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EDITOR'S STATEMENT

Regulation is the theme of this number of *Real Estate Issues*. It is a fitting theme for an election year, when our sense of vulnerability to regulatory tantrums tends to increase as the political temperature rises.

We lead off with Clifford Weaver and Richard Babcock, recognized authorities on zoning and land use controls whose interest in neighborhood revitalization is demonstrated in a challenging new approach to urban zoning. The closely allied subject of condominium conversions is the subject of Richard Roddewig's article. Roddewig analyzes the Chicago experience as a guide to the likely future of other cities and provides a fresh summary of anti-condominium legislation across the country.

Rent control is the related and equally timely topic of James Webb, who offers a national summary of the rent control picture and advice on how to fight the threat of such controls. He is followed by James Boykin's review of the usury question and discussion of the impact usury laws are having on affected areas, an impact which will surely be modified by federal regulatory changes under discussion at this writing. Walt Woerheide's analysis of the treatment of escrows by savings and loan associations may be losing its topicality as the home mortgage industry collapses, but will, we fervently hope, regain importance when current trends reverse themselves.

Brian Berry, a distinguished geographer and urbanologist, takes a fierce run at the basic assumptions of President Carter's shopping centers policy, a policy which has been immensely encouraging to preservationists and downtown revitalizers but which has some disturbing implications. Also on the subject of changing retail patterns, Counselor Bruce Hayden, former chairman of the Connecticut Mortgage Authority and the Greater Hartford Housing Development Fund and a member of President Nixon's national rent control board, offers practical insights into the rapid transformations occurring in the shopping center field.

We close this number of *Issues* with a bit of advice for the 1980s from Realtor Arthur Rubloff, whose many achievements as a real estate developer include Chicago's Carl Sandburg Village, Brunswick Building and Evergreen Plaza. His views are presented as the first in a series of statements from well-known real estate practitioners.

Jared Shlaes, CRE/Editor-in-Chief

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Real Estate Issues

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Zoning City Neighborhoods

by Clifford L. Weaver
and Richard F. Babcock

Zoning is again becoming a hot issue in urban neighborhoods across this country — a sign of new health in the cities. While businesspeople, developers, and planning professionals who work in big cities express widely varying views about the importance of zoning, it is clear that, for the people who *live* in cities, zoning is becoming more, not less, important. People who once fled from neighborhoods are now zoning them. People to whom neighborhoods were once abandoned are now rezoning them to undo the effects of the rezoning process that invariably accompanied their arrival. Anyone who believes that businesspersons or developers in most cities can get, by either fair means or foul, any zoning they want hasn't visited the neighborhoods where that simply is not true. No one who has talked to the people who live there, or to the city officials whom they elect, can accept either the theory that zoning is an impotent and meaningless tool or the notion that all hope for preserving our major cities is lost.

One of the great paradoxes of zoning everywhere, is that in the very residential neighborhoods where zoning is most revered and most powerful, it has also been the least innovative and frequently the least able to cope with threats to viable residential living. Most of the attempted innovations in zoning have been in the context of regulating large-scale new developments. Precious little time and attention have been paid to innovation in preventing change. Prevention of change may well be easy in a suburban community where most of the development is new and nearly all of it is monolithic. Neither of those factors is present in the average city neighborhood. Furthermore, there is no such thing as the "average" city neighborhood.

In order to think effectively about what residential zoning can do in a city setting, one must first realize that the typical city has three distinct types of residential areas: slums, stable areas and grey areas. The zoning issues in

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the first two are comparatively simple. To be sure, the simplicity derives from different sources. Stable areas are simple because there are no real zoning questions; slums are simple because there are no zoning answers.

SLUMS

Any realistic assessment of zoning power must recognize its severe limitations as a device for promoting rehabilitation of existing slums. Nevertheless, if zoning can't be part of the solution in these neighborhoods, it can at least avoid being part of the problem. The treatment of existing slums and deteriorated areas by most urban zoning ordinances is appalling. Many zoning ordinance provisions that make perfect sense in a stable city neighborhood make no sense in a neighborhood that has bottomed out. In many cases, a more liberal treatment of permitted uses, home occupations and occupancy provisions will be warranted. At the same time, the zoning ordinance should not, as many do, totally ignore the existing pattern of physical development in the hope that a huge increase in the permitted intensity of use will prompt the private sector to knock the slum down. Still, if city zoners succeed in adopting an ordinance which does not aggravate the problems of existing slum neighborhoods and does not contribute to the creation of new slums, they have probably gone as far as is realistically possible with the zoning power. The real answer to such areas, to the extent that government can offer an answer, lies in the promulgation and administration of codes other than the zoning ordinance and in the implementation of programs capable of dealing with the full spectrum of the causes and effects of slums.

Housing and other city codes tend, like the zoning ordinance, to ignore the realities of the slum. They ignore the fact that very low income households simply cannot afford all of the niceties that the middle class has come to define as "minimum standard." Saying that the poor can, or must, settle for less is difficult to do without sounding harsh and insensitive. If the only housing within the means of a low income family is "substandard" by middle class standards, tearing it down or boarding it up without providing a more "standard" environment is hardly a humane solution.

That, however, is what has gone on in many cities. The realities of the situation demand a more sensitive evaluation of those elements of community and structural amenity which should be encompassed within the concept of "minimum standard."[1]

This is not the place to discuss the sort of total approach to slums that is likely to have some effect.[2] The only real hope lies at the point where the neighborhood is sufficiently organized, and sufficiently self-confident, to approach city government and the private sector as an active, contributing partner in the business of neighborhood revitalization and not as either an adversary or a charity case. Bill Whiteside's Neighborhood Housing Services Program, which grew out of pioneering efforts of the Allegheny Conference in Pittsburgh's Central Northside area, and which has now gained official status as the Urban Reinvestment Task Force under the auspices of

H.U.D. and the Federal Home Loan Bank Board, is undoubtedly the best model for success currently available.

STABLE AREAS

Unlike slums, stable areas are easy for urban zoners because they present few, if any, questions that traditional zoning cannot easily resolve. Preserving an economically viable status quo is what zoning has always been best at doing. Where social and economic factors are conducive to the preservation of an attractive residential environment, zoning's only job is to prevent the intrusion of undesirable uses. That is a comparatively easy task in any area where the current owner/residents agree that the status quo is desirable and that change is not. The only significant problem faced by stable city neighborhoods is at their peripheries where, because of the patchwork development patterns of many large cities, they frequently abut inconsistent uses. Problems of transition at the periphery are far from overwhelming. To the extent that the periphery represents prezoning development patterns, it is a fixed fact of life which the market created and now, in one fashion or another, recognizes. To the extent that new development is proposed at the residential boundary, ample site design and buffering techniques are available for inclusion in the zoning ordinance. They are not difficult to conceive, to understand or to implement; they are also not worth talking about here.

GREY AREAS

The real residential zoning issues in major cities occur in those grey areas which are neither stable nor slum but on their way from being one to being the other. Some grey areas exist in neighborhoods which are declining or threatened with decline. The issues are how to stop the process before it is hopeless. Other grey areas are found in those rediscovered neighborhoods on their way up from the bottom where the issue is how to keep the momentum going without allowing a runaway situation in which an over-eager or speculative market destroys the underlying conditions which led to the revitalization in the first place. These are the exciting neighborhoods for urban zoners and planners; they are the neighborhoods where challenge and the hope of success co-exist. Realizing the hope by responding successfully to the challenge is perhaps the most difficult of all urban zoning issues.

There are several realities about cities and neighborhoods on the way up. Neighborhoods on the way down must be recognized in any zoning scheme intended to deal with these neighborhoods in transition. The process of transition, be it up or be it down, starts slowly. In a reviving neighborhood, there must be an initial pioneer or two capable of seeing and capitalizing upon the potential of the neighborhood and one or two specific pieces of property in it. In a declining neighborhood, there will inevitably be a handful of properties that will start the downward cycle — sometimes for no apparent or explicable reason. In each case, the zoning ordinance must be structured to create a market demand for those first pieces of property. The typical zoning response to both of these situations has been to increase either or both the intensity and variety of uses allowed throughout the entire neighborhood.

Because of a number of the other realities about cities and their residential grey areas, the traditional approach offers little hope. In the first place, most of our cities are experiencing a decline of population; in that context, it is a pathetic anachronism to try to encourage development by offering to allow more than anyone wanted in the first place. The fact that Detroit's R-2 District allows everything from single family residential through multiple family with up to eight units in a building has not prevented its neighborhoods from being peppered with vacant lots. In addition to the lack of sufficient demand to justify a great intensification of land use in older cities, simplistic notions of increased density do not respond to the realities of the market. The suburban market with which in-fill development must compete is the market for people who want some kind of single family dwelling unit, whether that be suburban detached or urban row house. City development at greatly increased densities is not going to compete effectively in that market.

LIBERAL ZONING: TOO MUCH OF A "GOOD" THING

Furthermore, the sort of liberal zoning allowances that might be necessary and justifiable to promote a revival or stop a slide will, if permitted everywhere in the neighborhood, both overtax the existing infrastructure and destroy the fundamental characteristics of the neighborhood: both of which are, without any help from regulatory blight, probably beginning to show signs of deterioration due to the natural aging process. Typically, attempts to revive an area by rezoning it are accompanied by total neglect of the physical infrastructure that must support the hoped-for revitalization; in the worst cases services are reduced rather than augmented. More important than the lack of regard for the infrastructure is the disregard of the neighborhood's physical character and social structure that often accompanies zoning revisions in greying neighborhoods. One New Yorker noted, "In-fill provisions that made perfect sense in Brooklyn's row house neighborhoods were unacceptable in Queens, because in this Borough, people like their sideyards." Not only the physical character, but the social character of the neighborhood demands attention. The problem has been described:

> . . . There have been places in San Diego where we've moved in and we've built the San Diego equivalent of the 4 plus 1. We've torn out a lot of nice old houses and small apartment buildings and put these things in. And at that scale there is a noticeable change, and the units become smaller and they cater to a whole different lifestyle, and that's another part of the problem. If we replace family units with more family units at an increased density it's one thing, but if we replace it with singles units then it's another kind of problem entirely.

San Diego's recent efforts to provide more effective and less destructive encouragements to central city redevelopment merit a brief digression here because they touch on an obviously important subject — the need to attract not only residents but also developers. The approach proposed by San Diego's Growth Management Plan was, in essence, to artificially increase the disincentives to outlying development as a means to encourage redevelopment and in-filling. "Densification" of existing urban areas was to be fostered by prohibiting or discouraging development in the outlying areas.

The problem with relying on disincentives in the outlying areas to encourage development in inner city areas is that no matter how effectively you prohibit a mass merchandiser type builder from putting up 150 $75,000 homes on Farmer Brown's back 40, you are not going to overcome the organizational and market factors that prevent that same builder from putting up $75,000 homes on 40 or 50 scraps of land scattered through a variety of inner city neighborhoods. Those builders simply are not equipped to handle small, scattered projects; if they could be made to try it, the chances are their product would cost even more than $75,000. Even at $75,000, the market for face brick and aluminum tri-levels in rundown city neighborhoods is limited.

CONSUMERS AND DEVELOPERS READY TO RETURN

However, just as there are housing consumers who are ready to come back to the city if it will accommodate their needs, there are also developers ready to develop in the cities if offered a bit of encouragement. It appears that there are plenty of small developers and builders looking for markets in which they can continue to make a living despite the corporate giants out in the cornfields.[3] Just as the facts of suburban life have created a potential pool of housing consumers for cities to tap, so have the ample difficulties and disenchantments surrounding outlying, clear-cut development created a pool of potential housing suppliers ready to give the city a try. Cities will do better to concentrate less on adding to the woes of the suburban developer and more on doing something positive in the cities to take advantage of the existing pool of small developers looking for new markets.

More density is not the answer on the consumer side and it also is not the answer on the supply side. Developers cannot get density in outlying areas, and yet they develop. It is not the lack of density that suburban developers, especially small suburban developers, are complaining about; it is the lack of public infrastructure and, even more, the abundance of red tape that delays every project for two or three years. No developer likes to spend money either on providing what he sees as "public" infrastructure or on bureaucratic delay, but for the small builder significant costs in those areas are simply out of the question.

Indianapolis had considerable success in using capital improvements programming to encourage in-fill development. It did so, not simply by refusing to sewer outlying areas, but by taking positive steps to upgrade its inner city sewers at public expense. An Indianapolis resident put it this way:

> Politics of sewers? If the sewers go south, you will have a township right south of here that will be one of the fastest growing places in this country. Property values will really zoom. On the other hand, if it does that, you have ruined an opportunity to rebuild the inner city. Because you've taken a lot of pressure off; you've given them a place to rent. Lugar understood that quite well . . . and under his administration those sewers were not built. What he did was upgrade the inner city sewers and even put in some new sanitary sewers in some places where we did not have the separation of storm and sanitary in the inner city. They spent the money doing that.

If infrastructure can be programmed to slow down growth, it is possible that central cities can program it to encourage growth.

Providing streets and sewers costs money, but eliminating needless red tape does not. Staff people in San Diego admitted, while they were talking about encouraging in-fill development, their codes and ordinances in fact made it much more difficult and time-consuming to develop in an already built up area rather than on virgin soil. Inflated front end and carrying costs have made delay one of the most costly dollar items in any development. The in-fill development process is fraught with its own set of unavoidable delays and difficulties, but so is suburban development. If cities will move aggressively to eliminate the *needless* delays, they will have taken a major step toward encouraging a resurgence of small-scale development in cities.

WHOLESALE REZONING IS NOT THE ANSWER

With that nod to the development community we return to the principal problem of exploring ways in which cities can, through their zoning ordinances, create, or at least encourage, a private market demand for those first few parcels that become the beginning of neighborhood transition. The usual approach of wholesale rezoning for more intense uses is not likely to work. An across-the-boards liberalization of zoning in a reviving or declining neighborhood is almost certain to delay the revival or speed the decline. In both cases, the reason is the same and understanding it may lead toward a better answer.

