly from theater and campus loans involving large, old structures of this nature, whether designated or not. The credit of the mortgagor would, of course, be of primary importance in any such financing and would not be affected directly by designation.

While freely acknowledging that the mortgageability and salability of many properties would be adversely affected by designation, we found that the Auditorium building, which had been devoted exclusively to tax-exempt educational and cultural uses since 1940, would not be so affected. The quality of the location and the value of the land were not sufficient to warrant demolition of the existing improvements, nor would the costs of converting the structure for office, hotel, apartment, or other use be justified. Loss of the real estate tax exemption which the property enjoys might well destroy its economic viability for any use, whether public or private. We were thus in the presence of a unique and special use which has value, as demonstrated by the present utilization of the property, but for which salability is a very minor concern.

The risk that Roosevelt University might move or disband was in our judgment offset by the possibility that another similar institution might be found to take over and continue the operation of the structure. Further, our analysis showed that the improvements add value to the land and that the property as improved would bring a higher price than could be justified if the property were to be sold for land value, bearing in mind the estimated costs of demolition.

An important factor in this judgment was the time likely to be required to find a buyer able and willing to pay market value. This we calculated to be at least one year, during which the owners could run through the 252 days required by the permit review process without any loss of marketing time. Any prospective mortgagee who looked carefully at the situation would recognize that demolition was economically and politically impracticable with or without landmark designation, so that even in the area of mortgageability no economic damage would be done by designation. We therefore concluded that apart from the noncompensable delays, uncertainties, risks and costs of the administrative and legal processes to which owners of designated landmarks are exposed, the Auditorium building was not damaged by landmark designation. While prospective mortgagees might tend to shy away from designated buildings in general, it was our judgment that no actual economic harm was worked upon the property and that the economic interests of prospective mortgagees would not be adversely affected.

Following our report, the City Council Finance Committee recommended designation. Action by the full City Council in this sense is expected shortly.

CONCLUSION

The buildings cited in these cases varied tremendously in size, quality, character, use, condition, age, and architectural significance. The problems they present, while highly diverse, by no means exhaust the range of issues outlined earlier in this article. If the cases disclose a common thread, it is the evident need of a fresh and open-minded approach to problems of this nature; old solutions are no longer sufficient. It is our hope that the examples given will stimulate new and useful answers to the many questions raised here and to others not yet formulated.

As a nation, we are moving toward a new equilibrium among public and private interests that is still only imperfectly visible. Perhaps the issues surrounding preservation will serve as a useful model in attacking this larger problem and moving toward a new level of reconciliation.

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National Fiscal Policy and Housing

by Dennis J. Jacobe and Kenneth J. Thygerson

Providing adequate shelter for all Americans is a top social priority in the United States. The 1949 Housing Act called for "... a decent home and suitable living environment for every American family," a statement that has been reiterated many times since 1949 and in some sense was responsible for the important 1968 Housing and Urban Development Act and subsequent legislation. This paper analyzes the way fiscal policy is used to achieve the nation's housing priorities. Included is a review of the growth of government spending and a study of the impact on housing of the fiscal-monetary policy mix, federal housing outlays, federal tax expenditures, and federal credit programs.

Total government spending including federal, state and local units increased from 10% of gross national product (GNP) in 1929 to 33% in 1974. A large share of these expenditures can be attributed directly to the federal government whose outlays accounted for 21% of GNP in 1974.

One way this expansion of the federal government has influenced housing is through the fiscal-monetary policy mix. Our analysis of overall stabilization policy disclosed a serious bias in the monetary-fiscal policy mix which has been increasingly adverse to housing in recent years. Large budgetary deficits even after high employment is reached have put undue pressure on monetary policy to correct for the resulting inflation. During periods calling for expansionary policies, the mix has been both favorable and unfavorable to housing although the 1974-75 period suggests that a heavy weighting toward fiscal policy can create demand expansion without bringing about a housing recovery.

Another way federal expansion has influenced housing is through budget allocations. A review of federal allocations to housing indicates that although housing has been given a great deal of lip-service as a national priority, the data does not substantiate this claim. Federal outlays for housing totaled less than 1% of GNP in 1974. Further, the impact these outlays do have actually acts to exacerbate the industry's instability. As a result of this instability in

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housing, the U.S. had far exceeded its cumulative housing goals as of fiscal 1973. Even after the record production declines of fiscal 1974-75, the nation is only modestly below its cumulative target as of fiscal 1975. However, it is clear as of fiscal 1976 that in the next three years (1976-78) total housing production will be far below the nation's 1970 housing goals. This failure to realize our nation's housing goals will take place despite the fact that federal spending is expected to continue to expand to 22% of GNP.

Federal tax expenditures grew rapidly during the late 1960s and early 1970s. Although this form of federal expenditure has decreased in importance in some areas, it has increased in its importance to housing. During the relative instability of the early 1970s, housing tax expenditures have stabilized housing.

Federal credit programs have grown significantly during the last decade (1965-1974). When the size of the federal deficits of the 1970s is taken into account, it is clear that the federal government has been requiring an even larger proportion of the funds available to U.S. credit markets. These trends are projected to continue as federal credit needs reflect increasing deficits in 1976.

Federal credit programs for housing have been a large part of this expansion. Although these programs have increased housing stability by providing subsidized mortgage funds, they have done so at the expense of private intermediaries which is evidenced by the artificial downward pressure on mortgage rates and by the increasing usurpation of the mortgage market by federal agencies. This harmful impact on private intermediaries has a destabilizing effect on housing as private lender uncertainty increases.

The increasing size of federal spending, federal deficits, federal tax expenditures and their changes in composition reveals the increasing tendency of the federal government toward immediate consumption and away from the savings-investment area. This orientation implies the possibility of a capital shortage in the 1980s with obvious related difficulties for housing. Even if a capital shortage is not realized, this orientation in itself has the potential for creating continuing housing instability.

THE FEDERAL BUDGET

Perhaps the easiest of economic laws to substantiate is Wagner's "law." This simply asserts that there is an inherent tendency on the part of government to increase in size and importance.[1] The growth of federal, state and local government in the United States during the past half-century provides empirical proof that this tendency does exist.[2]

In 1929, government revenues totaled $11.3 billion while by 1974 they were $455.0 billion. This represents a 40-fold increase over a period of 45 years with government revenues increasing from a rate of less than $1 billion a month to nearly $1.3 billion a day. The growth of government expenditures has been similar to that of revenues. Between 1929 and 1974 government expenditures

1. Adolf Wagner was a noted German theorist of the 19th Century. See James M. Buchanan, *The Public Finances*, e.g. rev. ed. (Homewood, Ill.: Richard D. Irwin, Inc., 1965), p. 50.
2. Although measuring problems are significant when government activity is being discussed, simple budget data substantiates Wagner's law; see Buchanan, *The Public Finances*, pp. 30-32.

increased 45-fold from $10.3 billion to $460.9 billion. This represents an expenditure increase from $28 million a day in 1929 to $1.3 billion a day in 1974.

Clearly all forms of spending have increased over this span of 45 years. The nation's gross national product experienced nearly a 14-fold increase going from $103.1 billion in 1929 to $1,397 billion in 1974. Real growth of the government sector then is not revealed by revenue and expenditure trends alone. We can envision the real growth of government, however, if we consider the percentages of the nation's total product (GNP) consumed by government. In 1929, government spent 10% of the nation's total product—$1 out of every $10. By 1974, government was spending 33% of GNP or $1 out of every $3—more than a threefold increase in real government size.

Between 1929 and 1974, federal expenditures alone grew from $2.6 billion to $299 billion—a 115-fold increase. This represents better than a fivefold expansion of federal claims on the nation's total product—from 3% of GNP in 1929 to 21% in 1974.[3]

FISCAL POLICY

The growth of government influences housing in many ways. One way housing is affected is through the nation's overall fiscal policy. The relationship between government spending and taxation—the existence of federal budget surpluses and deficits—is usually referred to as fiscal. The overall objective of fiscal policy is to eliminate the gap between aggregate demand and non-inflationary, full employment level of output. The two basic targets of fiscal policy are then price stability and maximum production. Fiscal policy cannot, however, be reviewed in isolation, but must be discussed in the context of overall stabilization policy which rightfully includes monetary policy. Presumably we can have the same overall production with an equally tight fiscal policy and an easier monetary policy or the reverse within some limit. The choice depends primarily on the formulation of our many subsidiary economic goals or targets which are presumably affected differently by the fiscal-monetary mix.

These subsidiary economic goals are at the nexus of the housing debate in so far as it relates to choosing the "appropriate" fiscal-monetary policy mix. It is generally conceded by economists that the policy mix does influence the composition of our economy's output. Housing clearly represents a subsidiary goal that may well be affected.

Although a number of recommendations have been made regarding the role of fiscal policy in meeting our housing goals, unanimity has not been achieved. As one reviews the literature, however, there does seem to be a general consensus of opinion over several issues related to the question of how the fiscal-monetary policy mix influences or should influence the economy and housing expenditures.[4] The major differences occur in the weight given by various

3. Total government expenditures as a percentage of GNP differs from the sum of state and local expenditures/GNP plus federal expenditures/GNP. This is the result of programs such as federal revenue sharing which create double counting problems.

4. *Policy: The Eclectic Economist Views the Controversy*, ed. James J. Diamond (Chicago: DePaul University, 1971), pp. 51-74; Gardner Ackley, "Fiscal Policy and Housing," *Housing*

analysts to the overall importance of these influences. General points of agreement or propositions include the following:

Proposition #1:

The primary goal of monetary and fiscal policy is to produce full employment output with price stability. Housing, while an important subsidiary goal, must be considered only as a secondary concern together with a number of other subsidiary goals such as: 1) the level of interest rates; 2) possible dislocations within the financial system; 3) balance of payments; and 4) effects of stabilization policy on the long-run growth rate of supply in the economy.

Proposition #2

The short-run effects of fiscal policy on the nation's output and employment are generally agreed to be quick and significant. Irrespective of the economic doctrine of the economist, a sharp acceleration or deceleration of government spending are assumed to have fairly strong short-term effects of aggregate demand. Monetariests concede this point, but hold that rises in government spending financed by taxes or sales on bonds to the private sector will eventually "crowd-out" private spending by nearly an equal amount over the long-run.

Proposition #3

The composition of federal spending is assumed to have long-run effects on the rate of supply capacity growth in the economy. That is to say, a fiscal policy that re-allocates resources away from current consumption to investment will alter the long-run growth rate of potential output. Also, fiscal policy can alter the long-run supply of housing by direct expenditures on new housing, rehabilitation, resources going into housing and manpower training.

Proposition #4:

Housing as a credit intensive durable good, is likely to be more adversely affected by a fiscal-monetary policy mix which puts its primary restraining responsibility on monetary policy as opposed to fiscal policy. That is to say, if we have the choice between two fiscal-monetary policy mixes, both of which are assumed to create the same overall aggregate level of demand and similar inflation rate, the policy mix which calls for the more restrictive monetary policy and less restrictive fiscal policy will be the most detrimental to the housing market.

Proposition #5:

Fiscal policy can do little by itself to promote housing goals, but must be coordinated with monetary policy to produce the desired outcome. The objective must be to select a total gross national product-employment target which is consistent with some level of acceptable inflation, then select

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and Mortgage Policy, Federal Reserve Bank of Boston, Conferences Services No. 4 (October 1970), pp. 9-40; Arnold Harberger, David J. Ott, and James S. Duesenberry, "Discussions"; Leonell C. Andersen, "A Monetarist View of Demand Management: The United States Experience," ***Review*** 53, Federal Reserve Bank of St. Louis (September 1971).

the appropriate combination of monetary and fiscal policy which will achieve the overall output and prime objectives but which also comes closest to achieving the required amount of housing.

IMPACT

Assuming general agreement with the above propositions, we might choose to review the extent to which fiscal policy during the last several decades has favorably or adversely impacted the housing markets. Such an evaluation is difficult for several reasons. First is the problem of the potential lack of coordination between fiscal and monetary policy. Clearly, a particular fiscal policy must be considered inappropriate if it resulted in undesirable output-employment, price, and housing outcomes and such a policy was determined with "perfect knowledge" of the monetary policy actually to be carried out. Unfortunately, fiscal policy can hardly be faulted for an undesirable outcome which occurred because the monetary policy pursued was unexpected or inappropriate. Nor can fiscal policy be criticized for bad forecasting of the outcome of any given policy. Finally, fiscal policy cannot be blamed for adverse housing conditions which are the natural consequence of the pursuit of more important primary or subsidiary goals.

These difficulties make it impossible for us to place blame, but they do not stop us from evaluating policy solely from the more narrow point of view of how the policies pursued affect housing output. In other words, while we might accept the notion that fiscal policy is blameless, we need not reject the temptation to evaluate the policies pursued for the narrow viewpoint of what would have been in the best interest of housing.