An overall liberalization of zoning simply increases the raw land value in relation to the value of the existing structure, thereby increasing the incentive to abandon the existing improvements. Assume that a typical city lot is worth \$10,000 and that, on customary ratios, such a lot should support a \$40,000 home. Assuming a stable situation, the house and lot together would be worth \$50,000. Now assume that the structure, over time, deteriorates to the point where it is worth only \$30,000 but that the neighborhood remains basically sound leaving the lot value at \$10,000.

Noticing the decline in the neighborhood, the city fathers rezone the entire area to permit four units per lot in the hope of encouraging revitalization. Let us assume that multiple family land is bringing \$5,000 per unit. The value of the lot, if cleared, is now $20,000, the value of the structure on it remains $30,000. But, in this case, 30 and 20 do not make 50. To the person interested in buying a home, the value is still, at most, $40,000; perhaps less because now the single family house is in an area where multiple family is permitted. To the speculator or developer, the property is worth, at most, $20,000; but probably something less because the existing structure detracts from the raw land value. The result is that the rezoning has, at one fell swoop, both decreased the value of the property and eliminated the incentive to maintain it. In the long-run, the property is probably more valuable without the structure than with it, but in the short-run, chances of anyone buying it for either multiple family redevelopment or continued single family use is diminished. Economically, the *sensible*, not evil or pernicious, thing to do is to maximize the current use value of the existing structure by converting it to two or three apartments, taking the cash flow and deferring maintenance on the structure which is, in any event, a long-term liability. At some point in time, the value of the structure, and the added expense of removing it, will have been amortized down to zero. About the same time, the accumulation of deferred maintenance will have made the structure ready for the bulldozer.

Multiply that example times a neighborhood and you have a zoning induced slum.

The difficulties of the scenario are compounded by the fact that rezoning the entire neighborhood for increased density simply increases the supply of lots available for redevelopment against what is, to begin with, a limited demand for housing in the neighborhood.By creating a buyer's market, the rezoning tends to defeat its own purpose by lowering the value of the land for redevelopment. Even higher densities will be necessary to offset the cost of acquiring and demolishing the structure and add further impetus to the market's tendency to amortize the value of the structure through a program of deferred maintenance.

The quality of life in the neighborhood declines at an accelerating rate as the zoning-encouraged conversion of existing structures to higher densities overtaxes the city's infrastructure at the very time the city is probably reluctant to put money into its maintenance or improvement; creates parking problems (or "solves" them by requiring the conversion of lawns into parking lots); and reduces usable open space while at the same time increasing the population.

THE ALTERNATIVES

But the question remains: What else can a city do? Once it has removed procedural impediments, increased intensity is about the only incentive that a city has to give — unless it is willing and able to spend significant public dollars to encourage private development. Density is the tool that cities must use and the problem is to find a better way to use it.

What is needed is a system by which a few lots in a neighborhood can be given the right to monopolize all of the limited increase in residential density that the neighborhood as a whole can absorb — in terms of market demand, of neighborhood character and of infrastructure capacity. The system should encourage the location of the increased density on larger parcels created by the assemblage of small lots. The system should make density increases available on a basis that encourages, rather than discourages, the preservation and maintenance of sound structures in the neighborhood. The system should encourage redevelopment which tends to solve, rather than compound, parking and open space problems. The system should encourage redevelopment that contributes to the solution of existing infrastructure problems. The system should encourage redevelopment plans and designs which are sensitive to, and compatible with, the existing fabric of the neighborhood. All of that is a tall order.

THE SIMPLISTIC APPROACH

It might all be possible if there were an effective way to solve the first problem of permitting a few lots in the neighborhood to monopolize the entire increase in density that might otherwise be spread across the entire neighborhood. Simple approaches obviously will not work. Decreeing that the four corner lots or every third odd-numbered lot in every square block should be allowed ten times the density of any other lot in the block would concentrate the allowable density but would, in every regard, be a disaster. So far as the law is concerned, such a simplistic approach would be almost certainly invalid. So far as planning is concerned, it would be monumentally ineffective.

As to equity, it isn't necessary to perform a detailed economic analysis to know that the owners of favored lots would receive a windfall, and everyone else would be wiped out. In terms of the desired objective, it is doubtful that the rezoning would produce any immediate redevelopment on the favored lots and it would certainly contribute to the decline of the rest of the neighborhood. If and when the economic situation finally warranted redevelopment of the favored lots, the rest of the neighborhood probably would have declined enough to discourage any thought of new development. If the favored lots were redeveloped at higher densities, it is conceivable that the owners of the rest of the lots in the neighborhood would then cite the high density development in support of their petition for rezoning to similar densities.

COMMON TECHNIQUES MAY BE THE ANSWER

While hope does not lie in simple solutions, an answer may be found in the thoughtful combination of a few relatively common and accepted zoning techniques. This is not the place to draft a zoning ordinance to solve the problems of a diverse assortment of neighborhoods located in a host of individually unique cities across the country. But we can sketch the elements of an approach which we believe offers a starting place.

Take as an example what might be a typical square city block containing 24 lots of 6,250 square feet each. Including its associated rights-of-way, the block would contain 5 acres of land. Presently, the block contains 24 units, 1 single family dwelling on each lot. The neighborhood developed before the marked increase in the popularity of automobiles and is not well suited to them. There is no public open space on the block and only a minimal amount within easy reach which has to suffice for an entire neighborhood. The underground infrastructure remains essentially sound and is probably sufficient in size for some increase in density on the block, especially if the increase comes in the form of smaller units which would not accommodate the large families for which this neighborhood was originally built. Some of the public infrastructure, like sidewalks, curbs, streetlights and parkways could be improved. Many of the homes are large enough to be converted into two, three or even four smaller apartments if permitted by the zoning. A number of the homes already show signs of age and owner neglect. Property values have begun to decline.

"REDEVELOPMENT OVERLAY DISTRICT"

The idea begins by combining elements of the transferable development rights concept with incentive and overlay zoning techniques in a "Redevelopment Overlay District". The advantages of the overlay would be available only in connection with redevelopment activity that met the standards of the ordinance. Without such redevelopment activity, existing zoning would remain in effect by virtue of the underlying district regulations. The overlay regulations would provide a scheme of variable densities depending upon the type of proposed redevelopment. They would also provide for transfers of density from one lot to another, whether contiguous or not. The right to make the transfer could be secured either by acquiring the fee to the lot or by acquiring the development rights under conditions authorized by the ordinance.

While this incorporates some elements of the "transferable development rights" (TDR) idea that has recently received a lot of attention in zoning literature, there are some important differences. Basically, the TDR scheme allows owner A to sell "development rights" from A's property ("transferor parcel") to owner B who can then use the rights to increase the amount of development on B's property ("transferee parcel"). The idea has been most widely discussed as a way to save "special" buildings or areas (such as landmarks or swamps) from development by allowing the owner to sell the development rights to someone else. The owner is then legally obligated to preserve, rather than develop, the transferor parcel. Unlike the usual TDR application, our idea focuses on urban areas that have nothing particularly "special" about them. Rather than being concerned mainly with preserving a special transferor parcel, it is concerned with the selective redevelopment of a limited number of transferee parcels in a fashion that will not overwhelm the existing character of the TDR district. Where the customary TDR program identifies a transferor parcel to be spared from market forces, the concern is to develop a program that lets the market identify those parcels that should be redeveloped and to make market redevelopment possible at an earlier stage in the neighborhood economic cycle. Finally, unlike most TDR proposals which assign fixed development rights to each transferor parcel and fixed maximum development densities to potential transferee parcels, the program seeks to vary both the TDRs and the development potential assigned to each parcel in a way that gives the market a range of redevelopment choices but rewards those choices determined to be most in the public interest.

EFFECTS OF OVERLAY REGULATIONS

To return to the example, the block has 24 single family dwellings on separate 6,250 square foot lots. After studying the existing infrastructure serving the block and the character and location of the neighborhood, the city determines that the block would, if appropriately redeveloped, have a total carrying capacity of approximately four times its existing density or 96 units. Rather than rezoning each lot for four units and inviting disaster, this is how the overlay regulations would assign density values to each lot:

1. Density without any redevelopment — one unit as permitted in the underlying district.
2. Density for conversion or redevelopment involving a single lot — two units, subject to site and structure performance standards.
3. Density available for transfer to a noncontiguous lot — 1.5 units with the right to maintain one unit on the transferor lot subject to the underlying district regulations or 3.0 units if the transferor lot is to be maintained as neighborhood open space or parking.
4. Density for transfer to a contiguous lot where the contiguous lots will be redeveloped as a unified whole — 3.0 units.
5. Density for development as a transferee lot in connection with a density transfer from any contiguous or noncontiguous lot — sum of (i) total units being transferred plus (ii) equivalent of total units, up to a maximum of 3 units, being transferred.
6. Maximum density of development permitted on any parcel — 1.0 unit per 1,000 square feet of land area in a single contiguous parcel.

In addition to the variable densities assigned to each individual lot, density bonuses or incentives might be established as follows:

1. Density Bonus for Specified Infrastructure Improvements — one unit per 1,250 square feet for providing proportionate share of designated improvements or cash contribution to fund established to provide such improvements.
2. Density Bonus for Consolidation of Separate Lots — .1 unit per 1,250 square feet of contiguous lot area in excess of 25,000 square feet where the development provides common open spaces and parking meeting the ordinance requirements.
3. Density Bonus for Design Excellence — .02 unit per 1,250 square feet of contiguous lot area in excess of 25,000 square feet for development

design judged excellent in integrating new development into existing development pattern.

The foregoing density allocations and bonuses are fixed so that if a developer succeeded in putting together all twenty-four lots and achieving all available bonuses, he would be entitled to ninety-six units, the assumed maximum density of the block. The densities might logically be set slightly higher on the assumption that the maximum bonus situation would never be achieved. The basic transfer densities might be set lower to encourage the use of the bonus density incentives.

This system would also lend itself to density bonuses to achieve a city's social objectives. The types of density allocations and bonuses thus far discussed might be fixed at a level somewhat under the maximum carrying capacity of the block so that additional density bonuses could be awarded for including some percentage of low and moderate income units in the redevelopment project. In effect, the system could provide a zero land cost for low and moderate income units by providing a density bonus of one unit per lot for each low or moderate income unit included in the development up to a specified maximum number of units. If the objective was housing for the elderly, the ordinance might even provide density bonuses in excess of the calculated maximum carrying capacity in light of the lesser impact of elderly developments on most infrastructure components.

SPECIFIC PROBLEMS/SPECIFIC ZONING VARIATIONS

The foregoing provides a crude outline of how one would begin to approach the treatment of density in residential grey areas. The possible refinements and variations are limitless and would have to be worked out in light of the specific problems being faced. The rather imprecise units per acre density control might be replaced or supplemented by more sophisticated controls which take account of unit type, size and configuration. Regulations pertaining to bulk, yards, open spaces, light and air, parking and other development factors would have to be added. Screening, buffering and transition controls would have to be provided. Questions relating to the possibility of vacating existing alleys or other public rights-of-way would have to be addressed. Urban design elements should also be considered. Thought should be given to the controls that would be applicable to lots that did not get redeveloped. In the underlying district, allowing the rental of one or two rooms without separate kitchen facilities as a home occupation by an owner-occupant might make the maintenance of a large old home economically feasible for an owner-occupant. Where redevelopment would consist only of the conversion of an existing structure to more units, regulations should be provided to control the possible adverse effects of such redevelopment. Such regulations might include control over exterior alterations, the amount and location of off-street parking spaces, minimum green area, and unit size and design standards. Changes in the subdivision regulations might also be appropriate to allow the development of additional detached single-family units on the back or side lots of existing units.

All of those sorts of regulations become more effective and workable once a basic mechanism is in place. This permits the market to capitalize on the raw land values of an urban neighborhood without totally abandoning the existing structures.

DENSITY TRANSFERS

By allowing density transfers from both contiguous and non-contiguous lots, but providing a greater transfer for contiguous lots, the system would encourage a developer to assemble large contiguous tracts and would tend to discourage any individual owner from holding out for an unreasonable price by offering him the carrot of a higher transfer on sale to a developer in the process of assembling a large tract and the stick of knowing that, even without his lot, the developer could buy up sufficient transfer rights to make the development feasible. Hopefully, the system would work well enough to eliminate the need for consideration of more radical proposals such as the use of the eminent domain power to aid a developer in assembling a tract large enough to support redevelopment.

A requirement of each density transfer would be that the developer make appropriate provision for the future use and development of the transferor lot. At a minimum, of course, that would involve covenants and planned-development type regulations prohibiting future development of the transferor lots at a density greater than that remaining following the transfer. Other regulations would depend upon the specific proposal. If a transfer was sought on the basis that the transferor lot would be maintained as open space or public parking, regulations providing for the development and maintenance of such uses would be necessary. If the transfer were made on the basis that the lot would continue to be used for a single-family dwelling, provision for necessary repair or rehabilitation of the existing unit as part of the development program would be appropriate.

CRITICAL ISSUES — DENSITY & DIVERSITY

The treatment of density is but one of two critical issues in city neighborhoods. The other is the allowance and control of use diversity. Of the two, diversity is found to be the easier issue, at least in terms of planning. Legally, it may be the more difficult. Many city neighborhoods are already characterized by a diversity of uses and most city residents display a tolerance for diversity that far exceeds that found in suburban neighborhoods. Eliminating that diversity is not a particularly sensible goal for an urban zoning ordinance. What is essential is that the zoning ordinance limit and control the diversity at a level where it enhances, rather than destroys, the residential environment. Again, it is a matter of singling out a few lots for special treatment. But, here the planning problems are less severe because existing land use patterns and market considerations tend to permit city planners to distinguish among lots in terms of their appropriateness for accommodating various uses.

SPECIAL TREATMENTS

Take, as an example, the problem of transitional care facilities such as "halfway houses" for groups ranging from battered wives to ex-cons. Planners can predict, in advance, something about the type of neighborhood and the type of structure that is adaptable to such a use. The zoning ordinance can limit the use to appropriate neighborhoods and can establish minimum standards for the type of structure that may be converted. Other standards relevant to the particular type of use can also be established. They might relate to minimum yard areas, parking requirements and relation to necessary supporting public and private infrastructure. To be certain, such pre-ordained standards could not, either realistically or wisely, be developed to the point of designating individual lots within a neighborhood available for such use. But that degree of specificity is not required. Once the minimum standards are established, the ordinance can rely upon the market to make the specific selection so long as it provides that, once the market selects a specific location within a neighborhood, it may not select another location within a specified area around the initial site. The combination of minimum requirements and spacing limitations insures that each site selected for the facility in question will be appropriate and that the neighborhood will not be overwhelmed by an undue concentration of such facilities. With variations in the specific standards and requirements, essentially the same approach can be applied to most non-residential and quasi-residential uses which are socially desirable or necessary but which, while requiring a residential location, tend to threaten the residential environment.

COMMERCIAL ZONES

If the issue is the location of limited commercial facilities to serve a residential area, the planners can usually pick the most appropriate areas for mapping of limited commercial zones. Frequently that will involve simply recognizing and attempting to bolster an existing commercial development. Where that development is an old strip which no longer has either the amenities or population to support it, its consolidation into discreet "nodes" might be encouraged by a combination of infrastructure improvements and modifications, special tax status and special zoning incentives to use part of the strip as transferee lots for residential development within the context of the Redevelopment Overlay District concept just discussed.

Developing an ordinance to permit, or even bolster, one commercial area at the expense of another presents in an acute fashion the troublesome legal issue raised by any zoning ordinance that attempts to allow, but control, a diversity of uses. Zoning for limited commercial uses involves the creation of a somewhat artificial zoning island. On one side of the line, commercial is permitted; on the other side, it is not. Unfortunately, there is frequently little to distinguish one side of the line from the other, apart from the designation on the zoning map. In the most aggravated situations, there may even be existing commercial uses on both sides of the line, as in the case just mentioned where planners attempt to salvage something out of a decaying commerical strip by rezoning large portions of the strip for non-commercial uses, leaving a limited number of commercial nodes in the hope that the limited demand for commercial space will gradually be concentrated in the nodes.

ARGUMENTS FROM THE ZONING DARK AGES

Such situations raise all of the old bugaboos. The neighbors who don't want the different use cry "spot zoning." The neighbors who see economic advantage in having their properties zoned for a similar use argue that the rezoning has established the "character of the area" justifying a rezoning of their own properties. Would-be competitors assert that the limited rezoning has created a monopoly in violation of the supposed rule that zoning may not be used to control competition.

Those are all arguments from the dark ages of zoning theory and practice. They make even a modicum of sense only when the zoning process is completely uncontrolled by either rational standards or pre-ordained policies. In suburban zoning, they have been circumvented by the planned development device which recognizes that there is such a thing as an optimum mix of uses within any development or neighborhood. In urban zoning, the same concept must be recognized by the repudiation of a whole variety of legal and planning theories that boil down to the position that permission to establish one of any kind of use is a confession that the neighborhood ought logically to be overrun by a half dozen more of the same thing. If the planners do their job, the courts can be persuaded to abandon the decrepit legal principles that have forced the creation of monotonous, "pure" zoning districts out of fear that any allowance for diversity would open the flood gates.[4]

THE TOOL FOR POSITIVE CHANGE

It is hoped that those who run cities may be encouraged to dust off the zoning ordinance and reconsider its potential as an innovative tool for positive change in our cities. The potential is there, but to realize it will require fresh thinking. The stale ideas and negative controls that characterize most of suburban zoning practice are clearly insufficient to deal with the land use problems of our cities. But, if city zoners will put their minds to it, it seems a good bet that they can move quickly to the forefront of land use theory. Given the current state of suburban zoning practice, if there are to be bright new ideas in this field, they will have to emerge like much of Western civilization, out of the need to cope with the diversity, conflicts, and challenges that result from the massing of people, things, and power in our great cities.

REFERENCES

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2. Babcock, "Case of Corporate Myopia," *Chicago Sun-Times*, Viewpoint section, January 26, 1975.
3. See, *New Opportunities for Residential Development in Central Cities*, p. 15 *et seq.* (Urban Land Institute, 1976); *House & Home*, p. 12, December 1976; *House & Home*, p. 50, October 1977; *Housing*, Febuary 1978; *Housing*, p. 60, Febuary 1979.
4. For more on the strategy of the legal assault, see, Weaver and Duerksen, "Central Business District Planning and the Control of Outlying Shopping Centers," *Urban Law Annual* 57. But see also Weaver and Hejna, "Antitrust Liability and Commercial Zoning Litigation," in *Proceedings: Shopping Centers, U.S.A.* (Rutgers Univ. Press, N.J., 1980) concerning the latest bugaboo — the federal antitrust law.

Condomania or Condophobia?

by Richard J. Roddewig

It was only a matter of time before the advocates of rent control found natural allies in the proponents of strict controls on conversion of apartment buildings to condominium ownership. That time has come. A barrage of rent control proposals hit voters and city council members in many jurisdictions from California to Connecticut.[1] In California alone, at least 53 communities considered or enacted rent control ordinances since the end of 1978. Frequently these new initiatives are combined with a call for tough controls on conversions.[2]

Rent control advocates argue that the relatively low vacancy rates in rental housing make it difficult for tenants to find decent accommodations, and make it easy for landlords to pass on large increases at lease renewal time. In the early 1970s, the vacancy rate in most metropolitan areas was between 5 and 10%. In 1979, few metropolitan areas had a vacancy rate above 5% and in many desirable neighborhoods it has dropped to 2% or less.

Tenants' groups readily admit that the primary reason for the decline in vacancy rates is the decline in new rental housing construction during the decade of the 1970s. Only 500,000 units were started in 1979 compared to the 1972 high of almost 1,000,000. Of those 500,000 new units, more than 300,000 had one form or another of government subsidy.[3]

The decline in production poses a difficult dilemma for tenants' groups. They advocate increased government subsidy programs to stimulate production, but fail to draw the conclusion that rental housing needs a subsidy to be built. Little new non-subsidized rental housing is being built because income is too low and construction and operating costs are too high. The logical implication that rents are generally too low in most metropolitan areas is unpalatable to tenants' groups.

In their need for someone to blame for the sorry state of non-subsidized rental housing construction in the United States, tenants' groups have now turned their ire on the condominium converter. If the government subsidized programs cannot produce enough new rental housing to meet the

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need, and the notion that rents must be higher in order to produce substantially greater numbers of non-subsidized units is philosophically unacceptable, then the converter can be made the lightning rod for the anger of tenants' groups frustrated in their search for other easy solutions to a perceived crisis.

RENT CONTROL AND THE CONDO CONNECTION

The logic is simple. The vacancy rate is low, which allows landlords to raise rents to artificially high levels. Rent control is therefore needed and must be imposed; but if it's threatened or imposed, landlords will convert units to condominiums. Therefore, restrictions on conversions are also necessary as a corollary to rent control. And in order to convince hesitant politicians that a conversion moratorium is necessary, it must be shown that substantial numbers of rental units are being lost through conversions.

To convince the public that condominium conversions have created a rental housing emergency, tenant groups have coined the word "condomania."[4] But is the number of conversions nationwide and in any given city enough to be evidence of "condomania"? Even if the number is quite large and the rental housing stock is being depleted, do the benefits of condominium conversions outweigh the effect? And if the number nationwide and in any given city is less than the critics claim, are there better solutions to the social problems created by condominium conversions than the costly remedies advocated by many tenants' groups?

These are the significant questions behind the rhetoric concerning conversions. Unfortunately, they are questions few communities have taken the time to carefully analyze before imposing lengthy (and costly) moratoriums or tough (and costly) "third generation" condominium ordinances requiring such measures as majority tenant approval or unit purchase prior to conversion, and tenants' right of first refusal upon sale of an apartment building to a converter.

THE RENTAL HOUSING INVESTMENT CRISIS: ONE UNDERLYING CAUSE OF CONDOMINIUM CONVERSIONS

There is an emerging national awareness that condominium conversions are really a symptom of a rental housing investment crisis. The profit in construction and operation of non-subsidized housing is not sufficient to attract real estate investors or developers. Rents have not kept pace with the costs of constructing, maintaining and operating an apartment building.[5] As Table 1 shows, the Consumer Price Index since 1967 has increased much more rapidly than rents. The CPI in July of 1979 was 57% higher than the rental price index as measured from the same base date.

The elements of the CPI that most affect landlords have increased even more rapidly than the CPI as a whole. Cost of home ownership has increased by 163% since 1967. The home ownership cost component of the CPI includes the expense items that affect landlords in the acquisition and operation of apartment buildings such as the cost of purchase, mortgage interest, taxes, insurance, maintenance and repairs. The cost of operating an apartment building has increased more than twice as fast as the rental income.

TABLE 1

EFFECT OF INFLATION ON URBAN RENTAL HOUSING

Item	July 1979 Consumer Price Index	% Increase Since 1967	% Increase 7/78 to 7/79
All Items	218.9	118.9	11.3
Rental Income			
Residential Rent	175.9	75.9	7.1
Rental Expenses			
Homeownership	263.0	163.0	15.2
Financing, Taxes, Insurance	308.6	208.6	19.0
Maint. & Repairs	257.9	157.9	10.0
Fuel & Other Utilities	243.5	143.5	11.7
Fuels Alone	293.8	193.8	17.2
Other Utilities	159.4	59.4	0.6

Source: Department of Commerce and Shlaes & Co.

This dramatic rise of operating costs in recent years affects all rental buildings regardless of their age. Table 2 shows that increasing costs have created a greater strain on the profitability of older buildings, especially older elevator buildings. But even the owners of the newest and largest apartment buildings are suffering. Non-mortgage expenses now consume more than 50% of rental revenues generated by the newest buildings compared to less than 46% in 1971.

Why haven't rents kept pace with the increasing operating costs? One important reason is rent control or its threat. Between 1973 and April of 1979, more than 250 communities across the country had imposed some form of it.[6] Since then, rent control has been established in an even greater number of cities and towns.

The going market rent for a particular type of unit in any city is usually established by the largest landlords. Because they have the most to lose if rent control is enacted, large landlords have been cautious about passing on too large an increase to their tenants in any given year; they have increased their rent levels much more slowly than their increasing operating costs require. Smaller landlords have had to follow the lead of the larger market makers or risk scaling their rents beyond the market limits.

TABLE 2

NON-MORTGAGE EXPENSES AS A PERCENT OF RENTAL REVENUES

Building Type	Year	Buildings Constructed 1968 to Date	1961-1967	1946-1960	1931-1945	1921-1930
Elevator	1976	51.2	55.9	58.6	62.5	69.8
	1975	51.2	56.8	59.4	60.5	68.6
	1974	51.7	54.6	58.5	60.4	65.5
	1973	49.2	52.4	57.4	58.0	58.9
	1972	49.0	50.7	55.6	58.1	62.5
	1971	45.8	49.4	53.7	54.9	60.4
Low Rise 12-24 Units	1976	46.5	47.9	54.3	59.6	55.0
	1975	45.9	49.0	53.6	54.1	66.6
	1974	43.0	49.8	47.7	60.9	64.6
	1973	46.5	49.0	49.6	55.4	61.6
	1972	44.2	47.3	49.8	54.4	63.2
	1971	40.3	45.1	52.7	58.4	63.9
Low Rise 25 Units and over	1976	49.3	51.7	55.2	63.0	67.8
	1975	52.8	40.4	54.9	60.1	66.7
	1974	48.4	49.1	50.6	57.4	66.1
	1973	44.9	47.2	52.3	52.5	61.8
	1972	45.1	48.2	49.9	58.0	65.8
	1971	45.1	51.3	52.3	55.7	66.1
Garden	1976	51.0	52.4	62.2	61.8	63.9
	1975	50.8	53.2	56.5	61.5	65.4
	1974	50.0	50.5	57.4	58.1	59.3
	1973	48.4	48.5	54.3	54.3	54.9
	1972	47.7	48.7	53.8	55.1	61.4
	1971	50.0	48.3	52.1	59.0	55.0

Source: Institute of Real Estate Management as cited in *AREUEA Journal*, Vol. 7, No. 1, Spring 1979, p. 59.

The poor performance of rental housing as an investment and the constant threat of rent control makes the conversion of rental apartment buildings — or the sale of a rental building to a condominium converter — very attractive to more and more landlords each year. Rent control and its threat is, therefore, one direct cause of the condominium conversion phenomenon in the United States.

CONDOMINIUMS AND THE HOMEOWNERSHIP DREAM

An even more significant cause — and one generally ignored by advocates of tough controls on condominium conversions — is that unquenchable American desire for home ownership. From a nation of tenants in 1940, we have become a nation of homeowners today. As Table 3 indicates, almost 65% of all Americans in 1975 were homeowners compared to less than 44% in 1940. One of the most persistent American dreams is a brand new single-family home in a quiet suburban subdivision. Once merely a reflection of the conviction that the best place to raise a family was in a nice single-family home in the suburbs, the American dream has been given new urgency by the high inflation rates of the 1970s. Americans have become convinced that home ownership is the ordinary person's best defense against the declining purchasing power of the dollar. They also understand quite well the income tax benefits of owning rather than renting: the opportunity to shelter some income by deducting mortgage interest and real property taxes.

Recent analysis by the Department of Housing and Urban Development indicates that a homeowner with a family income of $39,000 per year can expect a 20-22% annual return on his home as an investment. Stocks, bonds, savings accounts and even six-month certificates of deposit and money market funds yield a skimpy return by comparison.

TABLE 3

OCCUPIED HOUSING UNITS BY TENURE
U.S. TOTAL, 1975
(Units in thousands)

Year	Total Occupied Units	Owner Occupied		Renter Occupied	
		Number	Percent	Number	Percent
1940	34,855	15,196	43.6	19,659	56.0
1950	42,826	23,560	55.0	19,266	45.0
1960	53,024	32,797	61.9	20,227	38.1
1970	63,450	39,885	62.9	23,565	37.1
1973	69,337	44,653	64.4	24,684	35.6
1974	70,830	45,784	64.6	25,046	35.4
1975	72,523	46,867	64.6	25,656	35.4

Source: U.S. Department of Housing and Urban Development, *HUD Statistical Yearbook, 1976* (Washington, D.C. Government Printing Office, 1977), p. 261.