This presents another problem, however. Should the fiscal policy chosen be evaluated under the assumption of "full knowledge" of the monetary policy that was pursued? Or conversely, should monetary policy be evaluated under the assumption of full knowledge of the fiscal policy that was pursued? This chicken and egg problem is not easily solved even though most analysts assume monetary policy can be adjusted more quickly than fiscal policy. Nor is the problem of determining what the primary overall output, employment and inflation goals are for any given year. This latter problem is particularly important since housing, as a subsidiary goal, must be considered subservient to these other primary goals.

Given these problems, it is clear that any approach taken to the question of how fiscal policy affects housing must suffer from the criticisms of subjectivity and unrealistic assumptions.

Our approach will be to determine the extent to which fiscal policy has historically tended to foster favorable or unfavorable conditions for the housing market. From the above propositions, particularly propositions #4 and #5, there is general agreement that when fiscal policy assumes too great a stimulative role when expansionary policies are called for in relation to monetary policy, or similarly, where monetary policy assumes too great a restrictive role when deflationary policies are called for as compared to fiscal policy, that housing will suffer adversely. Our effort will be to determine the incidence of these occurrences during the last several decades.

One way of measuring fiscal impact in a full employment framework is the "high" or "full employment budget."[5] The high employment budget is a method of estimating the total revenues and expenditures of government under the assumptions of full employment and some estimate of potential long-run growth in output. Although there are many estimation, weighing, and timing problems associated with its computation, the budget does provide a useful indicator of the direction of discretionary fiscal action by isolating the effect of fiscal policy from the influences of changes in the level of economic activity on the budget data.

From the above discussion, it would appear that fiscal policy could be detrimental to housing under the following conditions:

1) If fiscal policy is stimulative when full employment is approaching or present then there is a tendency for such a fiscal policy to force monetary policy to burden too great a responsibility for slowing the growth in aggregate demand. Such a policy would be detrimental to housing since monetary policy works through the credit markets which is particularly burdensome to the housing sector.
2) If fiscal policy is too stimulative during a period of recession, then monetary policy is unable to ease commensurately as much as if a more balanced fiscal-monetary mix was employed. Such a policy will have a relatively smaller stimulative effect on housing than on other less credit intensive sectors of the economy.
3) If fiscal policy is too restrictive during a period of recession or excess unused capacity, then monetary policy may be forced to be overly stimulative, leading to excessive rises in homebuilding.
4) If fiscal policy is too restrictive during a period of fully utilized capacity, then monetary policy may result in relatively too much in resources being devoted to housing.

The occurrence of these four policy mixes during the last several decades is surprisingly evenly distributed, although through time there is not an equally random occurrence.

The following assumptions are made in analyzing the impact of fiscal-monetary policy mix on housing.

Assumption #1:

It will be assumed first that during periods when the wholesale price index is rising at, near, or above a 5% rate and unemployment is less than or equal to 5% that stabilization policy will be aimed at deflating aggregate demand.

Assumption #2:

It will be assumed that during periods when unemployment is in excess of 5% and when prices are declining or stable that stabilization policy will be aimed at expanding aggregate demand.

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5. James R. McCabe, "The Full Employment Budget: A Guide for Fiscal Policy," *Monthly Review*, Federal Reserve Bank of Richmond (May 1972).

PHASES

The quarterly high-employment budget and the annual percentage increase in M_1 (cash and demand deposits in commercial banks) and M_2 (M_1 and time and savings deposits in commercial banks) was evaluated for the period 1950-75. There are four periods when stabilization policy is assumed to be deflationary. There are four periods when stabilization policy is assumed to be expansionary. Each period is also evaluated on the basis of whether the fiscal-monetary mix was favorable or unfavorable to housing. In periods of deflationary goals, a policy weighted in favor of monetary policy is considered negative to housing, while a policy weighted in favor of fiscal restraint would be favorable even though housing would be expected to suffer in either case. In periods of expansionary objectives a fiscal-monetary mix weighted in favor of monetary stimulus is considered positive to housing and vice versa. In both cases, a well-balanced policy is considered neutral.

Deflationary Phases

1) II 1953 - III 1953 (Negative)	Complete reliance on monetary policy to slow economy. Full employment deficit increased stimulus from $9-10 billion.
2) II 1955 - IV 1956 (Negative)	Monetary policy tightened. Balance between monetary and fiscal policy slightly weighted to monetary policy. Sharp tightening of monetary policy and moderate additional restraint of high employment budget.
3) IV 1968 - IV 1970 (Neutral)	Balance between monetary and fiscal policy. Very sharp tightening of monetary and fiscal policy.
4) IV 1973 - II 1974 (Negative)	Balance with emphasis on monetary policy. Moderate tightening of fiscal policy and relatively sharp tightening of monetary policy.

Expansionary Phases

5) II 1954 - II 1955 (Positive)	Sharp expansion of monetary growth and tightening of fiscal policy.
6) I 1958 - II 1964 (Positive)	Monetary policy with the exception of 1959 was progressively more stimulative while fiscal policy remained relatively restrictive.
7) III 1970 - IV 1972 (Neutral)	Sharp easing of both monetary and fiscal policy.
8) IV 1974 - Present (Negative)	Very sharp fiscal stimulus and moderate monetary stimulus.

Our simple subjective analysis indicates:

1) During deflationary phases stabilization policy is heavily weighted toward the use of monetary policy. Rarely does fiscal policy provide sufficient restraint to balance the policy mix. Thus, during periods when deflationary outcome is desired, the fiscal-monetary mix has tended to be adverse to housing.
2) During expansionary phases of stabilization policy, the fiscal-monetary mix has been both favorable and unfavorable to housing.

3) Over the period covered, the tendency has been to use a relatively heavier weighted monetary policy mix during deflationary phases and heavier weighted fiscal policy mix during expansion phases. This is born out by the fact that the only positive fiscal-monetary mix took place during the mid-1950s and early 1960s.

These trends would suggest that housing may have experienced difficulties in recent years as a result of the increased tendency to weigh monetary policy more heavily than fiscal policy during deflationary phases of stabilization policy, and fiscal policy more heavily during expansionary phases. Both tendencies are generally less compatible to a strong housing market and available mortgage credit.

HOUSING OUTLAYS

Another way the federal government impacts the housing market is with its allocation of expenditures for housing. In this regard, housing must compete with other national priorities for funds. As a result, the amount of federal expenditures for housing does reflect at least to some degree the national priority status of housing.[6]

Housing as a national priority fits somewhere in between the foregoing examples. In 1965, federal outlays for housing totaled about one-half billion dollars while by 1974 they were nearly $5 billion—a tenfold increase in nine years. This rate of growth implies that housing has been an increasing national priority over the past decade. This impression is confirmed for the period 1965-1972 as housing outlays increased from 0.4% of total federal outlays to 1.9% and from 0.08% of GNP to 0.4%. However, in 1973 and 1974 federal housing outlays did not meet their 1972 levels representing only 1.75% of total outlays and 0.36% of GNP in 1974. Although housing has been an increasing national priority during the last decade, the trend did not continue upward during 1973-74.

More surprising than this reversal of trend, however, is the overall size of federal housing expenditures. Housing outlays representing less than 2% of total federal outlays—less than 0.5% of GNP—can hardly be seen as reflecting a major national priority.[7]

Goals

In spite of the small size of federal housing outlays, they do hold a significant potential for impacting housing production. Two ways in which the degree of use of this potential can be examined involve housing goals and housing stability. Ideally, the federal government should be capable of adjusting its spending to achieve specified housing production levels which reflect both improved housing for the population and stability in production.

In 1969, the nation's housing production goal was set at approximately 26 million new units over the next decade and a production schedule was estab-

6. *The Budget of the United States Government, Fiscal Year 1976* (Washington, D.C.: U.S. Government Printing Office, 1975), p. 109.
7. *Ibid.*

lished. This goal was revised to 25.5 million new units and 1.0 million publicly-subsidized, rehabilitated units in 1970. Since then a number of studies have been done estimating our nation's housing needs with estimates ranging from 22 to 29 million new units over 10 years.

Attainment of the 1970 production schedule on a cumulative basis was fairly good between fiscal 1969 and 1975. The cumulative target for 1975 was 16.3 million new units while 15.2 million were produced. As of fiscal 1975, the nation has achieved 93% of its target for the period 1969-75.[8] This success, however, has not been achieved in a stable, healthy manner. In fiscal 1971, production was 13% over its target followed by a 25% over-shot in 1972 and 15% over-shot in 1973. Then in 1974 actual production fell 23% below its goal followed by an even more pronounced fall of 55% in fiscal 1975. The sharp declines experienced in fiscal 1974 and 1975 indicate that even with a strong housing recovery in 1976 the nation will be well below its housing goal for the decade.

Another way housing production could be expected to be influenced by federal housing outlays is in the form of subsidized new units. In 1965, 48 thousand new subsidized units were produced representing 3.2% of total new unit production in that year. In 1974, these units totaled 45 thousand—only 3.4% of total production. Subsidized housing units represent only a small share of housing production and thus do not have a major impact.[9] Further, the number of subsidized units produced per year does not reflect a federal government attempt to use this source of impact as a method of stabilizing housing production. If these units were being used to aid housing production, they should increase as production falls below target levels and fall when production exceeds the annual goal. This has not been the case as subsidized production averaged 13.5% of total starts during the boom years of 1971-72 but less than 4.0% during the bust years of 1974-75. As a result, the production of subsidized units actually accentuates housing instability.

This also tends to be the impact tendency of federal housing outlays as a whole. Between 1969 and 1973 as housing production realized rapid expansion, the ratio of federal housing outlays to total outlays increased fourfold. Then as housing production declined swiftly in 1973-74, this percentage also declined. In conclusion, it is clear that any impact federal housing outlays did have on production acted to exacerbate housing instability.

TAX EXPENDITURES

Another aspect of government expansion is reflected by federal government tax expenditures.[10] Tax expenditures is the term used to account for those tax

8. *Estimates of Housing Needs, 1975-1980*, prepared for the Committee on Banking, Housing and Urban Affairs, United States Senate (Washington, D.C.: U.S. Government Printing Office, 1975), pp. 2-4.
9. "Housing Starts," July 1975, Department of Commerce, C20-75-7 (Washington, D.C.: U.S. Government Printing Office, 1975), pp. 4 and 6; and United States League of Savings Associations.
10. Some indication of the widespread use of this mechanism by the federal government is shown by John L. Siegfried, "Effective Average U.S. Corporation Income Tax Rates," *National*

revenues which the federal government does not collect because income subject to tax is reduced by special provisions, credits, deductions, exclusions, and exemptions.[11] For example, the deductibility of medical expenses is generally accepted as a tax expenditure.[12] Total federal tax expenditures for 1967 were $36.6 billion while by fiscal 1974 they amounted to $72.7 billion.

TABLE 1

TOTAL FEDERAL TAX EXPENDITURES[1]
(billions of dollars)

Year	Total Tax Expenditures	Year	Total Tax Expenditures
1967	$ 36.6	1971	$ 51.8
1968	44.1	1972	58.8
1969	46.6	1973-74	72.7
1970	44.1	1974-75	79.3

1. Data for 1967-72 in calendar years and for 1973-74 in fiscal years.

SOURCE: U.S. Department of Treasury; ***Special Analyses, Budget of the United States Government, Fiscal Year 1976***, pp. 108,109.

This represents a doubling in less than eight years with the result that in 1974 the federal government expended revenues in this form amounting to almost 6% of GNP. Federal tax expenditures and outlays combined accounted for nearly 40% of the nation's total product in 1974.[13]

Tax Journal 27 (June 1974), pp. 245-259, in his computation of the effective corporation income tax rates for 100 industries in 1963. He found that the average effective tax rate was 39% as opposed to the nominal corporate tax rate for that year of 52%.

Further evidence of the use of tax expenditures is noted in Stanley S. Surrey and William F. Hellmuth, "The Tax Expenditure Budget—Response to Professor Bittker," ***National Tax Journal*** 22 (December 1969), pp. 528-537; Secretary of the Treasury, U.S. Treasury, "The Tax Expenditure Budget: A Conceptual Analysis," ***Annual Report of the Secretary of the Treasury 1968*** (Washington, D.C.: U.S. Government Printing Office, 1968); B. I. Bittker, "The Tax Expenditure Budget—A Reply to Professors Surrey and Hellmuth," ***National Tax Journal*** 22 (December 1969), pp. 538-542; and Barry M. Blechman, Edward M. Gramlich, and Robert W. Hartman, ***Setting National Priorities: The 1976 Budget*** (Washington, D.C.: The Brookings Institution, 1975).

It is noted in the Brookings' publication that tax expenditures for 1976 would sum $91.8 billion—$21.0 billion in tax subsidies to the corporate sector (44% of corporate tax revenues) and $70.8 billion for individual households (67% of income tax revenues).

11. ***Estimates of Federal Tax Expenditures***, prepared by the staffs of the Treasury Department and Joint Committee on Internal Revenue Taxation, Committee on Ways and Means, U.S. Congress, June 1, 1973 (Washington, D.C.: U.S. Government Printing Office, 1973), pp. 1-3.
12. ***Special Analyses, Budget of the United States Government, Fiscal Year 1976*** (Washington, D.C.: U.S. Government Printing Office, 1975), p. 108.
13. ***Economic Report of the President***, transmitted to the Congress February 1975 (Washington, D.C.: U.S. Government Printing Office, 1975), pp. 249-328.

Tax Expenditure Mix

As federal tax expenditures have increased so has the allocation by function. These allocations, however, have not all increased equally, revealing once again changing national priorities. For example, consider the area of income security. Tax expenditures in this area include such items as the deductibility of medical expenses, the exclusion of sick pay, the exclusion of unemployment benefits, and additional exemption given those over 65. In 1967, tax expenditures in this area were an estimated $15.6 billion or 43% of total tax expenditures. By fiscal 1975, tax expenditures in this area totaled $27.2 billion or 34% of the total—a clearly declining tax expenditure priority.

By way of contrast, tax expenditures for state and local government are an increasing priority. This tax expenditure essentially reflects the exclusion of interest on state and local debt and the deductibility of nonbusiness state and local taxes. These expenditures were estimated at $4.6 billion in 1967 and $13.1 billion in fiscal 1975. As a result, state and local tax expenditures increased from 13% of total tax in 1967 to 17% in 1975.

Housing Tax Expenditures

Another way the federal government impacts the housing market is with its use of federal tax expenditures. Once again, housing must compete with other national priorities. As a result, the success of housing in this competition also reveals in part the national priority status of housing.

TABLE 2

HOUSING TAX EXPENDITURES[1]
(millions of dollars)

Function	1967	1968	1969	1970	1971	1972	1973-74	1974-75	1975-76
Bad debt deduction for thrifts	600	660	680	380	400	400	1,000	1,030	980
Housing rehabilitation with 9-year amortization	*	*	*	*	10	15	85	115	95
Excess depreciation on rental housing	250	250	275	255	500	600	480	520	540
Deductibility of mortgage interest on owner-occupied homes	1,900	2,200	2,600	2,800	2,400	3,500	4,870	5,590	6,500
Deductibility of property taxes on owner-occupied homes	1,800	2,350	2,800	2,900	2,700	3,250	4,060	4,660	5,270
Total	4,550	5,460	6,355	6,335	6,010	6,750	10,495	11,915	13,385

1. Data for 1967-1972 in calendar years and for 1973-1976 in fiscal years. Adjustments made to Treasury compilation of what are housing tax expenditures (S&L bad debt deduction included).

*Less than $1 million.

SOURCE: U.S. Department of Treasury; *Special Analyses, Budget of the United States Government, Fiscal Year 1976*, pp. 108, 109.

Housing tax expenditures reveal an uptrend. Included in this area are the deductibility of mortgage interest, the deductibility of property taxes, and the bad debt deduction for thrift institutions. Tax expenditures for housing were estimated at $4.6 billion in 1967 or 12% of the total. By fiscal 1975, these expenditure estimates had increased to 15% of the total or $11.9 billion. Housing is thus an increasing national priority from a tax expenditure perspective.

Goals

As was noted earlier, the U.S. has been fairly successful in achieving its 1970 housing production goals. The level of attainment does appear to be inversely related to the size of housing tax expenditures. As housing production expanded between 1970 and 1972, the size of housing tax expenditures decreased from 14.6% to 11.3% of total tax expenditures. Then in 1972-75 as housing production leveled off and then declined sharply, housing tax expenditures increased from 11.3% to 15.0% of total tax expenditures. These trends indicate that federal tax expenditures for housing have had a stabilizing influence on housing during the volatile 1970s.

FEDERAL CREDIT PROGRAMS

Government also has grown as a supplier of credit.[14] Credit assistance is provided through a number of programs which range from direct loans to private loan guarantees and interest rate subsidies. In 1965, federal credit programs advanced $8.9 billion or 13% of all the funds advanced in U.S. credit markets to nonfinancial sectors. By 1970, credit advanced under federal auspices totaled $17.4 billion while in 1974 it amounted to $26.6 billion. This resulted in federal credit programs supplying 20% of the credit advanced to nonfinancial sectors in 1970 and 15% in 1974.

Another aspect of the federal government's impact on the nation's credit market is reflected when the total funds raised under federal auspices (borrowing for federal credit programs and federal deficits) is compared to the total funds raised by nonfinancial sectors. In fiscal 1965, funds raised under federal auspices were $6.1 billion or 28% of the market total. This percentage increased to 34% in fiscal 1970 as federal funds raised totaled $18.1 billion and 34% in fiscal 1974 representing $25.1 billion.[15] In fiscal 1975, federal credit programs are estimated at more than $31 billion and federal funds raised were projected at $62 billion.[16]

Housing Credit Programs

During the 1970s, the federal government expanded its own mortgage market participation. This was accomplished through legislation fostering the growth of a relatively new form of housing assistance—the federal credit program.[17]

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14. *The Economics of Federal Subsidy Programs*, a staff study prepared for the use of the Joint Economic Committee, U.S. Congress (Washington, D.C.: U.S. Government Printing Office, 1972); and *Special Analyses, Fiscal Year 1976*, pp. 82-100.
15. *Special Analyses, Fiscal Year 1976*, p. 83.
16. For 1975 they are projected at 5.6%. See *Special Analyses, Fiscal Year 1976*, p. 366; and *The Budget of The United States Government, Fiscal Year 1976*, pp. 32-37.
17. Several studies of housing and other credit programs have been performed: note particularly

These programs operate through a number of federal agencies. The government has established five major institutions to expand the flow of credit to housing, particularly during times of restrictive monetary policy. They are: Federal National Mortgage Association (FNMA), Government National Mortgage Association (GNMA), Federal Home Loan Mortgage Corporation (FHLMC), Farmers Home Administration (FmHA), and Federal Home Loan Bank System (FHLB).[18]

During the early 1970s federal government utilized several of these agencies to subsidize housing credit through its tandem programs, originated in 1969 to provide mortgage financing for the subsidized 235 and 236 housing programs. Using the National Housing Act, the President authorized GNMA to purchase subsidized housing mortgages at par or at modest discounts. As GNMA issues a commitment to purchase a mortgage, it simultaneously obtains a commitment from FNMA to purchase the mortgage at its free market price. The tandem or piggyback process acts to minimize the impact of tandem programs on the federal budget balance.

In 1971, the tandem program was extended to FHA mortgages insured under unsubsidized programs and to VA guaranteed mortgages. During 1974, a further extension of the concept was made as GNMA was permitted to purchase conventional mortgages. The program grew rapidly between 1971 and 1974, and from 1971 to 1973 GNMA extended new home commitments of $0.8 billion. By contrast, in 1974 alone, GNMA made $7 billion in new commitments.[19]

The increasing importance of these federally-supported agencies is substantiated by the distribution of residential mortgage loans. In 1955 and 1965, these agencies accounted for only about 3% of the mortgage loans outstanding while by 1974 their holding increased to better than 11%.

CONCLUSION

The preceding analysis of federal budget trends of the past half-century, together with the analysis of the related areas of federal tax expenditures, indicates clearly that the federal government is increasingly consumption-oriented. This tendency on the part of the federal government is revealed not only by the simple growth of federal spending, its changing composition, and its changing priorities.

Rudolph G. Penner and William L. Silber, "Federal Housing Credit Programs: Costs, Benefits, and Interactions," *The Economics of Federal Subsidy Programs*, part 5, submitted to Joint Economic Committee, U.S. Congress (Washington, D.C.: U.S. Government Printing Office, 1972).

Also refer to Jack M. Guttentag, "The Federal National Mortgage Association," in George F. Break and others, *Federal Credit Agencies*, prepared for Commission on Money and Credit (Prentice-Hall, 1963), pp. 67-158; Charles M. Haar, *Federal Credit and Private Housing: The Mass Financing Dilemma* (McGraw-Hill, 1960), pp. 74-125; and Henry J. Aaron, *Shelter and Subsidies* (Washington, D.C.: The Brookings Institution, 1972), p. 91.

18. *1975 Fact Book* (Chicago: U.S. League of Savings Associations, 1975), pp. 70-74.
19. George M. von Furstenberg, "The Economics of the $16 Billion Tandem Mortgages Committed in the Current Housing Slump," unpublished (Bloomington: Indiana University), p. 1.

The implications of the consumption orientation of the federal government and thus the nation as a whole can be derived from the fact that housing is an investment good. As immediate consumption increases, the resources available for investment become more limited and the competition for them are more intense. Recent history indicates that housing does not do well as the intensity of competition for funds in the credit markets escalates.

One result of this crunch on funds is the appearance of disintermediation at thrifts. A milder but related aspect is the high cost of funds to all intermediaries. These difficulties have an obviously negative housing impact.

This situation is aggravated further by less direct aspects of the federal consumption orientation. Housing has not been aided by the lack of major energy-related investments and the resulting promise of ever-higher costs. Similar problems can be anticipated if in the future a lack of investment incentives creates shortages of building materials and other housing inputs.

What is worrisome about these trends is that with the allocation of government outlays increasingly oriented toward stimulating aggregate demand, the huge and growing credit needs of the government represent the tapping of our limited nation's credit pool to finance primarily non-durable consumption purchases. The implications of this are clearly detrimental to those credit-intensive durable goods industries such as housing.

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Doctoring Sick REITS

by Thurston H. Ross, C.R.E.

Most REITs which have gotten into trouble were primarily short-term lenders offering construction loans, wrap-arounds, land and land development loans, and land purchase leasebacks. Their profit was in leverage, the spread between the interest that banks charged the trust and what the borrower could be induced to pay. Many of these loans were based on an interest rate tied to prime for borrower and lender. When prime was at 6% or 7%, two or three percent over prime for short-term loans did not seem unreasonable. But when prime went up to 10% or 12%, the two or three percent over prime became disastrous. Many borrowers walked away from their properties and their loans; many took bankruptcy. REITs, after costly delays, became owners of properties which because of the virtual collapse of the real estate market were only partially developed or not completed; some completed buildings were standing vacant or at least not paying their keep. Condominiums remained partially or wholly vacant, and lands which carried great promise two or three years ago could not—for want of capital, because of environmental impact, inflationary costs for improvements, or overbuilding—have become tax and interest burdens, frequently without much hope of relief.

Further aggravation of the situation occurred when accounting procedures required reserves to be set up for carrying costs anticipated over a three or four-year period, these reserves being a direct charge against the capital of the trust. This reserve is calculated to cover all costs to carry the property until it is able to carry itself or is liquidated.

Inasmuch as many trusts by their organizational structures are required to pay out about 90% of their earnings to shareholders, it has not been possible to set up adequate reserves during periods of high yield. The dilemma is obvious.

The earning potential of many trusts has been frozen because of stoppage of available funds either to revitalize existing projects or to loan on new projects; its debt status is inflated because of speculative estimates of future interest and carrying costs on problem properties; its personnel is so absorbed in paperwork involving theoretical survival details that they have no time to search out and pursue constructive procedures for returning to profitable operation.

The calculation for reserves now required by a debtor trust calls for some of the most sophisticated forecasting as well as the most esoteric legerdemain ever

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demanded of a business operation. Leaving out any mechanics of compounding, a loan of $1,000,000 on a piece of property which has no market today but requires 10% or $100,000 for annual servicing becomes a loan of $1,300,000 in three years or $1,500,000 in five years. If the property has been worth $1,175,000 when the loan was made, it is anticipated that in three years it will be worth $1,529,412 or in five years $1,764,706 to merit a new 85% loan. If there is any prospect of such an increase in value of real estate in the next three to five years, it is not apparent now.

MEANS OF SURVIVAL

In many trusts the question arises as to whether to liquidate now and save the cost of struggling with bad loans and maintaining reserves (which means further capital deterioration) or to seek other alternatives, possibly with further administrative overhead. In some cases liquidation or even bankruptcy may be the easy and, in fact, the most justifiable way out of the dilemma. However, it should be considered only as a last resort when all other remedies have proven futile. Survival should by all means be the objective of the trust administration. This may mean a change in the existing trust form; it may be advantageous to abandon the advisor and internalize the trust. Perhaps, the advisor has no longer a useful function other than that which can be carried on by the trust organization itself. The advisor in some trusts, while performing an essential service to the trust, may have been primarily a mechanism for participating in the profits of the trust before distribution to the shareholders. While many advisors performed good services during the period while the trust was in the lending pattern, they may have little to offer in the process of working out bad loans or operating foreclosed properties. The trust itself may secure better qualified personnel and be better equipped to economically carry on these functions than the advisor, in which case internalization is justified. Nevertheless, the trust's problems remain the same.