For more and more Americans the dream may have a new scenario. Like a thirsty wanderer drawn toward the mirage of a desert lake, the home-buying public, especially young, first-time home buyers, find their dream home always just beyond their reach as new home prices increase faster than their incomes. As Table 4 shows, median family income increased by 39% between 1970 and 1975 while costs for first-time buyers of existing homes increased by 63% and for first-time buyers of new homes, by 82.4%. The increase in housing costs compared to the increase in median family income since 1975 has been just as dramatic. Table 5 and Table 6 detail the increase in new home prices and used home prices between 1976 and 1979 in selected American cities. Note that in two of those cities (San Francisco and San Diego) the median new home price for the three-month period June through August of 1979 was over $100,000. And in San Francisco the median price of a used home was also more than $100,000.

TABLE 4

PERCENT CHANGES IN HOUSING COSTS, INCOME, AND GENERAL CONSUMER PRICES 1970-1975

Housing Costs For:	
First-Time Buyers of Existing Homes	63.0
First-Time Buyers of New Homes	82.4
Owners Repurchasing	27.3
Owners Not Moving	22.8
Median Family Income	39.0
Consumer Price Index	38.6

Source: Congressional Budget Office, Budget Issue Paper, "Homeownership: The Changing Relationship of Costs and Incomes, and Possible Federal Roles."

TABLE 5

SELECTED AMERICAN CITIES:* NEW HOME PRICES AND PERCENTAGE INCREASES

	June-Aug. 1976	June-Aug. 1979	% Increase
Houston, TX	$ 54,600	$ 73,300	34.2
Miami, FL	49,600	55,900	12.7
San Francisco, CA	68,400	105,700	54.5
New York, NY	61,900	96,600	56.1
Los Angeles, CA	70,800	97,600	37.9
Chicago, IL	49,900	76,000	52.3
San Diego, CA	N.A.	100,600	N.A.
Atlanta, GA	56,900	75,300	32.3
Anaheim, CA**	70,800	97,600	37.9
Denver, CO	51,600	70,400	36.4
Washington, DC	61,600	96,300	56.3
Philadelphia, PA	51,500	68,300	32.6
Minneapolis, MN	53,900	84,100	56.0
Dallas-Ft. Worth, TX	53,800	80,800	50.2
Phoenix, AZ	N.A.	83,300	N.A.
Boston, MA	46,500	80,600	73.3
Salt Lake City, UT	N.A.	65,100	N.A.
Ft. Lauderdale, FL***	49,600	55,900	12.7
Riverside, CA**	70,800	97,600	37.9
Portland, OR	N.A.	76.400	N.A.
Baltimore, MD	59,100	82,900	40.3
Cleveland, OH	53,000	88,300	66.6
Detroit, MI	49,200	75,500	53.5

*In some cases, figures are for Standard Consolidated Statistical Areas which include geographic areas larger than Standard Metropolitan Statistical Areas

**Included in Los Angeles Standard Consolidated Statistical Area

***Included in Miami Standard Consolidated Statistical Area

Source: Federal Home Loan Bank Board, *Monthly News*, and Shlaes & Co.

TABLE 6

SELECTED AMERICAN CITIES:* USED HOME PRICES AND PERCENTAGE INCREASES

	June-Aug. 1976	June-Aug. 1979	% Increase
Houston, TX	$ 60,400	$ 69,900	15.7
Miami, FL	49,600	60,600	22.2
San Francisco, CA	60,400	103,000	70.5
New York, NY	58,300	79,900	37.0
Los Angeles, CA	62,600	92,600	47.9
Chicago, IL	52,500	67,500	28.6
San Diego, CA	N.A.	91,600	N.A.
Atlanta, GA	56,100	61,500	9.6
Anaheim, CA**	62,600	92,600	47.9
Denver, CO	46,700	74,800	60.2
Washington, DC	65,700	94,400	43.7
Philadelphia, PA	43,600	54,100	24.1
Minneapolis, MN	50,200	70,000	39.4
Dallas-Ft. Worth, TX	54,300	77,300	42.4
Phoenix, AZ	N.A.	67,700	N.A.
Boston, MA	50,800	63,200	24.4
Salt Lake City, UT	N.A.	76,400	N.A.
Ft. Lauderdale, FL***	49,600	60,600	22.2
Riverside, CA**	62,600	92,600	47.9
Portland, OR	N.A.	67,400	N.A.
Baltimore, MD	42,500	58,000	36.5
Cleveland, OH	43,800	60,700	38.6
Detroit, MI	41,800	57,000	36.4

*In some cases, figures are for Standard Consolidated Statistical Areas which include geographic areas larger than Standard Metropolitan Statistical Areas

**Included in Los Angeles Standard Consolidated Statistical Area

***Included in Miami Standard Consolidated Statistical Area

Source: Federal Home Loan Bank Board, *Monthly News*, and Shlaes & Co.

EFFECTS ON FIRST-TIME HOMEBUYERS

First-time home buyers have been particularly hard hit by the rapid increase in home values in recent years. A 1978 study by the United States League of Savings Associations found that the median purchase price for first-time buyers was $37,500 compared to $48,500 for repeat home buyers.[7] The percentage of first-time and repeat home buyers purchasing in various price ranges is shown in Table 7.

The strong buyer demand for condominiums is directly related to the rapidly increasing prices of new and existing homes in the United States. A large percentage of condominium buyers are either young, first-time home buyers or older "empty nesters" looking for smaller quarters. Condos are attractive to both groups because their price is usually less than the average price of alternative homes on the market. A 1977 study by the National Association of Home Builders revealed that approximately 44% of condominium unit purchasers could not have afforded a single-family detached home.[8]

TABLE 7

PERCENTAGE DISTRIBUTION OF HOME PURCHASE PRICES, FIRST-TIME AND REPEAT BUYERS

Home Purchase Price	First-Time Buyers	Repeat Buyers	All Buyers
Less than $30,000	28.1%	13.3%	18.6%
$30,000 to $49,999	50.4	40.0	43.8
$50,000 to $69,999	15.3	27.1	22.7
$70,000 or more	6.2	19.6	14.9
Median	$37,500	$48,500	$44,000

Source: U. S. League of Savings Associations.

Buyer demand for condominium homes is also an outgrowth of the celebrated (but often exaggerated) "back to the city movement."[9] In some attractive inner-city neighborhoods, the only available opportunity for homeownership is through purchase of an apartment.

THE NUMBER OF CONVERSIONS: MYTH AND REALITY

The conversion market has been strong in recent years because of this conjunction of supply forces (cost pressures on apartment building owners to convert) and demand factors (unavailability of alternative inexpensive forms of home ownership). How many conversions have there been nationwide? Despite the strong supply and demand factors encouraging the conversion of rental units to condominium ownership, the number may be less than some estimates made in the last five years.

The only comprehensive effort to estimate the number of condominium units nationwide was undertaken by the Department of Housing and Urban Development in 1975.[10] The HUD Condominium Cooperative Study claims there were 1.69 million condominium and cooperative units in the United States as of April 1, 1975. That was approximately 2.4% of all occupied housing units in the nation. It was impossible for HUD to determine the precise number but it estimated that there were approximately 125,000 condominium units in buildings that had been converted from rental ownership. Of those units, approximately 100,000 were converted between 1970 and 1975.

The Department of Housing and Urban Development made no attempt to estimate the number of condominium units in every metropolitan area. It performed an in-depth market analysis of only six Standard Metropolitan Statistical Areas (Boston, Columbus, Fort Lauderdale-Hollywood, Lake Tahoe, San Jose and Washington, D.C.).

HUD is presently in the process of completing a follow-up study of the phenomenon. Included in that report will be a more detailed estimate of the number of condominium conversions in a wider sample of metropolitan areas across the country. The results of the new study will not be available until mid-1980, however. No other nationwide study has been undertaken since 1975.

NEED FOR ACCURATE DATA

In the face of mounting criticism from tenants' groups, a few states and cities have begun to keep more accurate records of the number of new and converted units created each year. Some states, such as Michigan and California, require every building converted to condominium ownership to file a report with a designated state agency which must contain information on the number of units proposed for conversion. Many cities have similar requirements. But local condominium ordinances are a recent phenomenon, and accurate information on the number of condominiums in a particular city goes back no further than the adoption of the ordinance by the local city council. For example, the Chicago Department of Consumer Sales has accurate information on the number of condominiums created in the City of Chicago since January 1, 1978, but has no data prior to that date.

Because the total accumulating number of units or the distinction between units in new or converted buildings was not considered important when state legislation enabling condominium ownership was enacted, few state agencies have maintained good records. In many jurisdictions, the best source of information is the local real property tax assessor's office. An apartment building has a single legal owner and a single real property tax number. In many jurisdictions, when a building is converted every unit owner becomes a real property tax payer and his particular unit must be given a separate real property tax index number. Especially in those larger jurisdictions where the assessor's information is computerized, an accurate count of the number (and location) of units in the community may be available from the assessor's office. But because it makes no difference to the assessor whether a unit is new or converted, there may be nothing in the assessor's information to distinguish between a unit originally constructed as a condominium and a converted apartment.

LESSONS FROM CHICAGO

As a result of the lack of reliable information on the number of new and converted condominium units in most communities, political discussion on the need for tough restrictions usually degenerates into unverifiable arguments. Tenants' groups inflate the estimated number of converted units to justify their claim that there is a housing emergency. Real estate interests will often minimize the number.

In such a debate it is essential that someone make an attempt to accurately count the number of units in the community. In the Chicago debate concerning the proposed new regulations on condominium conversions proposed by the Byrne administration in the summer of 1979, tenant groups claimed there were between 75,000 and 100,000 condominium units — mostly conversions — in the City of Chicago. The proponents of tough restrictions claimed there had been as many as 20,000 units converted in Chicago in 1978 alone and 4,000 units in Chicago's suburbs, figures drawn from estimates made by Advance Mortgage Corp. and Citicorp Real Estate, Inc. in their joint publication *U.S. Housing Markets*. Advance Mortgage Corp. estimated there were 50,000 converted units in total in the City of Chicago and an additional 15,000 in suburban Chicago as of the end of 1978.[11] The Chicago Real Estate Board, in arguing against the proposed new restrictions and a 45-day moratorium imposed by the Chicago City Council, estimated that there were 48,000 units (new and converted) in Chicago as of the end of 1978.

The Corporation Counsel for the City of Chicago was asked by the federal district judge hearing the Chicago Real Estate Board lawsuit[12] challenging the moratorium to present some evidence justifying the city's claim that the condominium conversion phenomenon had created a rental housing crisis. The city was forced to admit that it had no accurate count of the number of units. When pressed, however, the Chicago Department of Planning, City and Community Development claimed it had a study verifying that there were 66,000 new and converted units in the city, but no such report was ever produced.

Not one of the parties involved in the public debate in Chicago had taken the time to actually count the number of condominium units in the city. Yet that was a relatively simple thing to do; one needed only to go to the set of plat maps published by a private firm under agreement with the Cook County Recorder of Deeds Office. The plat maps published in early 1978 listed the name and address of every condominium building in the City of Chicago and also showed the unit number for each unit in the building.

COUNTING CHICAGO CONDOS: SURPRISE RESULTS

Our real estate counseling firm undertook counting the condominiums in the City of Chicago in an effort to settle the debate,[13] and the results of the study surprised even the researchers themselves. As of the end of 1977 there were only 30,055 new and converted condominium units in the City of Chicago as recorded on the plat maps. Those 30,000 units were in 916 buildings, and based on the consultants' knowledge of the history of development in the City of Chicago, they were able to conclude that there were at least 5,137 units in buildings originally developed as condominiums. That left only 24,918 units in converted buildings. To determine the numbers for 1978, the consultants went to the Cook County

Assessor and asked for assistance in documenting the number of units receiving new permanent tax index numbers in 1978. The assessor's office estimated that when its work on the 1978 tax division was completed, there would be approximately 6,000 additional condominium units in the City of Chicago. Most of the units created in 1978 (at least 5,000) were conversions. The total number of units in converted buildings through the end of 1978 was thus approximately 30,000, and the total number of new and converted units approximately 36,000.

That precise count of the number and location of conversion units in the City of Chicago showed not only that the critics of the conversion process had exaggerated the number by 200 to 300%, but even that the real estate industry itself had grossly overestimated the number in the city. The City Council subcommittee charged with holding hearings on the proposed new set of condominium restrictions was grateful to receive a report that established a factual basis for the debate on the need for tougher restrictions.

The report not only counted the number of units and determined their location, but also counted the number of units converted annually since condominiums first became legal in Illinois in 1963 and analyzed changes in the location and size of converted buildings. Approximately 70% of all the conversions in the City of Chicago were occurring in just two neighborhoods, and those neighborhoods happened to be two of the wealthiest in the city. That documentation made it difficult for critics to justify their argument that condominium conversions were having a disproportionate impact on low- and moderate-income families, especially elderly households. Almost 54% of all the condominium units in the city were located in only 53 large, high-rise buildings located within two blocks of Chicago's lakefront in a narrow band stretching from the Loop north to the city limits.

CONVERSIONS AFFECT FEW NEIGHBORHOODS

The conclusion drawn by the consultants was that the condominium conversion phenomenon was a much less serious problem than had generally been believed. The numbers of units counted were relatively small, the phenomenon affected very few neighborhoods, and those neighborhoods affected were some of the wealthiest in the city. By analyzing Bureau of the Census data on the number of elderly households in the neighborhoods experiencing heavy conversion, and by analyzing turnover rates in the type of Chicago apartment building typically converted and the average percentage of tenants in Chicago who buy their units, the consultants attempted to estimate the effect on non-purchasing elderly households. The study found that on average between 1963 and the end of 1977, no more than 276 non-purchasing elderly households per year were affected by condominium conversion. The study concluded that there were other more precise and more effective ways to solve the problems than those that had been proposed by the Byrne administration.

ACCURATE DATA AND THE REGULATORY PROCESS

Other localities across the country have not benefitted from the same depth of discussion as had Chicago before enacting tough restrictions. Many cities — and even states — with only a handful of conversions have enacted long moratoria and burdensome regulations in the hysteria generated by tenants' groups' claims that rental housing would be eliminated completely. Perhaps none was more ill considered than the recent "emergency measure" enacted by the Connecticut General Assembly requiring installation of a separate heating plant for any rental unit proposed for conversion. The statute was a thinly disguised effort to impose a statewide moratorium during a session of the General Assembly that could only deal with energy legislation. The reason for the statewide ban in Connecticut was the perceived problem created by the conversion of an estimated 1,500 apartment units in Hartford in the previous year. Although Governor Ella Grasso signed that legislation, she refused to sign an executive order which would have imposed a statewide moratorium until May of 1980.[14]

The Philadelphia City Council in late September of 1979 enacted an eighteen month moratorium. Because that ordinance also amended the Philadelphia condominium regulations to require a one-year notice of conversion to all tenants, the effective length of the moratorium is thirty months. The Philadelphia moratorium was enacted despite evidence that there had been only 200 units converted in 1978 and less than 2,000 units in 1979 out of a total rental housing stock of more than 450,000 units.[15]

CONDOPHOBIA IN CALIFORNIA

Many California communities have been very innovative in restricting or halting the conversion of rental apartments. "Condophobia" is so strong in California that communities seem to vie with one another for the honor of having the most restrictive local ordinance. California ordinances fall into four groupings. First, some communities require that conversions be reviewed for consistency with the community's "comprehensive plan" which may include a housing component requiring protection of low- and moderate-income housing. Second, some communities in California require conversions to apply for a special use permit under the zoning ordinance and are allowed as a special use only if there is no significant effect on the community's general welfare. Third, some communities through their subdivision ordinances, building codes and zoning ordinances require buildings converted to condominiums to comply with code provisions for new construction. Fourth, a number of California communities are beginning to prohibit conversions when the rental vacancy rate is below a specified percentage, or to limit conversions to some percentage of new rental construction activity.

Marin County's regulation combines compliance with the county's comprehensive plan and a vacancy rate linkage. The county plan commission must review all applications, and may deny approval if it determines that the effect would be detrimental to the supply of rental housing in the county. The Marin County Planning Director has discretion to disapprove a conversion whenever the vacancy rate falls below 5%. If there is evidence that non-purchasing tenants in a building being converted cannot find comparable housing at a comparable rent, the county may require that a "reasonable percentage" of units to be converted be reserved for sales or rental to persons of low- or moderate-income. The percentage is based upon the similar percentages required of developers of new rental or for sale housing in Marin County.

La Mesa in San Diego County requires that condominium conversions meet current zoning standards and also current building standards. The City of La Mesa has also set a maximum limit on the annual number of conversions that it will permit. The number in any year is limited to 50% of the average number of new rental units constructed annually in the previous two years.

In Anaheim, California, the number has been limited by the requirement that converted buildings comply with new construction parking space requirements. Although most of the desirable buildings for conversion in Anaheim were constructed under zoning or building codes requiring only 1.5 garage spaces per apartment unit, conversions are not allowed unless there are two garage spaces per apartment unit in the building.

Some California cities, such as Sacramento, believing that conversions may be desirable in some neighborhoods but not others, are considering adoption of more complicated ordinances. A proposed new ordinance for Sacramento may prohibit conversions in only those areas of the city (especially downtown Sacramento) where rental vacancy drops below a specified figure and the impact of conversions on low- and moderate-income housing stock will be high.

All of this innovative — if not enlightened — local regulation in California is occurring without accurate local knowledge of the number of conversions and the causes. In California, every conversion project must be registered with the California Department of Real Estate, and a new or converted unit cannot be offered for sale until it has reviewed the disclosure information provided by the developer and issued a public report that must be available to each unit purchaser. Securing the review and consent of the California Department of Real Estate is usually the last step prior to marketing and sale.

Because local ordinances adopted in California are usually more restrictive and problematical than the California Department of Real Estate requirements, an application for the public report required by the California Department of Real Estate is submitted only after securing local government review and approval of a conversion project. Table 8 compares the number of conversions approved by the California Department of Real Estate and by selected California local governments in 1978. In each case a much greater number of units were given local approval than state approval in 1978. In some cases (particularly Los Angeles, San Diego and Walnut Creek) the discrepancy is remarkable. Because developers proceed to obtain local approval before state approval, some of the discrepancy may mean that units given local approval in 1978 will become units applying for state approval in 1979.

TABLE 8

APPLICATIONS FOR CONVERSIONS IN SELECTED CALIFORNIA CITIES

Jurisdiction	Units Approved by Department of Real Estate (1978)	Units with Local Approval (1978)	Total Rental Units
Culver City	778	1,508	6,489
Los Angeles	488	3,819	1,159,642
Oakland	229	665	80,198
San Diego	1,669	6,500	127,000
San Francisco	829	1,027	220,000
Santa Monica	446	1,685	36,000
Walnut Creek	150	1,150	6,150

Source: *Condos, Co-ops, and Conversions: A Guide on Rental Conversions for Local Officials*, State of California, Office of Planning and Research, 1979, p. 4.

Condophobia is so strong in California that many owners of apartment buildings file for local approval without any concrete plans for immediate conversion. Owners and developers fear that local regulation will become more restrictive in the future so they apply for approval now rather than risk future moratoriums or even more serious restrictions. That is often a self-fulfilling prophecy in California because local officials, receiving a larger number of applications for approval of conversion plat maps, are then pushed by local tenant groups to adopt even more restrictive limitations.

DEBUNKING CONDOMANIA AND CURING CONDOPHOBIA: THE NEED FOR ACCURATE DATA AND MARKET UNDERSTANDING

The legal justification for tough restrictions on conversions usually boils down to two key arguments. First, there is a rental housing emergency in a particular city as evidenced by a very low (less than 5%) vacancy rate. Second, conversions make a significant contribution to this rental housing emergency by removing apartments from the market. Although the methodology and the quality of the data that determines the vacancy rate used by tenant groups to argue the existence of a housing emergency can often be effectively attacked, the more significant point to remember is that rent control and other local police power regulations to alleviate a perceived housing emergency are only justifiable if their purpose is to alleviate a hardship on low- and moderate-income renters. Very restrictive local regulation or outright moratoriums may be unreasonable and therefore illegal if either of the following is true: first, there is no rental housing emergency; second, condominium conversions do not contribute to an existing rental housing emergency for low- and moderate-income families; third, even if there is some limited effect of conversions on the supply of low- and moderate-income housing, the benefits may so outweigh the marginal effects as to make overly restrictive regulation unreasonable.

A precise count of the number of past and present conversions in a particular market is absolutely critical to the establishment of the second and third legal arguments.

Condominium conversions do not contribute to a rental housing emergency (if one exists): the actual number of units may be substantially less than the city officials believed when they adopted a restrictive regulation. Even if a particular city had a firm knowledge of the number of units in its jurisdiction, their location may be in neighborhoods and buildings in which few low- and moderate-income or elderly tenants lived. That has been precisely the pattern in Chicago where the large majority of conversions occurred in the wealthiest census tracts of the city.

One of the most effective arguments against overly restrictive regulation is to prove that the benefits outweigh the effects, if any, on low- and moderate-income or elderly tenants. The statistical evidence that the increased instance of abandonment and tax delinquency on apartment buildings results from a rental housing investment and income crisis can be called upon to show that conversions may be the only way out for concerned landlords whose income has been eroded by the inflationary effects from expenses increasing more rapidly than income.

The soaring costs of single-family homes both new and used in the United States and in a particular market can be used as dramatic evidence that it is demand for home ownership, particularly among first-time home buyers, that is the real stimulus to the condominium conversion phenomenon. Fostering the ability of Americans to own their own home is as important a public purpose as protecting the ability of tenants to afford rental housing.

Condominiums may have a variety of other effects in a particular community. Conversions may prompt dislocated tenants to seek rental housing in another neighborhood, thereby improving the character and quality of another part of the city. There may be important property tax benefits to a city from the conversion process due to the difference between assessed valuation of a building as an apartment building and the combined assessed valuation of the individual units in that building after conversion.[16]

The need for accurate information has been made even more urgent by the introduction in Congress of legislation that proposes a three-year nationwide moratorium on condominium conversions, creation of a Presidential Commission on Problems Relating to Condominium Conversions, and a prohibition on federal community block grants to communities that do not either restrict conversions or develop some plan to guarantee "adequate rental housing" to displaced low- and moderate-income tenants.

CONCLUSION

The reason for the recent surge in local and national legislative efforts to severely restrict conversions is that the American public and its elected officials have become convinced that condominiums are a mania, a craze, a fad artificially created by landlord avarice and wealthy developers. Public opinion will be changed only if the facts about condominiums, rental housing investment, and the demand for home ownership are more effectively presented by the real estate industry. The statistics on the lack of investment in rental housing in the 1970s, the effect of inflation on the landlord's ability to obtain a fair return from his investment, the abandonment and tax delinquency that plagues the rental housing market in so many major cities, and the real number and location of condominium conversion units, as well as the fluctuations in the supply and demand for condominium units due to market factors, must be marshalled to convince the American public that tales of "condomania" are nothing more than evidence of "condophobia."

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How to Prevent and Defeat Rent Control

by James R. Webb

Rent control recently has become a topic of urgent concern and with good reason. Vacancy levels have decreased nationally but builders are hesitant to build if rent controls seem likely in the near to intermediate future. Even at current levels, rents have not nearly kept pace with inflation. While the Consumer Price Index has increased 107% since 1967, the rent component has increased only 71%. Many apartment complexes do not break even (no negative cash flow) until after the first two rent raises which usually occur at yearly intervals.

The prospect facing much of the nation is a shortage of rental units due to lack of building and removal of rental units from the market through demolition and conversion to condominiums. Prospective landlords are neglecting to build because of their fear of rent control, and current landlords are getting out of the business by converting to condominiums for similar reasons. The fear of rent control is affecting areas where controls have been only discussed, but not enacted.

Rent control in some form has already afflicted many communities in the United States in recent years.[1] Among them are Boston, Cambridge and Brookline, Massachusetts; Miami Beach, Florida; Washington, D.C.; Los Angeles, Berkeley, Davis and Santa Monica, California; Montgomery County, Maryland; and numerous small towns in New Jersey.[2,3] Nevertheless the threat may not be as great as many have hypothesized (as far back as 1969[4]).

This is not to say that rent control is not a disaster to everyone involved in the long run, but that rent control can often be defeated or, better yet, circumvented if appropriate actions are taken. However, rent control does seem attractive to tenants in the short term because few understand the intermediate and long term effects.

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CONDITIONS LEADING TO RENT CONTROL

Two key factors are necessary in rent control situations — the presence of a large percentage of renters in relation to the total population of the area and landlords who use their power to price gouge in a market with a low vacancy rate. However these factors are not sufficient to cause the enactment of rent control.

A large renter population helps carry the vote at the polls and/or helps put sufficient pressure on elected officials. "College towns" (i.e., towns where a large percentage of the populace is composed of student renters) and cities with many elderly renters on fixed income retirement pensions are prime examples. Berkeley, California and Miami Beach, Florida, for example, have both had rent controls enacted.[5] In Washington, D.C., where 74% of the residents are renters, rent control was enacted in 1974.[6]

Rent gouging is also an invitation to rent control. Some property owners blatantly use low vacancy levels as an excuse for excess profit. Stories of rents doubling and even tripling in one month are occasionally heard. In May 1979 an apartment tycoon in San Francisco raised rents in his 1,100 units by as much as 62% and flatly rejected a plea by the mayor to roll them back.[7]

Rapid price increases may be warranted by the economics of the situation but are fraught with danger even when rent gouging is not present. Each month people live in their selected urban space (apartment). They pay rent and receive certain services. Then upon a certain date (expiration of a lease, etc.) they are told they must pay more for the same space and same services. Rent increases significantly smaller than inflation generally can be justified, but those approaching or exceeding the general inflation rate cause extreme financial realignment for most families.

For the majority of the population, income has not been increasing as rapidly as inflation. The price of everything is increasing but the causes for increases in food, utilities and clothing either cannot be easily identified or seem too large to deal with effectively. Rent, which is a major portion of every budget, and, therefore, the landlord, who is readily identifiable, become easy targets for retribution. A chance to influence rents, even if the result is self defeating in the long run, is an extremely attractive opportunity for renters.

RATIONALE FOR RENT CONTROL

The reasoning supporting rent control movements generally consists of one of two related arguments.

1) Rental units have been in short supply and landlords have been charging over the fair market rentals that usually prevail (rent gouging). Therefore rent control is needed to restrict prices to fair market levels.

2) Rent increases have been significant and steady (even though perhaps in line with inflation). The poor and especially the elderly poor who are

on fixed incomes cannot pay the continually higher prices. Therefore rent control must be enacted to protect the poor and/or those on fixed incomes.

Either way the result is rent control. Economic theory would dictate that ideally rents be raised to acquire economic profit (profit over and above a "fair" rate of return) when the number of units available declines below normal vacancy levels (see Appendix). However, this set of circumstances often sets the stage for a rent control movement.

Renters caught in these circumstances do not care about the economics of the situation. All they see is their rents rising at rates higher than inflation. The fact that there are people in the marketplace that will pay the new high rents is no consolation to people who are forced to leave their apartments. The paradox is that the high rents will last only until more units are supplied. Then prices will adjust downward (in real terms) and the people previously forced to move can move back again (see Appendix).

But people on fixed incomes are hurt by any rise in rents regardless of the purpose. They simply must do without something (frequently food) if they wish to consume the same housing. The alternative is to change their residence to a less costly apartment.

CONSEQUENCES OF RENT CONTROL

Rent control advocates espouse numerous benefits that are to come with the elimination of rent increases or by allowing increases only under set conditions. The most common are the prevention of rent gouging and the alleviation of rising rents for the poor. In the short run both of these are accomplished. If rent gouging is occuring, controlling rents at a specific level will eliminate it. Secondly, rents of poor people will not rise. However, there are other less immediate, but serious effects.

Rents will not rise for people that are *not* poor either. What constitutes being poor? If rent level is used, then where is the line drawn? Is $250 a month considered poor and $255 a month middle class? In New York rents were decontrolled upon vacating.[8] The new tenant had to pay the market rent. But since poor people had less stable employment and moved more often, they were usually paying market rents. Stable middle class tenants in New York were reaping the benefits instead of those for whom the benefits were intended. This is an intermediate term effect that is not immediately obvious in a rent control scheme.