It is likely that some trusts will reorganize in corporate form; the idea of paying out practically all of the earnings without consideration of adequate reserves and the apparent advantage of tax savings has lost its luster. The real estate investment trust has generally gotten a bad name. The fact should not be overlooked, however, that corporations, syndicates, partnerships, and other types of business organizations dealing in real estate finance and development have suffered; a never-ending inflation, environmental impact, the energy crisis and a plethora of legal regulations and restrictions affecting real estate as well as dislocations in the financial market have made long-standing "normal" economic operations in real estate almost impossible.

Real estate investment trusts' problems may be described in two dimensions: one has to do with the lenders and the other with borrowers past or present. Banks are the principle trust lenders. These banks want their money back together with delinquent interest and although they have a profound knowledge of money, in most cases, they know very little about real estate. If they did they would not have made loans to the trusts in the first place. The trusts, on the other hand, generally lacked the profound knowledge of money and sometimes even of real estate or they would not have borrowed and reloaned the money. Now both sides are faced with a dilemma and in the attempt to find a solution are ordering audits, interminable projections, and surveys.

Quoting from the Chicago Mortgage Bankers Association Seminar, "now that trouble has struck, lenders have reacted by requiring additional layers of examination and approval before a decision can be reached, resulting in delays which compound cost escalation, construction completion, and marketing problems."

Unfortunately, most of the forecasting and surveying that anyone can do is a waste of computer time, clerical effort, xerox copies, and general paperwork unless it results in a clear and definitive operational effort to get the troubled trust with its real estate, and the bank with its delinquent loans, out of their difficulties. To provide such relief requires a direct practical approach to the real estate and its characteristics and attributes which make it attractive in the market today or in a reasonable future period of time. The core of this relief is operational planning and execution of formalized plans together with cooperation of all interests to provide money and qualified service to make the real estate security attractive in the market.

If lending banks are given a well-organized plan of action to examine, they should have reason to look more favorably on present relief for their customer and to cooperate in helping him initiate his plan. The trust, however, must have the plan as well as the right administration and people to put it into action.

PORTFOLIO REORGANIZATION

Some trusts are getting cooperation from their bankers and their public investors, the often forgotten component of the lending entity, and are not only approaching their problems of survival but getting back into business as qualified real estate operators as well as liquidators. This involves a reorganization of their portfolios as follows:

1) Loans on real estate supported by values which assure repayment of capital, interest, and other carrying costs; in other words, firm assets.
2) Loans on real estate which after thorough investigation are on properties temporarily in trouble and exploration of ways and means for their rehabilitation.
3) Loans on hopeless real estate not only in the current market but in view of future prospects.
4) Owned properties in the above classifications.

Great care must be exercised to distinguish between bad loans and bad real estate. Some trusts have become so obsessed in their money problems that they have lost the capacity to rationally evaluate their real estate security. While the loan securities in category 1) usually need only standby attention, the properties in 2) and 3), as well as owned real estate, demand most careful administrative attention and astute management. They also demand cooperation from banks and other lenders.

The loans in category 2) may be on raw land, developed land, unfinished construction, completed buildings (unfortunately many slow-moving condominiums), existing improved and occupied property, wrap-arounds, subordinated land loans, and standbys with problematical takeout prospects.

Unfortunately, raw land is the least marketable real estate to realize on today and is the most difficult to keep out of category 3). In most cases because of the static real estate market and in view of high development costs, environmental and other restrictive regulations, increasing taxes and other matters beyond a developer's control, most raw land can be disposed of only at a substantial loss or abandoned. The internal and external costs to carry raw land are enormous and the justification of incurring them is subject to serious consideration.

Should this land be liquidated now at a sacrifice price? Should it be abandoned for taxes and wait out the redemption period in anticipation of a rising market? Will it be worth its present liquidation price plus carrying costs for a reasonable period of time? Although the lender will hold the trust responsible for interest and principal for the full amount of its loan, it may be better to abandon the property to save taxes and possible assessments and give more attention to properties which show more promise of survival.

ALTERNATIVES FOR DEVELOPED LAND

Developed residential lands with utilities, favorably located in compatible surroundings, frequently offer good opportunities for realization. In some cases zoning may have to be changed or variances applied for, but tax-hungry cities are becoming less reluctant to make adjustments where opportunities to increase the tax rolls are in prospect. Few REITs have the expertise or personnel to undertake the improvement of such properties because they are organized as financial institutions and not as real estate operators. If they have not already done so they had better enlist the services of practical real estate professionals in the geographic areas of their troubled properties, to find ways and means to administer this real estate as intelligent owners and operators instead of absentee liquidators. To do this they must have personnel qualified by experience and training to advise and cooperate with their field operators.

These observations apply not only to developed lands but also to improved projects and involve all phases of brokerage, including local planning, financing, operation, and/or sales of real estate. If a trust formalizes definite plans for this type of operation on all the owned or troubled properties in its portfolio and seeks the cooperation of its own borrowers as well as banks, it is likely that the result will be more productive and less costly procedures than those produced by all of the statistical and accounting studies now in vogue in most of the troubled trusts in the country. The costs to trusts of such investigative exercises are enormous. The statistical gurus were not too effective in warning of impending disasters in the past and their recommendations for the future may also be of questionable value.

Examination of appraisals made under historical market conditions, bookkeeping reports and audits, forecasts on properties remaining in the same condition as put them on the delinquent list, and notices of creditors' insolvency become academic as contrasted with what is popularly known as "affirmative action."

The REIT is a useful component of the overall real estate market but its structure is faulty in at least two ways. Perhaps not more than 50% of its earnings should be paid out as dividends. This remainder should be equally divided between real estate equity investments and reserves to guard against losses in a

highly cyclical real estate investment market. This reserve can be examined from time to time and, if desirable, reduced to pay an extra dividend or increased in prospects of an approaching storm.

Secondly, the trustees as well as the advisor should include real estate professionals (not only real estate lenders) knowledgeable in market conditions in the geographical areas of lending, in addition to people well qualified in the field of finance. The separate or internalized advisor should have the responsibility for proper accounting, adequate legal advice and other operational functions which will assure the beneficiaries of sound long-term results rather than the feast and famine of the last several years. Leveraging is out of date as it was used in the past although it cannot in principle be abandoned. Perhaps more types of securities not under such cyclical influence as short-term bank loans might be appropriate, but in any case the ratio of borrowed short-term capital to ownership and preferred types of capital should be reduced. This is an imperative requirement for the future viability of the real estate trust. Banks should not be forced into the position of long-term lenders by trusts who often serve, in fact, only as their real estate lending agents without a sufficient capital base to properly administer their own, that is, the trusts' financial responsibilities.

THE COUNSELOR'S ROLE

Real estate counselors have been quite effective in assisting trusts in working out their problems. Unfortunately, anyone who can read and write and has some such experience as a door-to-door book salesman can call himself a real estate counselor. Unless his professional qualifications include membership in a recognized counseling body or association, he may not be able to perform much useful service. On the other hand, if he is well qualified in the real estate business and can intelligently understand and use the services of the engineer, the attorney, the accountant, and other professionals who may be called upon, he may be considered a true real estate counselor. He should not only practice objectivity but be as qualified as the engineer, the attorney, or the accountant are in their respective fields.

Without depreciating the need for accounting records so essential in maintaining the statistical position of the trust, the "bottom line" does not provide all of the information essential to the intelligent administration and programming of the operation of a real estate parcel. It certainly does provide an excellent accounting display and may set a pattern for the establishment of trends, but often at best can be only one element in the formulation and testing of real estate operational policy. Trust managers have tended to view all of their owned property or property in prospect of ownership on the basis of historical data, which, in many cases, caused the trust to assume positions of unreasonable risk. Now management must take advantage of all of its facilities and provide new ones which pay less attention to historical trends and more attention to property potential under skilled operation and management. Often such action may be the first step toward the development of the equity trust posture, thus taking trusts out of the assumed lending agent patterns of the past. Some inventory lands may be broken up into attractive parcels for marketing; existing improved properties may be rehabilitated; and others may be

given a new market identity by formulation of new plans and aggressive salesmanship. Usually this takes money which the trust itself would have great difficulty in raising without current lenders' continued cooperation.

Sound counseling may suggest that such properties be deeded to a new corporation or other entity which has borrowing power, thus enabling the real estate to be put into attractive marketable condition for disposal or retention as a profitable asset. Creativeness can bring new value to real estate, justifying a larger mortgage loan and providing equity return over a long period of time.

The trusts which have the expertise and qualified personnel to work out their present difficulties very probably will be attractive buys in the real estate market in the future, provided, however, that:

1) They are not strangled by interminable investigations of historical events and studies resulting only in enormous trust overhead.
2) They are treated as bank customers today and in the future rather than as economic disasters.
3) Long-time working capital is provided to give the trust a firm capital base.
4) Trust structure is reshaped to enable it to take long-term equity positions in real estate projects, both existing and proposed well-organized developments with carefully analyzed prospects.
5) Economically justified profit distribution procedures are formulated to offset overall cyclical market movements.
6) Their operation includes provisions for long-term as well as short-term or interim financing.
7) Their lending policies are on the security of the real estate itself and not on the sometimes ephemeral credit of the borrower.

These suggestions are starters for relief of present difficulties as well as for setting up revised trust structures. The beneficiaries then would be owners of shares in solid real estate operational entities with substance, rather than participants only in financial brokerage operations which have proven so disastrous.

Flood Disaster Protection Act

by William Eugene Nichols, C.R.E.

A few weeks ago a friend said to me, with some degree of indignation, that this Flood Disaster Protection Act had slipped up on us. That's quite an accurate assessment of the majority response and reaction in the real estate industry and among the general public. But it needn't and shouldn't have been so. This legislation has been around for ***six years!***

What happened in 1973? This six-year-old Act was fitted out with a brand new set of very sharp teeth. In examining the enactment in its entirety with special emphasis on the legislation's new masticating capabilities, let me first establish three predicates to bear in mind in considering the details of the current law.

The Flood Disaster Protection Act of 1973 ***is a law.*** It's an accomplished fact; it is in force right now. It's almost certain that as the owners of real estate or the practitioners in the real estate business you will be confronted with the provisions of this law shortly, if some haven't already directly or indirectly been impacted. There are many who have already been affected by this law and just don't know it. Those in this uninformed category are very late in accomplishing the things they must do under the dictates of this law to serve their own best interest.

Secondly, it is obvious that the application and administration of this law are the province of the lawyer and the courts when those inevitable and numerous instances of legal interpretation, advice, and litigation arise. Therefore, a part and parcel of the second predicate is a declaration that I am not a lawyer and disclaim any presumption of such ability.

Rather, my point of view is that of a real estate counselor. Individuals who have been invited to join the American Society of Real Estate Counselors (ASREC) number only 400+ persons across North America. They are becoming well-known outside of the real estate field for their extensive backgrounds and expertise and are entitled to use the Society's professional designation C.R.E. (Counselor of Real Estate).

The basic function of the counselor is to take a given consideration or problem assignment—assuming that such an assignment is within his or her particular

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This article is based on the author's presentation at the Southwest Regional Real Estate Conference (co-sponsored by ASREC and the Southern Methodist University School of Business), held November, 1974 in Dallas, Texas.

William Eugene Nichols, C.R.E., is in private practice as a real estate counselor in Dallas, Texas.

professional capability—analyze and evaluate it, and reduce the subject to a set of basic facts (as I will do here) that are clearly understandable by either the non-professional or professional client, and upon which that client can establish a reasoned and informed decision. Ethical canons circumscribing the practice of the members of ASREC provide that the counselor can have no contingent beneficial interest in the outcome of any matter upon which he renders counsel or arising from the action or inaction of the client in response to the counselor's report, opinion, or advice.

This third predicate should be understood as a context for my remarks pertaining to land use legislation and regulation. The aim is not to "sell" a point of view. The only purpose is to explain and evaluate the existing situation.

In addressing the title of this Act, it is well to note that it is somewhat deceptively named. The term "flood disaster" calls up visions of large-scale catastrophes, and it does so quite properly. But this law also addresses itself to a real estate unit as small as a single mobile home.

At the 1973 conference on this subject, Commissioner Armstrong remarked that he didn't like the words "land use controls" or "regulation." He stated a preference for such words as "land resource management." But the fact is that the statutes being examined are laws which will substantially control and/or regulate the use of land, as soon as enforcement starts. For some land owners that point in time is measurable in terms of a few months. For many others, the effect has already set in but they just are not aware of the substantial implications. The process of finding out—either through personal experience, word of mouth, or observation—will also begin in the next few weeks or months. Since a major purpose of my remarks is to warn and inform, the text will be liberally punctuated with the terms "land use," "control," and "regulation," the same words that pervade the various items of documentation relating to the Flood Disaster Protection Act of 1973, including the Act itself. Through these observations, I hope to increase understanding of these statutes and enable them to become viable land resource management tools.

LAND USE CONTROLS

Make no mistake about it! The Flood Disaster Protection Act of 1973 *is* a land use control and regulatory statute whose effective date was March 2, 1974. To some who are greatly impacted, it may prove to be the most stringent of all the land use laws extant, or that may be enacted in the future. Virtually all who own unimproved, improved, or partially improved land designated by the Federal Insurance Administration as a flood-prone area are going to suffer a negative economic effect. The only question is one of form and extent.

There is very little general knowledge currently in the industry or the public mind as to the details of this statute, and little preparation is being made so far to accommodate it. Time for preparation has already passed. The inception date was July 1, 1975. There are probably many for whom the "stop-watch" is already running, whether they are involved personally or in a professional position with a company that has problems created by the Act's provisions.

Details of implementation, compliance, and enforcement can become quite complicated and comprehensive. Perhaps a pragmatic analysis of what the Act

provides and some of its more prominent characteristics will assist in implementing a rational response.

If you own real property, plus personal property thereon—either improved, partially improved, or unimproved and identified as flood-prone by the Federal Insurance Administration (FIA)—it is mandatory that you comply with the provisions of the Act by July 1, 1975 or twelve months after the date of actual designation, whichever is later. You must also apply for participation in the National Flood Insurance Program and buy flood insurance on any building or mobile home, and any personal property which may be affected by federally-related financial assistance. The insurance must be purchased for a period of time covering the anticipated economic or useful life of the improvements on the land and in an amount at least equal to the replacement or project cost, less the cost of the land, or to the maximum limit of coverage available for the particular type of property involved, as described in the 1968 legislation. However, if the "federally-related" financial assistance provided is in the form of a loan or a loan guaranty, the amount of flood insurance required need not exceed the outstanding principal balance of the loan and need not be required beyond the maturity date of the loan. Failure to comply with these requirements will result in a status of non-compliance, the sanction for which (under this law) is to sever the land owner from ***any*** formal source of borrowed capital to acquire, improve, or renovate any improvement on the land.

FORMAL SOURCES DEFINED

Borrowers and lenders should note that "formal sources" of borrowed money are defined as lending institutions affiliated with or directly or indirectly regulated by any of the following: commercial banks that are members of the Federal Deposit Insurance Corporation; members of the Federal Home Loan Bank System or the Federal Savings and Loan System; the Farmer's Home Administration; the Veterans Administration; the FHA; the Federal National Mortgage Association; the Federal Home Loan Mortgage Corporation; the Federal Reserve System; the Comptroller of the Currency; the Securities and Exchange Commission; the Federal Savings and Loan Insurance Corporation; the National Credit Union Administration; any insurance company; any REIT; and so on.

Most of the lending systems have been instructed by their federal regulating agency as to what they must do to comply with this law. What this amounts to is that—absent compliance—the only money that can be risked in such an area is the property owner's or that which can be borrowed from an unrelated source willing to accept risk. Any loan outstanding on a designated property cannot be renewed, extended, or changed if compliance is not complete. All residential brokers and lenders should be aware that numerous residential properties designated as flood-prone are not yet in compliance, hence are ineligible for new mortgages.

Every residential lender, residential broker, and appraiser must know the locus of any designated flood-prone area or areas within the scope of their business operations, including existing homes. After learning whether their community is participating in the flood insurance program, Realtors should obtain copies of the flood insurance policy, if available, to present to the lender when a new

mortgage is part of the sales transaction. Title insurance companies should also be informed of the law's requirements and a copy of the flood insurance policy must now be one of the exhibits included in the closing process if the house is in a designated and eligible flood insurance area. If the community fails to participate in the program and a new mortgage is essential to the sale transaction, financing and closing will be virtually impossible. This requirement is effective now and there are thousands of affected houses throughout the country, many of them ineligible for insurance. The public must understand the implications and Realtors must be prepared to respond with professional assistance. The withdrawal of almost every source of mortgage capital—absent compliance—is the sanction that forces mandatory compliance with this law. It is the "teeth" that were left out of the 1968 Act. For those who are affected, these "teeth" took a firm hold on March 2, 1974.

FLOOD INSURANCE EVOLUTION

It is pertinent to know that individuals actually cannot, separately and alone, comply with the Act. Such compliance has to be undertaken by a community-wide effort, the practical aspects of which are treated elsewhere in this report. Background information on the source of this legislation is helpful in understanding its application and purpose.

Since 1936 the federal government has spent approximately $9 billion on flood protection works across the country. Notwithstanding this enormous expenditure, flood losses have continued to increase annually as a result of population growth and development of the land, including a not inconsequential amount lying in flood plains of flood-prone areas.

Prior to the enactment of the National Flood Insurance Act of 1968, the only relief available to victims of property destruction caused by floods were special disaster loans and grants. These funds were federal tax monies dispensed to both the innocent and negligent victims, without distinction. Such destruction was financed by the tax-paying public. The thrust of the current law is to transfer the cost and risk liability for the land development to those responsible, and to remove that liability from taxpayers who do not create risk situations.

In spite of a lack of awareness of the law's provisions, federally-subsidized flood insurance is not a novel subject, with one exception. The exception is that compliance with the 1973 Act is mandatory, which—absent compliance—imposes the sharp sanctions mentioned above.

The Federal Flood Insurance Act was passed by the Congress in 1956. However, funds weren't appropriated for its administration because the Act did not include mitigation measures to reduce the incidence of flood damage.

There were efforts to revive flood insurance legislation in 1962, 1963, and 1965. A feasibility study authorized within the Southeastern Hurricane Disaster Relief Act of 1965 was completed and sent to the Congress in August, 1966. That report indicated that the flood damage hazard in the United States was continuing to rise as increasing numbers of people moved to coastal and river locations to live and work.

As a part of the Housing and Urban Development Act of 1968, the Congress passed the National Flood Insurance Act of 1968. This, in brief, provided

federally-subsidized flood insurance through private companies in designated areas in a trade-off for the adoption by the insured of land use control measures, removing the risk of flood damage to a specific property. But there were no provisions for sanctions in the Act. In other words, there was nothing to induce compliance and, in general, there was little. It became clear to the Congress that without mandating provisions no real accomplishment in restricting the use of flood-prone lands could be expected from that legislation. The 1973 Act is actually an amendment of the 1968 Act to include such a mandate. Put another way, if you're involved, particularly in developing unimproved land, the federal government requires you, at your cost, to improve the land to a condition which will reduce government expense to only one chance in a hundred (annually) of having to pay a flood loss claim. Land owner-developers are now required to buy insurance; to be insurable they must comply with federal standards and pay each year's premium in full in advance, or be faced with the alternative of supplying all capital needs from cash on hand and accepting losses that may occur from the forces of nature.

Administration of the Act is by the U.S. Department of Housing and Urban Development. Authority vested in the Secretary of HUD has been delegated to the administrator of the FIA.

FLOOD INSURANCE COVERAGE

The program provides coverage for all types of buildings, whether public or private, profit or non-profit, religious, residential, industrial, commercial, or agricultural in nature. Contents are also insurable, independently of whether the structure in which they are located is insured, but they are generally insurable only while within the enclosed structure described in the policy. Note that dams, roads and bridges, water and sewer lines, and underground structures cannot be insured; if any of these are a necessary part of a development plan, successful completion may be effectively inhibited.

There are between 9,000 and 14,000 such flood-prone communities throughout the United States involved in this program. The identification notice for flood-prone areas is made by letter from HUD to the local official noted in the Federal Register; instructions are then forwarded detailing the moves necessary to install the program in the designated area. The communities thus identified which may be an entire state, corporate municipality, county, town, township, or any body that has extraterritorial jurisdiction, must make application to the Federal Insurance Administration on behalf of all of the property owners who are involved in such a designated area.

It is only necessary for the community to make a written commitment to adopt ordinances or building codes applicable to the designated area which comply with the FIA criteria. Upon the basis of this and the execution of the application form, they are designated as eligible for the sale of flood insurance. Usually, policies are available within a working week after eligibility is declared. Later, the FIA dispatches technicians to make detailed studies of the designated area, establish the actual bench marks delineating the area, and adopt criteria for the use of impacted land; thereafter, the development of

such land must comply with dictated criteria or the eligibility designation can be suspended or withdrawn, and sanctions imposed. The detailed study may take from nine months to two years.

There are no requirements for retroactive flood-proofing of existing buildings, nor construction of flood works. All land use criteria specified will pertain to new (future) land development and improvement, and construction of buildings or substantial improvement (as defined) of any existing structure.

HUNDRED-YEAR FLOOD

The key criteria which has thus far been adopted is the so-called "hundred-year flood," the standard for identifying the extent of special flood hazard areas and the base elevation below which all lands are subject to controls.

The term "hundred-year flood" has been used freely by many without an understanding of its meaning. It represents the flood level that, on the average, will have a one percent chance of being equalled or exceeded in any given year, and can also be referred to as the minimum safety flood. This standard has been adopted to achieve uniformity throughout the country as an estimate of the degree of risk without creating regional discrimination. A standard of probability was also required as a means of estimating potential annual damages for given locations and types of properties to determine actuarial rates for new construction as required by the 1968 legislation.

In ascertaining the areas subject to inundation by the hundred-year flood standard, historical data is considered. However, it is not possible to establish flood safety elevations based on historical storms alone. To use only historical water data without applying such factors as topography, wind velocity, levees, and so forth, would be sufficiently indiscriminate as to require designation of the last flood as the only level to protect against. Complete hydrological as well as historical data doesn't guarantee that a particular flood will occur each hundred years, and doesn't diminish the desirability of attempting to use the total available data to determine the likelihood of flood losses at particular elevations and particular communities during a storm of specific intensity.

In a statement on the hundred-year flood standard the FIA implies that such an occurrence is actually an "intermediate flood," and is a compromise between minor floods and what the Corps of Engineers terms a "standard project flood" which is the greatest flood thought likely to ever occur in a given area. Actually, in many cases the hundred-year flood is already far below the largest flood of record in a given area. For example, hurricanes Camille and Agnes and the 1973 floods on the Mississippi all involved floodings substantially in excess of the hundred-year flood.

IMPACTS OF HUNDRED-YEAR STANDARD

Thus, the rationale for the establishment of the bench mark. What does or can that mean to the land or improved property lying within the designated flood area? As a practical consideration, the law provides that any new structure built upon such land must have its first floor at or above the elevation of the projected hundred-year bench mark. The first floor of a building can be construed as the basement, if the building has a basement. If there is more than

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one sub-structure, the lowest one is considered. That one application of criteria should certainly conjure visions as to the limitations on future development of lands so designated. The guiding information supplied by FIA shows many suggestions by which buildings can be built at elevations below the hundred-year bench mark and be sufficiently flood-proof to qualify for insurance without modification to the land itself.

But consider the practicalities involved. Say, for example, that a manufacturing or warehouse facility is in a known constructed flood hazard area; the building is in complete compliance with the specifications necessary to qualify for flood insurance; a flood occurs and the building is partially inundated, but it is not damaged because it was built to withstand such a flood; the contents are also safe, but the access facilities to the plant are below the hundred-year bench mark elevation. What are the economic consequences? If the facility is used in a manufacturing process which is a twenty-four hour procedure, a shutdown for one shift could be exceedingly disruptive and expensive. The same is true for refrigerated warehouses loaded with perishables.

Consider yet another probability: a typical combination office-warehouse building. Most individuals are aware that an important consideration in such a building is the door height for the loading and unloading of trucks or rail cars. As a matter of necessity, one has the choice of building such a structure in compliance with the specifications established to protect the building from any loss in the event of a flood (and bearing such added cost of construction), while at the same time accepting the risk of surrounding inundation and a complete shutdown of the facility. Possible damage to uninsurable items such as the roadway system, parking areas, or rail siding remains an unknown risk. So, it seems rational that to avoid such risk exposures, including the interruption of business and consequential loss of income, the building and all access facilities would have to be built at or above the hundred-year bench mark. The added cost impact of such a decision will be a function of distance below said bench mark and it obviously implies creating structures and facilities above flood-prone elevations. The attending cost could very easily exceed the value of the land.

As an introductory statement it was alleged that those owning land designated as flood-prone or land which becomes so designated will be financially affected, the only question being the nature or degree of the effect. It is easy to appreciate that once the land use criteria is established by the FIA, *some* of the land which lies below the hundred-year bench mark will have had its utility value for development completely diminished. Even under favorable circumstances the owners or purchasers of such land will be obliged to spend varying amounts of capital to put the land into a condition of utility. Such expenditures are capitalized into reduced market values of the land. The greater the necessary expenditure, the nearer an owner draws to that ultimate point where the money value of his land for higher use is wiped out.

LAND USERS GUIDELINES

With this conclusion in mind, and remembering repeated reference to land use controls (which a community composed of private property owners must agree to adopt to become eligible for flood insurance) and the consequence of failing

to comply, all users of land should consider the pertinent criteria that have already been formulated and included in the FIA application form.