The consequences of rent control center around five possible situations, but every rent control plan has its own peculiarities.

The most immediately visible consequence of rent control is "longer lines," that is, people must spend more time searching for a space, location, etc. that they find agreeable. (This assumes that the market rents would be higher than the controlled rents. If the controlled rents were the same as market rents, the market would operate as if no controls were present.)

Because rents are controlled the incentive to use space efficiently is diminished. For example, even if people need less space, they will not move because it may (if rents are decontrolled upon vacancy) cost more to do so.

Secondly, bribes may be paid. "Key money" in New York was a well known part of apartment searches.[9] Bribes can be in the form of goods, services or cash. If willing to break the law, the landlord can get closer to a market rent and a market rate of return by engaging in bribery.

Controlled rents also allow landlords to discriminate without penalty. In the absence of rent controls, if a family with three children wanted to rent and could pay the requested rental, a landlord would have to lower the price to quickly attract another tenant or leave the unit vacant longer to find the "desired" tenant. In a rent control situation, there may be two, three, four or more prospective tenants. Because the landlord can charge only the controlled rent, he or she can now "discriminate" by selecting the tenant they personally desire instead of the one willing to pay the highest price.

Bribery and penalty-free discrimination are evident in the immediate term following the enactment of rent controls but become increasingly pronounced as the controlled rents diverge more from market rents.

Another consequence of rent control that becomes evident in the intermediate term and grows more serious in the long term is maintenance. Landlords simply neglect building maintenance in an attempt to attain a fair rate of return for their investment. Non-maintenance is removal of capital from the property. Since cash flows cannot be increased by raising rents, the principal is reduced instead. The idea is to reduce the capital to the point that the diminished cash flow permitted by the controlled rents represents a fair rate of return. The result is rapid deterioration of most rental properties affected by rent control. In New York City over 30,000 units per year are being abandoned rather than being maintained and taxed.[10, 11, 12]

The administration of a rent control law is costly also. Eventually all taxpayers, perhaps single family homeowners more than others, share in the cost of a new bureaucracy as the assessed valuation of rental units decreases due to rent controls. The single family homeowner whose property is increasing in value must pay a higher percentage of the total tax bill to maintain the same service base as before.

The last and the most serious result of rent control is that new multi-family units are never built to expand the supply. This expansion of the supply is generally what was needed in the beginning and the resulting shortage of units is what encouraged the rent gouging. Otherwise the market situation would have financially "punished" the behavior of those who engaged in rent gouging by leaving them with unfilled apartments.

As buildings deteriorate more rapidly when rents are controlled and are torn down, new buildings to replace them are never built and in the long run the shortage becomes even worse. In New York City in 1969, the average real estate broker could find units for only one out of every 100 applicants.[13]

REMEDIES TO RENT CONTROL

Prevention. It is better to prevent a rent control movement than to have to defeat it at the polls or in court. There are several stratagems which can be used.

1) Establish a local "landlord association" to act as a clearing house for information, etc. This can be done independently or preferably with a local Realtor organization. A combined group yields more political clout as well as more rapid dissemination of information.

2) In conjunction with the landlord association (and its rent control subcommittee if one exists) set up an informal rent appeals board. Although the board has no legal authority, it allows tenants to "let off steam" through a nondestructive channel. The effect of the rent appeals board is based only on moral suasion and peer pressure. However, because an angry tenant believes someone has listened and is aware of the problem, tension (which encourages rent control) is alleviated.

3) At regular intervals encourage local newspapers, magazines and other media to publish articles that explain the damage caused by controlled prices in general and by rent control in particular. If news people cannot be persuaded to write the articles, perhaps a committee member with writing skill or a local university professor can be hired. The information can be presented in the form of a news release or a feature article. The defeat or removal of rent controls anywhere in the United States is a good introduction, i.e., "Rent controls were defeated in Anywhere, United States last month. Inflation is a serious problem, but the people of Anywhere recognized that the damages of controlled prices are even more disastrous . . . ." This is positive propaganda or public relations which may become crucial if a rent control movement begins to gain a foothold.[14]

4) Managers of large projects should periodically take attitude surveys of their tenants. The questionnaire, which should be simple and straightforward, is mailed to the tenants who are requested to complete and return the forms in order to help maintain effective management. To avoid allowing the tenant to identify the survey with rent payments, have the questionnaires returned to a different address and at a different date than those associated with the rent.

5) As expenses rise keep tenants informed about increasing expenses through memos or other notices. Do not wait until it is time to raise the rent. If tenants are aware of signficant changes in the landlord's budget as they occur, a signficant increase in the rent does not come as such a shock as can give rise to rent control movements.

6) An innovation that has not yet been applied to residential property is the graduated payment lease. The way it works is, for instance, instead of raising rent $50 per month for a twelve-month period, raise it $10 each month for the first six months. The remaining six months (of a one-year lease) would be at a higher rate ($5 more than the last

graduated payment) resulting in the same overall increase. By offering tenants a choice between the two, they can select a plan that suits their budget.

In general, whenever possible eliminate or reduce the shock of sudden rent increases before a rent control movement can reach the political stage.[15]

Political action. If preemptive measures were not attempted or did not succeed, the political arena is the next stage. This is an opportunity to defeat rent control if it is handled properly. Rent control advocates often use emotional appeals. A carefully reasoned rational appeal, instead of an emotionally charged one, will be more helpful in convincing people of the worthiness of anti-rent control arguments. A campaign to defeat rent control once it has reached the political arena follows several steps.

1) Get organized and be prepared to spend money to fight. If a landlord association has not been formed, now is the crucial time to do so. Next, money must be raised for hiring people and/or for doing public relations to work against the proposal at hand.[16] (Newspaper articles are an excellent medium for this type of campaign.) An anti-rent control fight in Berkeley, California cost $130,000. In 1977, the California Housing Council, a Los Angeles based landlord group, spent $400,000 to fight rent controls. Detroit public relations firm Simons-Michelson, for a fee, helped defeat rent control in Ann Arbor and East Lansing, Michigan.
2) Focus on the content of the initiative (proposal) and on the specific solutions being recommended. Do not get caught up in people's general economic conditions or in the "big bad landlord vs. poor little tenant" situation. Keep personalities out of the campaign and never attack proponents of the measure on personal grounds. Don't defend rent gougers or any other questionable behavior by landlords. Discuss specific problems as they are brought up and point out why the current proposal is not the solution.
3) Point out the many problems inherent in the proposed rent control and "divide and conquer" by directing your appeal to special interest groups who can be affected by these issues. For example, that discrimination can occur more easily under the disguise of "waiting lists" is important to minority groups; for single family homeowners, the real estate tax burden will increase (as a percentage of the total) as the value of multi-unit housing decreases due to rent control as it is proposed; or for renters who wish to sublet, it may become necessary to receive permission from a government board. It is also important, especially in college towns, to explain how rent control can cause deterioriation of property. Include a list of expenses that have increased recently and point out that if renters want to live in well maintained housing, it must be paid for.
4) Lastly try to get an automatic expiration date written into the proposed legislation. If rent control advocates admit rent control is not a long term solution, then an automatic expiration of the current initiative is a logical inclusion. This puts the burden to get the legislation extended on the rent control advocates again sometime in the future.

Reaction to voting results. If the rent control proposal was defeated, move to correct or alleviate those abuses that originally incited people to action. Also set up the machinery to assure that any abuses in the future are defused before reaching the political stage. If this is not done, a repeat of the campaign just completed may become necessary again in a few years.

If the rent control proposal was passed, there are still some alternatives. The best remedy at this point is an appeal suit. Controls sometimes can be attacked as being confiscatory without due process if the law is carelessly drawn, if it is too strict or if rent boards are too slow in acting.[17] Controls that are constitutional under federal law can still be unconstitutional under state law as in Madison, Wisconsin and in Philadelphia, Pennsylvania.[18] Courts struck down the Berkeley, California rent control measure that was passed at the polls in 1972. Controls in Miami, Florida and Washington, D.C. are being fought based on U.S. Supreme Court decisions that date back to post-World War I requiring the existence of a "housing emergency" and a "reasonable rate of return," neither of which are defined.

OBSERVATIONS AND CONCLUSIONS

Rent control seems to be regarded universally as harmful in the long run to the goals of most rent control advocates. Nevertheless, rent control movements continue to form periodically. Many of them seem to be overshadowed by an emotional appeal based on a few "war stories" concerning rent gouging or seemingly unjust evictions due to nonpayment of rent.[19] However, consistent high rent raises at the inflation rate or larger will also outpace most tenants' income and will quickly result in a rent control initiative. This often happens when there is a shortage of housing units available for rent.

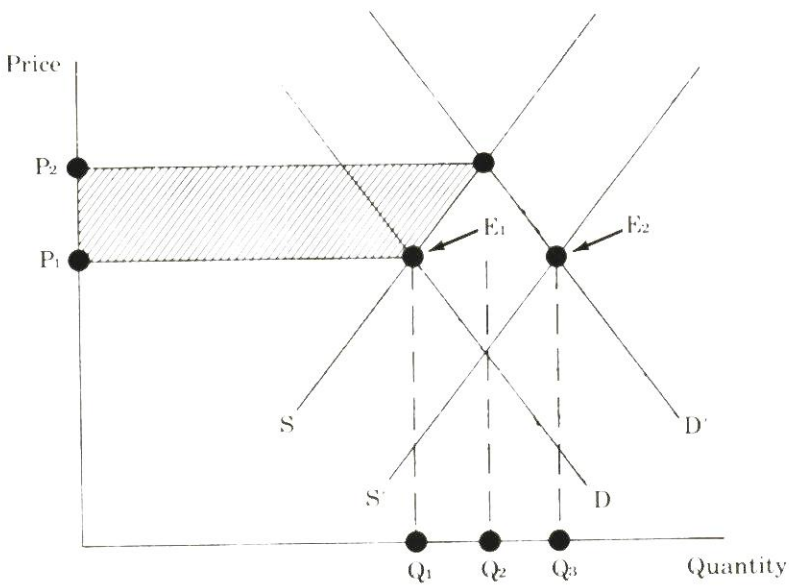
Therefore, by not building rental units, builders may contribute to a shortage of units and may indirectly set the stage for the next rent control movement. There are ways that building can be continued and risks can be minimized in relation to rent control. The first is by constructing buildings with fewer units. Single family, twinplexes, triplexes and four-family structures have been exempt under many rent control laws. This allows rents for these types of units to stay in line with the free market mechanisms. Secondly, large projects should be built with ease of convertibility to condominiums should the need (rent control) arise; that is, build for a market in which condominium conversion would have a high probability of success if necessary.

Both of these alternatives exclude low income groups, who are often the excuse for having rent controls, but are generally the group most harmed by them. In some cases the possibility of rent control enactment is damaging to low income groups because builders stop building when they fear enactment in the future. People on fixed incomes, especially the elderly poor, are harmed by rent increases also. This is a social and economic problem that seems best dealt with through an income or rent subsidy from the government or through government incentives to lenders and/or investors for low and moderate income housing.[20, 21]

Even when rent control proposals and laws allow for a "reasonable rate of return," the result is absurd. Generally the return allowed is 6-8% on assessed value after operating expenses but before debt service.[22, 23] This amount of return hardly induces investors or lenders into a real estate venture with millions of dollars of sunk capital involved. The reduced return will also quickly reduce the value of existing property subject to rent control.[24]

Sweden and England are both moving toward market control of rents after decades of rigid rent control.[25, 26] Hopefully the majority of the United States will not have to endure the unmitigated disaster of New York City or the failure of Sweden and England to learn the consequences of rent control.

APPENDIX



Economic theory argues that if a shift in the demand schedule from D to D' (generally evidenced in a free market by a reduction in the vacancy rate below 5%) takes place, then the price should rise to P_2 from P_1. A short term increase in units would occur as the quantity expanded from Q_1 to Q_2. The economic profits (P_2-P_1) would then act as an incentive for builders to expand housing in the long-run to Q_3. At Q_3, the price is back in equilibrium with the quantity expanded by Q_3-Q_1 units.

However, the point at which economic profits begin is the same point at which rent control becomes easy to justify for all but the landlord and some academics. This is especially true since many of the effects of rent control (i.e., non-maintenance and lack of new units being built) become evident only in the intermediate to long term.

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Mortgage Usury Ceilings—Statutory Denial of Home Ownership

by James H. Boykin

There has been considerable debate on the issue of state-imposed usury ceilings in recent years. This issue, affecting so many people, abounds with contradictions, paradoxes and inconsistent logic — all of which hinder rather than help the consumer. Usury laws are not new but due to an unrelenting high level of inflation we are more keenly aware of them. The intent of such laws is quite justified. Nevertheless, their adverse influence has been startling in recent inflationary periods.

It may be helpful to review the meaning of usury and its historical evolution prior to grappling with the nature and effects of state-imposed usury statutes.

USURY IN ANCIENT TIMES

Usury is defined as interest charged in excess of that rate permitted by law. Although regulated by law, usury is influenced by ancient philosophical and religious attitudes. As early as 1800 B.C., Hammurabi, a king of the first dynasty of ancient Babylonia, gave his people the earliest known formal code of laws. All loans had to be accompanied by written contracts witnessed before officials. If a higher than legal interest rate was collected by subterfuge, the principal of the debt was cancelled. From around 450 B.C., the famous Roman Twelve Tables, a codification of law, also dealt with usury. Interest on loans was limited to no more than 8 ⅓% per annum. Higher than legal interest was penalized by fourfold damages.

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Along with the early development of money and credit, there also grew abuses and prejudices. Most of the earliest legal codes sought either to prevent the abuse of credit or to prohibit its use. The Israelites did not permit lending at interest. As late as 450 B.C., the Iranians considered it dishonorable to take interest on a loan. The Babylonians and Romans permitted credit, but limited the rate of interest. The Greeks encouraged credit without a limit on the rate of interest but forbade personal bondage for debt.