1) When the administrator has not defined the special flood hazard areas within a community, the minimum standards (which must be adopted) call for the community to:

   a) Require building permits for all proposed construction or other improvements in the community.

   b) Review all building permit applications for new construction or substantial improvements to determine whether proposed building sites will be reasonably safe from flooding.

   c) Review subdivision proposals and other proposed new developments to assure that (1) all such proposals are consistent with the need to minimize flood damage, (2) all public utilities and facilities, such as sewer, gas, electrical, and water systems are located, ***elevated,*** and constructed to minimize or eliminate flood damage, and (3) adequate drainage is provided to reduce exposure to flood.

   d) Require that new or replacement water supply systems and/or sanitary sewage systems be designed to minimize or eliminate infiltration of flood waters into the systems and discharges from the systems into flood waters, and that on-site waste disposal systems be located to avoid their impairment or their contamination of other items during flooding.

2) When the administrator has made full identification of all criteria, the community must minimally do the following:

   a) Meet the requirements outlined above.

   b) Require new construction or substantial improvements of residential structures to have the lowest floor (including the basement) elevated to or above the level of the hundred-year flood bench mark.

   c) Require new construction or substantial improvement of nonresidential structures to be constructed in compliance with the same elevation.

   d) Designate a floodway for passage of the water of the hundred-year flood. The selection of the floodway shall be based on the principle that the area chosen for the floodway must be designed to carry the waters of the hundred-year flood without increasing the water surface elevation of that flood more than one foot at any point.

(This last criteria is one of the regulations that communities agree to apply to new developments in designated areas when it makes application to the FIA for eligibility to enter the program. This one alone will create compliance problems in riverine areas, impacting millions of acres of land.)

e) Provide that existing nonconforming uses in the floodway shall not be expanded but may be modified, altered, or repaired to incorporate flood-proofing measures, provided such measures do not raise the level of the hundred-year flood.

f) Prohibit fill or encroachments within the designated floodway that would impair its ability to carry and discharge the waters resulting from the hundred-year flood, except where the effect on flood heights is fully offset by stream improvements.

3) When the administrator ***has*** identified the flood plain area having special flood hazards, but has produced ***neither*** water surface elevation data nor data sufficient to identify the floodway or coastal high-hazard area, the minimum land use and control measures adopted by the community for the flood plain must, in part:

a) Take into account flood plain management programs, if any, already in effect in neighboring areas.

b) Provide that within the flood plain area having special flood hazards, the laws and ordinances concerning land use and control and other measures designed to reduce flood losses shall take precedence over any conflicting laws, ordinances, or codes.

Thus, one of the effects of this law will be to cause some of the unimproved lands to remain as flood plains, perhaps in perpetuity. Such lands can be developed for attractive open space and recreational uses such as bike trails, hiking trails, bridle paths, picnic grounds, and so forth. Some impacted lands might retain economic value and market appeal to municipalities for uses in the public sphere areas.

COVERAGE FOR OTHER EXPOSURES

There are also hazards other than flooding which the Act addresses. It requires management procedures, meaning development restrictions and regulations, for land areas subject to mudslides, erosion by wave action, and land subsidence. All of those exposures may be added to the sum of what has previously been outlined. The requirements for protection against these hazards are basically the same as for flooding, hence there will be no added redundancy; but, it is important to know these exposures by definition.

Documents detailing the Act define a mudslide as a general and temporary movement down a slope of a mass of rock or soil, artificial fill, or a combination of these materials, caused or precipitated by the accumulation of water on or under the ground. A mudslide or mudslide-prone area means one characterized by unstable slopes and land surfaces, whose history, geology, soil and bedrock structure, and climate indicate a potential for mudslides. For those having interest in the coastal areas, the following is particularly meaningful: a coastal high-hazard area means that portion of a coastal flood plain (having special flood hazards) that is subject to high velocity waters, including hurricane wave wash and tidal surges.

This section of the Act further provides that no land below the level of the hundred-year flood in a coastal high hazard area may be developed unless the new construction or substantial improvement, 1) is located ***landward*** of the reach of the mean high tide, 2) is elevated on adequately-anchored piles or columns to a lowest floor level at or above the hundred-year flood level and securely anchored to such piles or columns, 3) has no basement, with a space below the lowest floor free of obstructions so that the impact of abnormally-high tides or wind-driven water is minimized.

If an affected property owner or group feels that the criteria established by the Secretary of the Department of Housing and Urban Development are incorrect, the law provides a well-defined appellate procedure. However, during the appeal period the Secretary's findings stand, and the affected parties remain eligible for subsidized flood insurance provided that their area has been identified as eligible for the sale of flood insurance and maintains its standing.

RECAP OF FLOOD LAW PROVISIONS

In summation, it's the stated purpose of this law (as contained in the language of the 1968 Act) to:

1) Encourage state and local governments to make appropriate land use adjustments to constrict the development of land which is exposed to flood damage, and minimize damage caused by flood losses.

2) Guide the development of proposed future construction, where practicable, away from locations which are threatened by flood hazards.

But, for those with homes, businesses, or other improved real property in a designated flood-prone area, the program proffers flood insurance at a reasonable rate which would otherwise be unattainable (or if attainable at all, only at a prohibitive cost).

The quote from the 1968 Act simply means that all prominent characteristics of this law, in combination, function to diminish or remove the developable utility of certain designated land areas. This is, of course, especially and particularly true of unimproved or partially improved land.

The 1973 Act effectively succeeds the 1968 Act which denied disaster relief to persons who could have purchased flood insurance for a year or more and did not do so. The effective date of that provision was December 31, 1974. As a sequel, admittedly a confusing one, the Disaster Relief Act of 1974 has been "hooked onto" the Flood Disaster Protection Law (a direct result of hurricane Agnes).

This law, on one hand, clearly acknowledges the exclusion contained in Title II of the 1973 Act which restored the availability of disaster relief to eligible flood insurance recipients. Further, the law provides (effective March 2, 1974) that if the FIA administrator has identified the areas having special flood hazards in a community in which the sale of flood insurance has been made available under the 1968 Act, buildings and contents not covered for the full insurable value or the maximum amount of insurance available (whichever is the lesser) are not eligible for federal financial assistance. Financial assistance

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The Disaster Relief Act also says (for all project applications approved after June 30, 1975) that if the FIA administrator has identified an area as having special flood hazards, but the community is not participating in the flood insurance program under the National Flood Insurance Act of 1968, restorative work for flood-damaged buildings is ineligible for federal assistance.

It seems clear that the 1968 Act took away disaster benefits for individuals who should have had flood insurance and did not; the 1973 Act restored the availability of disaster relief under conditions which would be clearly stated in the disaster acts; and the Disaster Act of 1974 has taken disaster relief away again if communities failed to sign up for flood insurance under the 1973 Act.

Prior caution was extended against the exclusive visions of large-scale disaster as distinct from the reality of reducing loss impacts on the individual. Therefore, the urgency, immediacy, and the personal subjectivity of this particular law (indeed three laws) should be thoughtfully regarded by all concerned with real estate. It should also be remembered that although insurance coverage and compliance with FIA criteria is important to large land owners, it is equally essential for the single mobile home owner. Finally, it should be noted that no new contract for flood insurance can be entered into after June 30, 1977.

Changes in Land Policy: How Fundamental Are They?

by Mason Gaffney

FROM GROWTH TO EXCLUSION: A FUNDAMENTAL TIPPING OF THE SCALES

The last 25 years have witnessed a fundamental change in state and local land policy, reflecting a revolutionary change in attitudes towards immigration and growth. Local governments used to compete to attract people; now they seem to exclude them. In the battle of boosters versus knockers, the knockers have won going away.

We have had low density policies with us always, but in the past they were different. King George III, for example, wanted to reserve the lands west of the Appalachian crest for the Indians, but he really didn't care about preserving their low density way of life. His idea was to keep English colonists in the east and under better control. Alexander Hamilton soon revived the same idea after the revolution and his expressed motive was to retain cheap labor. George III's containment policies lost out to the revolutionaries and Hamilton's lost out to the Jeffersonians. Since then successive waves of both containment and expansion forces have been at work. The expansionists have always won more than they lost—until now. But our generation has seen the greatest proliferation of exclusionary selective and containing land policies ever to exist in North America.

Philosophical and Linguistic

Consider the evolution of the word "speculator" as a pejorative. A speculator used to mean someone who withheld land from use, waiting for the rise. Now it means someone who would develop it for a higher use, as often as not. Twenty years ago I wrote a dissertation on land speculation and, after scanning the literature on the subject, had to conclude that the only consistent meaning of speculator is a land owner you don't like. In the old days people didn't like owners who withheld lands; today they don't like owners who develop land.

This article is based on a paper presented by the author to the Western Agricultural Economics Association in Fort Collins, Colorado on July 20, 1976.

Mason Gaffney recently served as executive director of the British Columbia Institute for Economic Policy Analysis and is currently a professor in the Graduate School of Administration of the University of California.

Witness the evolution of arguments made to justify the private collection of rent. Defenders used to say that socializing rent would remove incentive to put land to the best use; now, however, the argument most commonly heard against taxing land values is the opposite, namely that it creates too much incentive to put land to its best use. Isn't this what preferential assessment of farm land is all about?

Accordingly, if we carefully read the so-called anti-speculation laws, like those in the state of Vermont or the province of Ontario, we note that they are punitive and anti-developmental in their spirit and impact.

In passing, note that the people are right who argue that taxes on land values tend to push land into a higher use. This is sometimes overlooked by those who have their eyes fixed on a lower use and see heavy fixed charges on land driving it out. Such charges, whether privately collected rent or publicly collected taxes, serve the function of driving out lower uses in order to reallocate the land to higher uses. This point is sometimes missed even by economists who should know better. Some, in seeking to explain the decay of central cities, have alleged that high rents drove industry away. In general, that does not make much sense.

Provincial and State Zoning and Exclusion

Municipalities of exclusionary bent have been around a long time, but the exclusionary-minded state and province are something new. Some states (New York and Massachusetts come to mind) have made gestures towards pre-empting the zoning power of local governments when this was used in an excessively exclusionary way. The stronger movement, however, has been towards anti-growth policies by provinces and states, such as Florida, Oregon, and Vermont.

In Canada, British Columbia is one outstanding example that I have observed closely. Their exclusionary stance has to do with public policy discouraging the conversion of farmland to urban uses, above and beyond mere preferential assessment of farmland which British Columbia has also had for many years. The newer device is exclusive agricultural zoning imposed by the province on a province-wide basis. It is administered from the top down by a provincial commission, the British Columbia Land Commission, which classifies land as agricultural and places it in the Agricultural Land Reserve (more familiarly the ALR). Through this straightforward device, a great deal of land with speculative potential has been effectively withdrawn from consideration for urbanization in the immediate future.

The Land Commission Act, originated over loud protests in 1972-73 when the New Democratic Party first came to power, enjoys fairly strong support. It was unusual in at least two respects: its wide coverage (since it is provincewide) and the decision to allow no compensation for the loss of development rights. Actually, the imposition of low density zoning is not normally accompanied by compensation, so this is not as unusual as its critics may have inferred. In the 1975 election campaign, the leader of the New Democratic Party, Premier David Barrett, seemed to sense that the Land Commission Act was among his more popular measures and campaigned on it as a major achievement. He may have been wrong for he did lose the election resoundingly, but

on the other hand the newly triumphant Social Credit Party (or Socreds) did not indicate a disposition to repeal it and so far have not. It would appear to have a measure of bipartisan support.

At the same time, one must observe that a high degree of uncertainty prevails about the future of the ALR. Land which is in it and zoned exclusively agricultural, is still being bought and sold at developmental prices. It seems that the market does not altogether believe that this zoning will hold.

Meantime, ALR zoning did succeed in stopping further sprawl. It also forced urban real estate prices up to incredibly high levels. These high values, with the pressure they brought towards intensive development, might have stimulated infilling and redevelopment of the urban areas. But a decentralist campaign was launched against further development of the central cities in the lower mainland particularly, and there was a strengthening at the local level of a variety of exclusionary devices, such as impost fees charged for new developments. It was not merely sprawl that was made more difficult; it was building and development in all areas.

The result presented the anomaly of a government which sometimes called itself "Socialist." The New Democrats are an amalgam of Socialists and New World Populists and, like most political parties present a mixed and sometimes confusing personality: that of a Socialist government creating an artificial scarcity of land, in effect choking off building and raising property values and rents to the great distress of the landless laboring classes.

The actual location of ALR lands was not based on containing sprawl, except incidentally. Rather it was based on a Canada Land Inventory classification of agricultural land, a classification conducted by agriculturally-oriented soilsmen without much regard for urban alternatives. Thus, good farmland near in whose best use might be urban cannot be urbanized, while bad farmland far out may be, even though it should not be. Nothing whatever has been done about the fundamental problem of utility rate structures, so that utilities can and must still run their lines anywhere anyone chooses to settle and charge common province-wide rates. And so we still get sprawl.

Of course there is nothing in this kind of legislation to clean up old sprawl or encourage infilling. On the contrary, it gives grandfather-clause monopoly protection to ancient and honorable sprawl and assures its perpetuation. Worst of all, by creating the illusion that something constructive is being done, it preempts the field and discourages other actions that might be more effective.