It was not until the eleventh century, when European buying and trade revived, that the Roman Catholic Church's doctrine on usury was examined in detail by scholars and the prohibitions were spelled out by church authorities. Usury was then declared to be a form of robbery, a sin against the Seventh Commandment. Pope Eugene III decreed that "mortgages, in which the lender enjoyed the fruits of a pledge without carrying them towards the principal, were usurous." Restitution was required as in theft.[1]

EARLIER EFFORTS OF GOVERNMENT AID TO HOME OWNERS

The Homeowners' Loan Corporation (HOLC) in 1933 signaled the creation of a national secondary mortgage market. A year later, the Federal Housing Administration (FHA), which helped to establish a national mortgage market, came into being. Both of these governmentally-created agencies became a powerful force in encouraging home ownership for Americans. Due in large part to the efforts of these agencies, home ownership climbed from 45.6% in 1920 to 64.6% by 1975.[2]

CURRENT USURY LAWS

Usury laws today are about as diverse and uncoordinated as seemingly possible.

Perhaps more so than in the past, state legislators are especially concerned with protecting individual consumers from exorbitant interest rates. In striving to accomplish this objective, both individual and corporate consumers frequently are hurt by unrealistically low interest rate ceilings. Implementation of such state usury ceilings creates far more problems than it solves.

Governmental efforts that encouraged home ownership a half century ago have been substantially undermined by legislated state usury ceilings. In earlier periods of moderate inflation and interest rates, there was a relatively unfettered flow of mortgage funds from slow growth, capital surplus regions to rapidly expanding, capital deficit areas. Imposition of state controlled interest rates has set up artificial barriers, inhibiting the free flow of mortgage funds that was intended by the creation of HOLC, FHA, and later mainstays of the secondary mortgage market, FNMA and the Federal Home Loan Mortgage Corporation (FHLMC).

Consider, for example, the following jumble of state usury ceilings in the first five states alphabetically from a digest prepared by the Mortgage Bankers Association of America as of November 30, 1979.

MAXIMUM STATE STATUTORY INTEREST RATES
FOR FIRST MORTGAGE LOANS

State	Maximum Basic Rate	Comments
Alabama	8% add-on for home mortgage loans	Interest equalization bill passed by the legislature was struck down in the courts. Exemption for FHA/VA loans.
Alaska	Variable	5 percentage points over the discount rate charged by the 12th F.R. district. No limit loans over $100,000. Exemption for FHA/VA loans.
Arizona	12%	Exemptions for FHA/VA loans.
Arkansas	10%	Business and agricultural loans over $25,000: 5% over Fed 90 day commercial paper rate.
California	No limit	Loans by regulated lenders including licensed real estate brokers. Exemption for FHA/VA loans.

Even this partial listing of state usury standards clearly depicts the incongruity of state usury laws. An even more acute situation is caused by stringent usury laws that exist in fast-growing states. Most of these are "Sun Belt" states which have high levels of inmigration from other parts of the country. With so much of this population growth prompted by inmigration, the demand for housing is more acute than from increases in existing (and already housed) resident households.[3]

OTHER PRICE FIXING SITUATIONS

There is an inherent weakness in governmental efforts to intervene in the normal distribution of goods and services via private enterprise. Well-intended but short-sighted efforts to substitute the will of government in place of the collective judgment of producers and consumers often have had harsh consequences for the intended "protected" groups as well as for other individuals. One cause for this suffering is the tendency for such legislative action to treat only one dimension of a complex economic issue. These profoundly extravagant governmental efforts have been properly labeled by Senator Thomas F. Eagleton as "panacea politics, the quick fix or instant solution."[4] Such efforts may seek to limit increases in costs to consumers or raise workers' wages while ignoring the impact of such changes on operating costs of producers or the eventual passage of these increased costs onto consumers. Examples of some of the failures of such price-fixing efforts follow.

FEDERAL MINIMUM WAGE CONTROLS

Consider federal minimum wage controls which exert an upward push on the cost of doing business. The intent of setting a minimum wage over the past 41 years has been to improve the lot of the workingman. Has it succeeded? What has been the result of the minimum wage bill passed by President Carter in 1977 which increased minimum hourly wages from \$2.30 in 1977, to \$2.90 in 1978, to \$3.35 by January 1, 1981? The National Restaurant Association in an interview of its 2,000 members found that after the minimum wage was increased on January 1, 1978, 95% of the members raised their prices, 78% reduced man-hours, and 63% laid off people. More than one-half indicated that they had invested in equipment that would reduce their labor force.[5]

The Marriott Corporation found that the upward pressure of minimum wages just in Washington, D.C., has become so acute that in the past three or four years they were forced to close fourteen restaurants, putting 1,300 people out of work, about one-third of whom were minority youths.[6]

Rather than repeal this economically damaging legislation, the federal government creates make-work programs like CETA — the Comprehensive Employment and Training Act. This program alone was expected to grow by \$135 million in 1979 to help offset the job dislocation caused by the minimum wage increase. J. Willard Marriott, Jr., has pointedly criticized this legislation. "In the end, the minimum wage practically wrecks the people it is supposed to help."[7]

RENT CONTROL LAWS

Have rent control laws been any more successful in assisting a "protected" group than minimum wage laws? No! In fact, the dismal failure of governmental intervention in rent control may prove to be even more damaging than wage controls. Rent control provides a shortrun political solution to redistributing wealth from property owners to tenants at apparently no cost to a municipality. In the long run, however, it exacts a heavy price from society. Property owners, trying to bring operating costs in line with income, allow their properties to deteriorate. Building and health code violations follow. Neighborhood blight occurs. The exasperated owners either abandon their properties or convert them to condominiums, usually too expensive for tenants to purchase. The tax base is diminished while the level of public services increases. Also, the deficit in tax revenue must be passed onto home owners and businesses, putting more pressure on these groups to leave the city. Investors refuse to build new apartments in such a hostile environment, leading to housing shortages.

Consider the following track records. By 1948, after 30 years of rent control in Paris, dilapidation was rampant. There was virtually no new construction, and properties could not be sold because of negative returns.[8]

The British experience with rent controls has resulted in no significant housing being built since World War II, except luxury units. In 1947, the private rental sector accounted for 61% of dwellings; thirty years later this share had fallen to 14%.[9]

Similar disappointing results have occurred in Sweden, Holland, and in New York City and Washington, D.C. Abandonments in New York City are occurring at the rate of 20,000 units per year.[10] For Washington, the construction rate dropped 92.4% after rent controls became effective.[11]

A survey of 2,351 controlled apartment units in New York City reveals a fundamental reason for realty investors to avoid rent control cities. From 1970 to 1975 operating costs increased 56.3% while rents increased only 35.6%.[12]

The chronology of events associated with rent control has been: 1) the quality of housing suffers and the quantity is reduced, 2) the private ownership sector withdraws, and 3) the government (using tax dollars) attempts to provide housing.

INTEREST RATE CEILINGS FOR FHA/VA MORTGAGES

A national parallel to state usury laws is the congressionally imposed interest rate ceilings for FHA and VA insured and guaranteed mortgages. By placing ceilings on these federally-sponsored loans, buyers are deprived of using programs which were intended to encourage home ownership through low downpayments. Whenever FHA/VA interest rates lag conventional loan interest rates, the seller is forced to pay discount points to the lender in order to increase the yield on these government-sponsored mortgages to match conventional loan yields. At times these discount points can place a discouragingly severe burden on a seller, so much in fact that many sellers refuse to sell their homes via FHA or VA secured mortgages. These seller-paid discount points can easily reach 3 to 6% of the face amount of a loan. For a $70,000 loan an owner, in addition to having to pay up to 8% of the sales price in sales commission and closing costs, would be required to pay $2,100 to $3,500 in discount points to sell his home.

A similar aversion to be bound by price controls occurs in states where usury laws cause unprofitable mortgage loans. Funds are diverted from a state's mortgage market to other usury-free states or into alternative investments that produce acceptable yields.

EFFECTS OF STATE USURY LAWS

A summary of some recent studies made on the effect of usury ceilings on mortgage lending when market rates exceed usury ceilings follows.

1. A significant increase in out-of-state morgage lending activity occurs at the expense of states constrained by usury ceilings.[13] This funds shift

would be expected of financial intermediaries that are required to invest a specified amount of their assets in mortgages. Lenders not so encumbered simply shift to non-mortgage investments or to mortgages not subject to such price controls. By redirecting a share of these assets into non-mortgage investments, the share of lenders' assets held in mortgages is reduced.[14]

A paradox of this effort to benefit the housing consumer is that it assists an unanticipated group. The targeted consumers in the usury state are denied mortgage funds except on unfavorable terms. The infusion of additional capital into "free market" states raises the supply of mortgage funds in relation to demand. Hence, prospective home owners in unregulated states may obtain favorable mortgage interest rates at the expense of frustrated buyers in usury controlled states.[15]

2. Residential real estate market activity declines. One study in Philadelphia showed a 23.1% decline in single family, residential mortgage lending volume by insured savings associations when a one percentage point change occurred between the Philadelphia and national effective mortgage interest rates.[16] A deterrent to originating below-market interest rate loans is the subsequent difficulty in selling them in the secondary market.

3. More stringent credit rationing occurs in such forms as larger down payments and shorter repayment periods,[17] often with lower income persons being squeezed out of the market. A recent survey clearly reveals this problem. Over half of first-time buyers under age 30 paid less than 20% down on their home. These home buyers represent almost 63% of all first-time home buyers. Nearly a third of these young home buyers entered the home market by means of a 90% or 95% mortgage. It further was revealed that about 45% of first-time home buyers had family incomes less than $15,000 while 54% of home buyers with family incomes between $15,000 and $25,000 paid less than 20% down on their homes. These combined groups represent 71% of all first-time home buyers.[18]

4. Discount points may be charged to the buyer or seller when permitted by state law — reducing the sale profits to the seller or sharply increasing the buyer's down payment. Other means used to increase yields to competitive levels are reducing the loan term and requiring larger down payments. Any of these devices impairs the ability of lower income home buyers to purchase homes.

5. Housing construction is lower in usury-affected states than in those states where mortgage lending is uninhibited by these controls. Various studies have shown this decrease to range from 11 to 23%.[19] Most of the declines varied from 14 to 19%[20] with Ostas observing a 14.4% reduction in permit activity for every one percentage point difference in free market rates and usury rates.[21] Similarly, Robins found that an increase in the statutory ceiling of one percentage point leads to about a 16% increase in single family starts.[22]

Builders and ultimately home buyers suffer in other ways from relatively low usury ceilings. Home builders, if required to pay discount points, can pass the added cost onto buyers or reduce the size, amenities, or quality of construction. Either of the alternatives may discourage prospective buyers and in turn reduce the volume of housing starts.

6. Lower income families are especially affected by stringent loan terms. For example, in Canada during 1963-67, when interest rates on government-insured loans fell under that of conventional loans, only 13% of the Canadian government loans were made to persons in the bottom third of the income distribution compared to 30% during 1971-75 after the usury ceiling had been lifted.[23] Thus, these prospective home owners feel the pain of this "helpful" legislation. Another group also suffers from these interest rate ceilings. Persons who could afford to pay the prevailing interest rates are denied mortgage funds because of the debilitating influence of such laws.

7. Corporations exempt from usury laws can contribute to a shortage of mortgage funds for individuals. The rationale for this exemption seems to be that corporations, or in some cases loans in excess of some dollar amount, have ample expertise available to protect their interests in any mortgage agreement. Thus, another perplexing situation arises. By the larger borrowers being exempt, funds are diverted away from small borrowers. Alternatively, as in some states, corporations or large borrowers are treated essentially the same as individual mortgagors. The question raised in this situation is why does a large, well-staffed borrower quite capable of protecting itself in negotiating for a mortgage loan need the "protection" of usury ceilings?

USURY CEILINGS UNDER ATTACK

Many of the state usury ceilings either had never been changed or were altered only in recent years as they caused hardships to prospective home owners in this era of sharply rising interest rates.

Today, with unrelenting inflationary pressures pushing the cost of housing up, virtually any housing price controls would seem desirable. Yet usury rate laws are so diverse that they frustrate the free flow of mortgage funds between states. The following digest of present usury laws as of November 30, 1979 according to information developed by the Mortgage Bankers Association of America shows that most states still have fixed usury limits while very few states have eliminated their ceilings altogether.

STATE MORTGAGE INTEREST RATE CEILINGS[24]

Fixed Rates	Variable Rates	No Limit
24 (48%)	16 (32%)	10 (20%)

Ceilings for fixed rate states tend to be set at 12%, followed by several states which have an 18% ceiling; overall, the ceilings range from 10 to 21%. FHA and VA loans commonly are excluded from the ceilings except in Utah where only FHA-insured loans are exempted. Connecticut, with a 12% ceiling, places no limit on realty loans over $5,000. At the other extreme, Hawaii has no limits on loans over $750,000.

In the past few years, a strong trend has developed toward use of floating rate ceilings. The first state to introduce this type of ceiling was Delaware in 1974. Two more states were added in 1975; just three more were added from 1976 through 1978, but in 1979 twelve states switched to floating rate ceilings.

Exemptions from usury ceilings are effective until certain future dates in some states (Illinois and South Carolina) and over specified dollar amounts in other states (Kentucky and North Carolina). Massachusetts has no limit up to 20% which is classified as "criminal usury" whereas Michigan imposes an 11% ceiling for non-regulated lenders.[25]

FLOATING RATES

The inability of lenders to make mortgage loans has prompted some state legislatures to opt for floating, or indexed, interest rate ceilings. Floating rates are not new. Variable interest rates have been available at California savings and loan associations since 1961 and from the Federal Land Banks since 1972. Even earlier, variable interest rates on construction loans were available via periodically adjusted interest rates that were 3 to 5 points above prime interest rates.

The two most common bases for setting floating interest rate ceilings have been U.S. Government bond rates and the Federal Reserve discount rates. Despite generally favorable reaction to efforts to replace fixed interest rate limits with floating rates, a lingering question remains. Are these indexed ceilings sufficiently high to alleviate curtailment of high risk mortgages during high interest rate periods? An ideal index would continually provide an ample margin so that mortgage lending activity is sustained and the interest rate can be adjusted frequently enough to prevent interruption of mortgage lending activity.