On an international basis, the policy has also encouraged a great deal of sprawl from British Columbia spilling over to the state of Washington, where land is much more available.

As a land planning device, therefore, the ALR does not get the highest mark. It is not, in that sense, a "fundamental" change, but it is successful and it is fundamental in another sense. That is, it has been successful in retarding the growth of population.

Was this just stumbling and bumbling by a green raw cabinet as alleged? In my opinion, people generally get what they really want, regardless of what they say they want. Exclusive agricultural zoning in rural British Columbia

coupled with low density zoning and heavy impost fees in urban British Columbia have worked together quite consistently to slow down immigration. This is the point of consistency; ergo, this is probably what was really wanted.

I have lived in many places, a few in which people did not think that they had something very special and that the world would flood in and overwhelm them if given half a chance. But when you say this to people in British Columbia, hoping thereby to encourage a little objectivity by getting them to laugh at themselves, the answer is: "Yes, but British Columbia is different; here it's really true." "Socialism" in British Columbia was a device to use the power of government for the purpose of excluding immigrants and increasing the value of property.

I recently examined some figures from the B. C. Assessment Authority which has placed a 100% market value on all the taxable real estate in British Columbia. In the Vancouver Assessment Area (which means, basically, the city of Vancouver) the total value of land alone, without buildings, is $10.7 billion and the mean value per parcel is $115 thousand. The top ten percent of the owners measured by value own 73% of the total value of land. The top one percent own 62%. As a ballpark estimate, the value of land in Vancouver doubled from 1972-1975. It would be hard to argue that a policy which contributed to the doubling of value of an asset as closely held and so large in relation to the government's welfare budget and other equalizing devices, was a step in the direction of the egalitarian ideals sometimes associated with the word socialism.

In fairness, one must record that the members of the Land Commission vigorously deny that their zoning activities had anything to do with this increase in urban values, which they believe would have occurred anyway. I do not know anyone else who agrees with them (certainly not I), but no doubt other factors were involved as well, and we will never know just how much of the increase they were responsible for.

A secondary objective of the legislation was to punish evil men called land speculators. They were evil because they made money—or were they? When we analyze it, the punitive spirit has not been directed at making money as such, for some five billion dollars has been made by the doubling of land values in Vancouver without that being called evil. No, the animus was directed against the evil of intensifying the use of land and increasing the capacity of British Columbia to absorb immigrants. This is the unpardonable sin.

It is not my intention to seem sarcastic or critical. The province may have legitimate reasons for wanting to exclude people. My purpose is simply to brush aside the cloak of conventional cant and hypocrisy to get a handle on what was really done and for what reason. After that, we can better come to grips with it.

Preferential Assessment of Farmland

More common than exclusive agricultural zoning is the preferential assessment of farmland. The Maryland legislature started it back in 1956 and doggedly pushed it through in spite of vetoes by Governor McKeldin and a declaration of unconstitutionality by the Maryland Supreme Court. Prominent among the

proponents was Spiro Agnew and I am tempted to think of this as his contribution to American culture; but he was not alone, for California came along in 1957 and so did several other states. I, false prophet that I was, confidently said at the time it wouldn't fly. My exact words were to the effect that anything that cannot bear analysis will do better under the table than over it. This was in reference to the fact that preferential assessment of farmland had been occurring under the table for many years before these laws were passed; indeed, the laws were only necessary because of the assessment reforms which were beginning to undermine the long-practiced de facto underassessment of farmland. Preferential assessment of farmland spread from state to state and has enjoyed wide popular support. British Columbia joined the parade some time ago.

Preferential assessment is a fairly fundamental change in the philosophy of land taxation. It makes the part of the property tax that falls on land a penalty tax on growth. For example, land near Vancouver which is farmed is assessed at 3 or 4% of its market value compared to 50% which is the normal assessment ratio. In other words, it is being assessed at 6 to 8% of what it should be. But if someone converts the use from agricultural to commercial or residential, the land assessment rises 10 or 20 times. The effect, of course, is to slow down the conversion of land to more intensive uses. As I indicated before, people usually get what they really want, and I am inclined to think that is the objective.

There are numerous other devices for stopping growth and excluding immigrants. A moratorium on sewer construction can be very effective, as the Washington Sanitary and Sewer Commission has demonstrated over the last four years. Impost fees are an effective device, as shown by British Columbia. Indeed, almost any sovereign power which has been delegated to a local government can be used in an exclusionary way and many of them are. Rather than cataloging them all, let us just note that they are numerous.

REVERSAL OF ATTITUDES

Dozens of reasons are advanced to explain the growing hostility towards immigration and population growth. The ones that make sense are primarily environmental and fiscal.

Environmental Reasons

People have always valued their environment and resisted invasions of it. Sheepmen and cattlemen didn't like each other, cattlemen didn't like sodbusters, and wheat farmers didn't like irrigators. Yet, the attempt to force exclusionary policies lost out. What now has changed? Or is all this environmental talk just hypocrisy, hatred of man masquerading as love of nature, as I once thought?

Higher per capita wealth and income is certainly a factor. Cleanliness is next to affluence; more affluent people can afford to sacrifice profit for amenities. It has always been the higher income suburbs that zoned out commerce and industry while the blue collar suburbs competed to attract them. Now we simply have more high income suburbs.

The technological multiplier of personal offensiveness is an enormous change which has not received nearly the weight due it. Modern capital-intensive recreational technology particularly has multiplied by an enormous factor what we may call the "offensiveness-efficiency" of normal human behavior. When we look at the evolution of technology in this light the only kind of personal offensiveness that technology has abated in the last 30 or 40 years is body odor, replacing it with stale tobacco smoke. As to other factors, I'm reminded of the parent whose juvenile delinquent son was sent on a trip around the world. A freind inquired, "will travel improve his behavior?" "No," said the parent, "but it will spread it over a wider territory."

People don't need much space for the true pleasures of life: reading, writing, walking, swimming, hiking, gardening, jogging, cycling, conversing, and so on. What truly requires inordinate areas are motoring, golfing, hunting, flying, skiing, all-terrain vehicles (shudder), snowmobiles, motorcycles, rock and roll bands with P.A. systems, portable radios, power mowers, and noise-making of all kinds. Equally demanding of space, although less numerous, are those individuals who require huge, sparcely-populated wilderness areas to escape the personal offensiveness of the technologically efficient polluters.

A homesite on a noisy street drops in value and cannot qualify for mortgage loans. A house on a quiet cul-de-sac commands a large premium. Everyone hopes that his neighbors or the police will take care of these matters and few people like to talk about it, much less do anything about it, but the market betrays the evidence. People are bugged not so much by other people, but by the modern machines which magnify their thoughtlessness or, in the case of disturbed males of a certain age, undoubtedly their intentional offensiveness. Things that we used to laugh or gossip about have become major economic factors.

There is also a decline of traditional social controls with a corresponding rise of irresponsible behavior. The phenomenon is obvious to one and all. There are solutions, but they are generally labor-intensive solutions which involve policing, counseling, and the development and support of local authority figures like clergymen and teachers. Anything labor-intensive has gone out of style in the last generation. The trend has been to substitute land and capital for labor in almost all circumstances. In terms of social control that arranges land settlement patterns in such a way as to eliminate problems by neighborhood segregation and regional segregation: "Keep the pests out of our neighborhood and then out of our state and our country." All this involves exclusionary policies and an enormous increased consumption of land and the capital necessary to develop land at low density.

Fiscal Causes

Some of the fiscal reasons for the increasingly hostile attitude towards immigration and population growth are:

Rising expectations for public services. Immigrants to a neighborhood, city, or state are no longer aliens from Europe or Asia. They are native citizens from way back; they have high standards in terms of public services, frequently higher than those of old settlers. They are likely to be sold on the value of

generous public support of education. Lower income people who used to drop out of school early now demand more schooling than ever before, even up to the junior college level. In their book ***Modernizing Urban Land Policy,*** Marion Clawson and Harvey Perloff said that consistency with the reforms of the Warren Court called for equal opportunity in access to land, for housing in particular. So they predicted a decline in exclusionary policies. With great respect for the authors and a sharing of their ideals, I suggest a more pessimistic interpretation. Exclusionary land policy can be and is used to substitute for other kinds of discrimination. The fact that newcomers can vote, as well as claim legal rights and public services, increases the motivation of old settlers to keep new settlers out. Human experience is not marked always by consistency, but by compensatory devices.

High federal personal taxes. The federal Treasury now relates to individuals as their net exploiter. Alfred Marshall distinguished what he called onerous taxes from beneficial taxes. Onerous taxes were those in excess of public benefits received, while beneficial ones were matched by equal public benefits. (I don't know why he didn't have a third class of taxes which were less than public benefits received, but you can draw your own conclusions about that.)

When persons move into a region, a big share of their income goes off to Washington or Ottawa. The federal government's extraction of the cream reduces what the traffic will bear for local taxes. Of course, the federal Treasury returns subsidies to localities. Note however, these do not go to individuals, but to local governments. Thus local governments get revenues without necessarily having people. The Feds are inclined to grant subventions for capital-intensive things: sewers (where most of that so-called pollution control money goes), water supply in part, highways, hospitals, suburban housing. All local public works, of course, are subsidized by the federal exemption of the income of state and local bonds from taxation in the United States. Thus the Feds help the locals bear the high capital costs of low density sprawl.

Most of these capital-intensive facilities render "services to property and not to people." A great point is made currently that property taxes should not pay for services to people, but only services to property. The fact is, on a large scale, people pay for services to property via the federal budget, but little is said about this. Ironically, it is considered "liberal" and egalitarian to set up fiscal matters in this way.

If I were a landless orphan, blinking my eyes at the wonders of this world set up by others for others, I would wonder at the justice of a system which levied a payroll tax on whatever I earn, and income tax on my salary, in order to make capital grants to municipalities which borrow the sovereign power of the state to zone land in such a way as to prevent my living there. I would wonder at the values of the people who said that I was a net fiscal liability who was not carrying my weight. Be that as it may, that is the way local governments regard the immigration of landless orphans and the result is a growth of exclusionary local policies.

Compare the present fiscal situation with that existing just after World War II, the time in the United States of the G. I. Bill. A veteran moving into a locality received, in addition to the gratitude of his new neighbors for services ren-

dered, a substantial federal subsidy which attached to him as an individual. He could carry it around from place to place, he could get loans for housing and tuition for education. In addition of course, he was about to become a regular taxpayer and would not be producing school children for a few years at least. Immigrants under that arrangement were much easier to accept than they are under present arrangements.

Federal Subsidies to Urban Sprawl

We have had a generation of subsidies to housing for the lower-middle class; we have apartments being built for tax shelters; we have enormous federal subsidies for highways. All of this has made housing expansive and intrusive. It has come to saturate the absorptive capacity and the tolerance of local governments in a way that probably never occurred before.

Increased Suburbanization and Balkanization

Owing to the proliferation of suburbs and the growth of each one, metropolitan decisions are now divided into fractions. Although everyone may recognize that there are advantages to urban scale, they want the advantages without the disadvantages and they have a chance to get them. The suburbs borrow their scale from the central city to which they have occasional access when needed. No one wants the dirt and the garbage, and no one gets the exclusive benefit from creating economies of urban scale. Suburbs easily fall for the fallacy of composition: if low density is good for us, it is good for everybody.

Increasing Cross-Subsidy

The urban world is increasingly dependent on public utilities. Access to land is no longer enough; the land has to be sewered and watered. It must have telephone service, power lines, probably natural gas, and so on. In low density areas the volume of service per mile of line is much lower than in high density areas and the costs in low density regions are correspondingly higher. Yet the rates charged are usually uniform; in fact, they frequently favor the low density areas because of quantity discounts based on the volume per meter.

Since the high density areas subsidize the low density areas, the inclination is to become a low density area if you can. This factor undoubtedly increases the attractiveness of exclusionary policies.

At the same time, this factor makes central cities unwilling to let low density suburbs latch onto them. This is quite a reversal from the Roaring Twenties when cities were so anxious to grow that they carried a variety of capital costs for land developers. But now, without quite knowing why, central cities are getting the feeling that they have been had and the result is a spasm, not always rational, of anti-growthmanship.

This leaves four basic causes for the growth of exclusionary policies: environmental, fiscal, particularistic, and responsive to the incentive created by cross-subsidies.

LESSER CAUSES OF ATTITUDE CHANGE

Now let's take a look at some other reasons which I believe do not bear analysis or carry so much weight.

Reduced regional rivalry for representation based on population. History records several races for regional dominance in the legislature by attracting population. Has this motive disappeared? On the contrary, reapportionment now occurs faster than it used to and the government passes out more largesse than it used to. This may prove the undoing of the exclusionary movement.

The population control movement. To relate this to exclusionary zoning is pure romancing. Exclusion is not the route to zero population. It is a zero-sum game. Here we are back at the fallacy of composition, or overgeneralizing from subsystems. Some people believe a reduction of density on their block will reduce it everywhere. There are also those who claim that keeping apprentices out of their union local and raising their wages, will increase wages everywhere. If you think about it, excluding people from one block must raise density everywhere else, or at least somewhere else.

In terms of solving the problem of population pressure on the earth, exclusionary policies are very expensive. All the gains of exclusion are offset by losses elsewhere, but all the losses are real. These losses (or costs) are the enormous capital and resources requirements of low density settlement.

The alleged reduced influence of land developers on local governments. There may indeed be some increase in local democracy, but the influence of big land owners is not dead. It is alive and well under the rock and is merely exerted in a different way. Land controls are now used to hold down land assessment and taxes until that time when the collectivity of land owners is ready to sell out to higher density users.

Aid to poor small farmers. There has been a good deal of rhetoric about widows driven from their homes and engulfed by high-powered alien sub-dividers, disrupted families, forced sales of old homesteads, dislocation, unemployment, and so forth. The above verbiage is all found in a dissenting opinion filed in Maryland in 1960 when the State Supreme Court declared the original preferential assessment act in violation of the state constitution.

I have put together some data from the computer bank of the British Columbia Assessment Authority on the concentration of ownership of different property classes in the several assessment areas in the province. In the Richmond-Delta assessment area, a part of the Vancouver urban fringe, the Gini ratio for farms is .70, for industrial property .63, for residential property .32. The only kinds of real estate more concentrated than farmland are commercial and exempt.

The mean value of farm real estate can only be estimated since these farm assessments are based on capitalized farm income rather than market value. Consultation with the assessor, however, suggests $150,000 as the correct mean value, as compared with $143,000 for industrial property. These figures, note, apply to land only. Ah ha! you say, but the industrial property has a higher ratio of buildings to land values. True enough, but it's the land value to which the preferential assessment applies. Ranking the farms by size shows that the smallest ones are not very land-intensive at all. Most of the land by a wide margin is held by the top ten percent, where most of the benefit goes. If we want to help that class of property whose mean value is the lowest, resi-

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dential and condominium property is the place for relief. If we want to help those farmers whose assets are small, farm improvements and farm labor need relief, not farmland.

But what about the low income of farmers? A recent presentation by the B. C. Federation of Agriculture to the Commission of Enquiry into Property Taxation presented data on farm income in which part-time farmers were counted as full-time people but only their farm income was counted as income. The whole person went into the denominator but only a fraction of his income went into the numerator. Correcting for this, per farmer income in British Columbia is not lower than urban income. I wonder how many other studies contain this obvious flaw? Is it possible that such shoddy data might have gone unchallenged by professional economists for years? I am afraid so. Look at the generally-accepted material alleging that the property tax is regressive. All kinds of pap was churned out, complete with the most elementary statistical fallacies. When people are determined to believe something, anything goes; I'm afraid that is the lesson of intellectual history.

Preferential farmland assessment granted to recognize the special land-intensity of farming. Data collected by economist Allan Manvel for his study for the National Commission on Urban Problems, showed that farmland values were much higher relative to urban values than I previously thought. The aforementioned B.C. data suggests quite otherwise in this province. Of course, there is no high degree of accuracy on the land-to-building ratios indicated near major cities owing to the preferential assessment of land. There is a strong clue to be found, however, by comparing land/building ratios in metropolitan areas to those in remote rural areas. Here the finding is quite striking. In the Vancouver assessment area, the percentage of total real estate value (which is land value) is about 78%. But when we get out to remote Trail, it is more like 13%; in Port Alberni it is around 35%, in Penticton 32%, and so on. One should not hasten to conclude, therefore, that preferential land assessment is an acknowledgment of the high land intensity of low-income farmers. The facts do not support it. According to my data, if we want to find high land intensity we should look at real estate activities classified as "commercial." There is another class called acreage which is 99% land value, so commercial does not include purely empty speculative holdings. And while we are talking about tax exemptions, it is worth noting that the next most land-intensive class of property is that called "exempt." A stroll around the campuses of any of the province's universities will give you a good idea why.

The loss of scarce farmland. It is hard to take this rationale seriously. In the days of the soil bank, the conservation reserve, and so on, it was altogether laughable. Now that such programs are clearly on the wane, it might make a little more sense. But let me record an exchange I had two months ago with the agricultural representative of the B. C. Land Commission, who was defending the Agricultural Land Reserve. It is a terrible thing, he said, that farmers are leaving the land. Yes, I agreed. We are losing our capacity to produce food and fibre, he warned. That is bad, I agreed. Warming to our topic and sensing a common interest I said, let's get more farmers out on the land producing food and fibre. Hold on, he said, that could create problems. I continued,

let's intensify the use of land, let's get more out of each acre, let's get more food to the consumer. Stop! he said, are you crazy? That would lower food prices. But, but, but, I sputtered, I thought . . . No way! he said, if you lower food prices you will drive all farmers out of agriculture forever, and then where would we be? My objective is to hold this land in reserve for the next century, so we will have something to leave our grandchildren.

I will draw the curtain of charity over what I said or wanted to say in response to that, but it's going to take a fundamental change in the attitudes of farm spokesmen before anybody else can believe they are very serious about the danger of running out of good farmland.

Containment of urban sprawl. No, I cannot buy that one, because urban planners are as busy at the centers of cities trying to lower density there as exclusionary suburbanites are at the fringes. One group of planners kicks people out of the cities and the second group forces them back in. The common result is to make things tougher on people who are looking for a place to land. There is no consistent rationale of city planning to be observed other than exclusiveness.

LIKELY DAMAGES FROM EXCLUSIONARY POLICIES

Exclusionary policies may create such undesirable situations as:

Low density living. This is not only expensive; it increases the land, capital, fuel, and commuting time costs of life, and reduces the effective levels of constructive urban linkages and synergism achievable for any given costs.

Structural unemployment. When areas or jurisdictions stop competing to attract people, and worse when they compete to exclude people, they weaken the quest for payrolls. Now, everyone wants to attract capital intensive industry, if any industry. Labor, especially cheap labor, seeking employment is driven from pillar to post. The rate of unemployment of teenage blacks is up to 40 or 50%. Could this relate to the fact that so few jurisdictions encourage the entry of the kind of employers who might offer them jobs?

Locational segregation. The sorting of people according to wealth and income is now carried to great extremes in American cities, replacing other social controls. But is it replacing them, or are there simply no social controls over many segments of society now, other than police, and often not them? And what about the high economic costs of locational segregation? There is a natural flow of exchange between high and low-income people, which is made very difficult by locational segregation.

Division of society into classes. When the value of property rises and remains high, it naturally divides society between those who have and those who do not have property. Always before in North American history, the exuberance of land developers and competing jurisdictions has brought down the value of real estate and blurred the distinction between the haves and have nots. Now, on the other hand, we are in danger of developing a class structure more rigid than anything ever seen before over a long period of time on this continent. A class structure without social controls leads to divisiveness, crime, hostility, counter-culture, welfare dependency, and the other unpleasant situations we see burgeoning today.

Inefficient allocation of land. Exclusionary policies require planners. Planners are generally allergic to market conditions. If they have an engineering background, they talk about "requirements," or fixed coefficients of land per person, which are independent of price. Some of them are recreationists, who regard lower economic uses as higher social uses and would sacrifice commerce and industry to parks and wilderness areas. I cannot forecast the results in detail, but can guarantee you they will be less efficient than anything concocted by a free market.

Absentee ownership. One of the historical motives for encouraging immigration was to put settlers on land of their own and reduce the number and power of absentee land owners. Excluding immigrants undoubtedly has the opposite effect. If we want land safely in the hands of a passive investor who only wants security for the future and has no plans to use it, there are many in Germany, Switzerland, Belgium, and elsewhere who are happy to oblige. However, I seriously doubt that this is the way to create healthy communities.

SOLUTIONS

Exclusionary policies have a harmful aggregate impact which is quite different from that intended by their local sponsors. It behooves us therefore to seek solutions, whose nature follows quite directly from the analysis of the problem.

Fiscal Aspects

We must simply reverse the fiscal arrangements that create the problem. Instead of levying onerous taxes on individuals, the federal government should reduce their tax burden and replace it with increased property taxes. I do not mean that the federal government should invade the field of property taxation currently pre-empted by provincial, state, and local governments, although constitutionally this could be done if required. However, it should only be necessary to reform the income tax in a variety of ways that have been recommended by many tax reformers for other reasons anyway. Close the loopholes now available to property and open some for labor.

On the granting side, federal grants should go to persons in the forms of social dividends rather than to governments in the forms of shared revenues, capital grants, and so on.

States and provinces too are in the business of granting subventions to local governments. These grants could be changed and allocated to persons instead of governments. For example, California, in response to the Serrano decision, could go to a statewide property tax and distribute school aid in the form of vouchers to school children. Or it could base school support on average daily attendence.

Central governments should reduce or eliminate grants made to local governments, which are essentially a collection of local land owners working together to maximize the value of their land. Grants to local governments are essentially grants to land owners, therefore grants which increase their wealth without requiring them to turn the land to the service of other people. Conceivably a local government might have only one land owner, in which case the situation would be dramatically clear; in fact, there are such cases. For instance, a special service district in the San Francisco Bay area is clothed with

the powers and immunities of sovereignty, representing only one land owner. There are company towns everywhere, many in British Columbia, with essentially one owner. I have always been mystified at the frame of mind among certain Washington or Ottawa liberals who believe there is something socially wholesome about taxing the payrolls of poor working stiffs to share revenues with the owners of these company towns.

Federal authorities in Canada and the United States both could limit the local use of taxes that repel population, thus forcing greater reliance on promotional taxes. Under the British North America Act provinces are theoretically limited to the use of "direct" taxes; if Ottawa wished this could be construed very narrowly to prevent the provinces from taxing sales or, for that matter, anything except land, because the land tax is the only one which, to my knowledge, can never be shifted and therefore deserves to be called "direct."

Environmental Measures

The nature of the solution is dictated by the nature of the problem and consists of at least six measures. First and most obvious, is direct action against polluters and noise-makers of various kinds. Second, is a reduction in the technological multiplier of personal offensiveness. This may be achieved by a combination of taxation, direct controls, and outright prohibition of technological apparatus whose external offensiveness is large relative to its possible value to the owner. I never cease to find it incredible, for example, that communities should allow irresponsible children to possess mini-bikes and that it should require the intervention of a policeman to stop them from issuing loud noises that may disturb the peace for several blocks around. Third, is a general increase in the quality of personal behavior and considerateness. Fourth, is a decline in the incentives for ownership of personal consumption capital. I do not mean that we should impoverish ourselves. I refer to the bias in the tax system, whereby capital devoted to the service of others earns money income which is taxed while capital devoted to personal use yields imputed income which is tax free. Fifth, would be a decline in the amount of public space which is made available to polluters. Sixth and last, would be a decline in the ability of the leaders of society, the people with the real clout, to escape from pollution, to go off to or beyond the suburbs and surround themselves with lots of space. This is part of the whole pattern of locational segregation which I have been criticizing. Anything that weakens the ability of social leaders to escape from the problems which they create will, of course, increase their incentive to solve those problems for everyone.

Suburbanization and Balkanization

The orthodox "good guy" solution to this problem is to expand urban jurisdictions into metropolitan jurisdictions. I do not favor this myself, because metropolitan settlement has already proliferated over four or five times as much land as would be economically desirable for the number of people involved. And the metropolitan jurisdiction would undoubtedly be a vehicle for strengthening the cross-subsidization of the low density neighborhoods by the high density neighborhoods, the economic institution which created half the problem in the first place. The solution is rather for the remains of the central city to pull itself together and adopt growth-oriented renewal policies which

would cause it to suck in most of the proliferating demand and become a city once again.

Cross-Subsidization

Many seers have pronounced it hopeless to set up a rate structure that was anything but uniform over wide areas. They are mistaken. We already have declining block rate structures and the current movement towards inverted rate structures is a practical step in the direction of encouraging smaller customers, and smaller customers characteristically live at higher density. A more direct approach is taken by utilities in California and the U. S. Pacific Northwest. Zonal rates provide higher electric rates for areas of lower density. Pacific Gas and Electric is the leading example, since it has five zonal rates for its service which ranges from very rural (less than ten customers per mile of distribution line) to the high-density Oakland-San Francisco area with over 200 customers per line mile. What is needed is a reinforcement and extension of this good example.

At the same time, of course, we need pressure towards "positive containment." Scattered settlement is often blamed on people who choose to locate far out and, surely enough, they share the blame. Equally responsible, however, are people who own land near in but fail to develop it intensively. Their role is normally overlooked. What is needed is the positive pressure of a stiff land tax based on the value of centrally-located lands to encourage intensive central development in a positive way.

Just how we get from here to there in every detail is beyond the scope of a short paper. I have tried, however, to indicate that these are not far out and unthinkable proposals, but merely extensions and applications of practices already observed in some places. Thus remedial policy may be fundamental and effective without being revolutionary or catastrophic.