Of the eighteen states using indexed usury ceilings on November 30, 1979, the following breakdown was revealed.

CHARACTERISTICS OF INDEXED USURY CEILINGS

Index (no.)		Point Spread	Frequency of Adjustment
Federal Reserve Discount Rate	(5)	3-5%, generally 5%	monthly, quarterly, or rate in effect at date of executed contract
Long Term U.S. Bonds (generally 10 year)	(9)	1.5-3%, mostly 3%	generally monthly on 20th day of preceding month
Average Yield for FNMA Conventional Auction in month	(2)	.25 & 2%	monthly
Lowest Daily Prime Rate of 3 Largest U.S. Banks	(1)	2-3.5%	monthly
Premium Interest Over Maximum Time Deposits	(1)	5.5%	

Source: Mortgage Bankers Association of America.

In Minnesota it was discovered that its rate ceiling was too restrictive when set just 200 basis points above the yield on long-term government bonds. Similar experiences occurred in Vermont and West Virginia.[26] Other states, such as Iowa, found that by allowing only quarterly ceiling adjustments, periodic mortgage capital shortages occurred. State floating ceilings are more responsive to borrowers' needs when they are pegged to prime rates or commercial paper rates because these rates are dictated directly by market forces instead of fiscal policy. The ceiling also must be set sufficiently high, perhaps 25 to 50 basis points over the prevailing average conventional mortgage interest rates, on newly-built homes so that higher risk (e.g., 95% loan-to-value ratio) mortgage loan activity is unimpeded.

Congress has been involved in changing state usury provisions. For example, H. R. 2515, signed into law by President Carter, overrides the usury law in Arkansas which affected business and agricultural loans over $25,000. A Senate bill (S. 1988) would grant S & Ls, state banks, and credit unions the lending privileges of national banks which are allowed to make real estate loans up to 1% above the Fed's discount rate. H. R. 2282 provides an exemption from state usury provisions for VA loans if FHA insured loans are exempt by state law.

A strong case can be made for eliminating mortgage ceilings altogether as already done in ten states (with certain exceptions). A step in this direction is made by Congressional bill H. R. 4986 which would override state usury restrictions for home mortgage loans secured by stock.

CONCLUSION

However salutary the intent of state usury ceilings may be, their result inevitably is counterproductive. Imposition of fixed interest rate ceilings distorts mortgage markets, harming lenders and builders as well as prospective home sellers and buyers. Interregional flow of mortgage capital is disrupted, proving particularly harmful in the fast growing "Sun Belt" states where growth is strongly buoyed by inmigration. The ability to provide affordable housing for this unhoused sector of a state's population largely depends on importation of capital which is thwarted by relatively low usury ceilings.

Minimum wage laws failed to improve living standards of low income workers; rent control laws expected to assist lower income apartment residents worsened the quantity and quality of the housing stock; fixed ceilings on FHA and VA sponsored mortgages deprives home owners of access to mortgage funds. The undeniable fact is that each of these expensive governmental efforts at controlling prices and wages have backfired, doing more harm than good for intended "protected" groups. Moreover, there is no more cause for optimism in expecting state usury ceilings to improve the cost and availability of mortgage funds to consumers than there was in expecting price fixing mechanisms to achieve their objectives.

In the past half dozen years there have been attempts to relieve would-be home owners of the constraining noose of usury ceilings by raising the ceilings, adopting indexed ceilings, or in some states abandoning ceilings altogether. Still, a complex and bewildering array of state usury ceilings confronts prospective home owners. These laws persist even when consumers are protected now as never before by such federal consumer laws as Truth-in-Lending and the Real Estate Settlement Procedures Act.[27] The time has come to replace the outmoded price controls with "ceilings and floors" established by parties transacting business in an open mortgage market. Such a refreshing change would be in the consumers' interest.

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Escrow Accounts at SLAs

by Walt Woerheide

Consumer and political interest in the treatment of escrow accounts has been on the rise lately. In 1978 Mr. and Mrs. Dean Alexander won a case before the Oregon Supreme Court that required savings and loan associations (SLAs) to pay interest on any escrow accounts in which the borrowers had not consented to interest-free use of their money.[1] A similar case is currently pending in Virginia.[2] Since 1972, nine states have passed laws requiring that some minimum interest rate be paid on escrow accounts (these minimum rates range from 2% to 4%).[3] Another state, Illinois, has since 1975 required that mortgagors be allowed to pledge as collateral in lieu of escrow payments a savings account whose balance exceeds the projected annual escrow payments.

Some of the research on the issue of escrow accounts focused on developing estimates of the "average cost" per account and the "average profit" per account.[4] Little attention was devoted to the role of the escrow account as one component in the package of terms that make up a mortgage contract. This article analyzes the role of the escrow account as an economic instrument employed by the mortgage lender, and provides statistics on the treatment of escrow accounts at SLAs in each state.

THE ESCROW ACCOUNT AS ONE FACTOR IN A LOAN OFFER

Many factors are considered by an SLA in an mortgage loan offer. The primary factor is the contract rate, but other terms include the number of points to be charged, an assumability clause, and the terms for prepayments. Another factor is the method in which borrowers handle their property taxes and insurance premiums. Lenders may allow the borrowers to pay the property taxes and insurance premiums themselves or the lenders may require the establishment of an escrow account.

In a mortgage loan offer, the terms are expected to maximize the lender's profit from the transaction. In a normal competitive environment, two constraints restrict lenders from being usurious. The first, and probably

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most important, is that if the terms of the mortgage loan are exorbitant relative to the terms offered by competitors, borrowers will go elsewhere. The second is that borrowers may simply not accept the mortgage and defer purchase of the home.

Because of the variety of terms included in a mortgage contract, many different term combinations could provide a lender with the same expected profit on a loan. A lender could offer one borrower a mortgage with a "high" level of points, a "low" contract rate, and no requirement for an escrow account. This same lender may offer a second borrower a mortgage with a "low" level of points, a "medium" contract rate, and a requirement the borrower set up an escrow account on which the lender will pay a 2% yield. A third borrower may receive an offer that contains no points, a "high" contract rate, and a requirement to set up an interest-free escrow account. Despite the variation in terms, the expected profit on each of these loan offers may be the same.

Lenders in each mortgage lending market will set similar terms. It becomes common practice for mortgagees to offer mortgages which require payments into interest-free escrow accounts, and there will be little propensity to change this policy over time. If certain lenders wanted to become more aggressive, loan customers could be attracted by offering interest on escrow accounts. Most lenders have not provided interest on escrow accounts except after legal stimulus, because the treatment of escrow accounts is usually a minor consideration for most borrowers. As a practical matter, to offer interest-bearing escrow accounts is probably a less effective marketing strategy to attract loan customers than other available strategies.

RELATIONSHIP BETWEEN ESCROW ACCOUNTS AND RISK

Previous research has concentrated on estimating the "average profit" per escrow account. This approach has several weaknesses. It assumes that thrifts demand escrow payments because these accounts are profitable which is not necessarily the case. One of the risks in the mortgage lending business is that homeowners will default on their property taxes or insurance premiums. A tax default would create a lien on the mortgaged property to which the mortgage is subordinated. A failure by the borrower to pay an insurance premium exposes the lender to the risk that the collateral could be destroyed and the borrower might default with little recourse to the lender. A prudent lender will establish a monitoring system to ensure the payment of the taxes and premiums. The FHA requires that all loans it insures include a pro rata portion for property taxes and special assessments in the monthly payment. Some lenders apply for and obtain exemptions from the FHA. As of June 30, 1979, there were 166 SLAs which had FHA mortgages and did not have escrow accounts.[5]

Two monitoring systems are currently used. One is that the lender requires the borrower to submit receipted tax bills, or the lender refers to the county or municipal records at stated intervals.[6] The other is that the lender requires escrow payments. If the latter procedure is used, three methods may be set up: 1) an interest-free escrow account, 2) an interest-yielding escrow account, or 3) the escrow payments may be capitalized.[7] This last alternative is equivalent to the borrower receiving interest on his escrow account at a rate equal to the contract rate on the mortgage. The lender is not restricted to use any one procedure for all of its loans, and many use a combination of these monitoring procedures.[8]

Most lenders select the monitoring method which maximizes the expected profit for each loan. If a loan applicant has substantial wealth and asks for a low loan-to-value mortgage, then the lender may believe the risk of property tax default or premium lapse is small and the loan is sufficiently attractive that no escrow payments are requested. In other words, a lender may be willing to monitor city tax records in order to make this loan or may even be willing to forego monitoring altogether. In another case, a lender may believe that a loan to a low-income applicant requesting a high loan-to-value mortgage will have substantial risk of property tax default or premium lapse. Under these circumstances, a lender would probably require payment into an interest-free escrow account to make the expected profit on the loan commensurate with the risk.

The thrifts use a variety of monitoring methods and as the choice is based on economic motives, any computation of the "average profit" per account is misleading. The loans with interest-free escrows will likely be the high risk loans, and the "profit" on the escrow account may be necessary compensation for the riskiness of these mortgages.[9] A study by the U.S. Savings and Loan League showed that 73.5% of the SLAs responding to the League's questionnaire waived escrow payments on some loans.[10]

SIGNIFICANCE FOR MANDATORY INTEREST PAYMENT LAWS

The foregoing analysis has several implications for laws on mandatory interest on escrow accounts. If mandatory interest payments are required, then the cost of monitoring tax payments via escrow accounts rises. The expected profit per loan in which the interest-free escrow account would have been required declines. One of two events will occur: either the lender will alter the other terms in the loan offer to make it more profitable (e.g., an increase in points or in the contract rate), or the lender will not provide the high risk loans that otherwise would have been made.

Another implication is that the impact of mandatory interest payment laws will not necessarily be uniformly felt. The low risk borrowers who had previously been able to avoid interest-free escrow accounts will be unaffected. The high risk borrowers, however, will either find their interest income from the escrow will offset their added mortgage costs or they will find themselves unable to obtain the mortgage. Low income and low wealth households may be excluded from the mortgage market in certain instances due to laws concerning mandatory payment of interest on escrow accounts.

SURVEY OF ESCROW PROCEDURES

The Table provides a state-by-state description of the escrow procedures used by SLAs.[11] Column 1 shows the number of SLAs in each state as of June 30, 1979 that were insured by the Federal Savings and Loan Insurance Corporation. Column 2 shows the number of SLAs in each state which have escrow accounts.[12] One caveat should be noted with respect to the numbers in Column 2. The number of SLAs in each state which have escrow accounts may be less than the number that require escrow payments. The difference is the number of SLAs which capitalize all escrow payments. Based on the aggregate total, 84.7% of the SLAs have escrow accounts. The remaining 15.3% either capitalize the escrow payments or use other monitoring methods.[13] Additional calculations show that in every state, those SLAs that have no escrow accounts are smaller in terms of total assets than those SLAs which have escrow accounts.

COMPARING INDIVIDUAL STATES

Column 3 shows the number of SLAs in each state which have interest-bearing escrow accounts.[14] In all but one of those states which have laws requiring mandatory interest payments on escrow accounts, some of the associations with escrow accounts have interest-bearing escrow accounts. For example, in California 159 of the 174 SLAs have escrow accounts, and 115 (or 72%) of these have interest-bearing escrow accounts. The exception is Minnesota; its law requires interest be paid only on escrow accounts required on mortgages where the loan-to-value ratio is not greater than 80%. Since the law has been passed, almost all of the SLAs in that state have ceased to require escrow accounts on these types of loans.

Nearly one-third of the SLAs in Pennsylvania and fourteen of the sixteen associations in Washington, D.C. have interest-bearing accounts despite the absence of a mandatory state law. The large number in Pennsylvania appears to be tied to consent decrees in recent class action suits. In Washington, D.C., the accounts have been established primarily for loans made in Maryland subsequent to June 1, 1974, when Maryland passed its law requiring interest on escrow accounts.

"CLUSTERING" OF INTEREST-BEARING ESCROW ACCOUNTS

In many states, there is a smattering of SLAs which offer interest-bearing escrow accounts. Three states of note include Illinois where 6 of the 383 associations have interest-bearing escrows, New Jersey where 7 out of 174 have them and Virginia where 5 out of 84 have them. All 5 of the Virginia SLAs are located in the Washington, D.C. SMSA. Three of the 7 New Jersey SLAs that have interest-bearing escrows are in the New York City SMSA, and 3 of the 6 SLAs in Illinois are located in the Chicago metropolitan area.

Two explanations may account for these clusterings. One is that in the cases of Virginia and New Jersey, these SLAs may be providing loans in

Maryland and New York, respectively, and establish interest-bearing escrow accounts on these loans to comply with the respective state laws. The other explanation is that these SLAs may be providing interest-bearing escrows to meet the competition in the adjacent states.

Column 4 shows the number of SLAs in each state which offer only interest-bearing escrows. A comparision of columns 3 and 4 reveals that more than half of the associations with interest bearing-accounts also have interest-free escrow accounts. In most states, it is the larger SLAs which tend to offer only interest-bearing escrow accounts.

Column 5 is a rough approximation of the average annual yield on interest-bearing escrow accounts. The numbers in Column 5 are obtained by multiplying by two the amount of interest paid on escrow accounts during the first six months of 1979 and then dividing this number by the balance in the interest-bearing escrow account on June 30, 1979 for each association. Unusually high or low balances in the escrow account on this date would seriously bias the resultant interest rate estimate. The larger the number of SLAs in each state with interest-bearing escrow accounts, the more reliable the estimate of the interest yield on escrows. Casual observation of Column 5 indicates that the typical rate is in the 2%-4% range, but SLAs in several states pay an average of close to 5%.

Columns 6 and 7 show the averages in each state of the ratio of the escrow balance to the total of mortgages outstanding on June 30, 1979, and June 30, 1974, respectively. Only those SLAs in each state which had escrow balances are included in these averages. In six of the states the average ratios of the escrow balances to mortgages outstanding were higher in 1979 than in 1974, in forty-six of the states they are lower, and in one state it was unchanged. This ratio will be influenced by the level of property taxes in each state, as well as differences in escrow policies and the types of loans an association makes. The average ratio for all fifty-three jurisdictions in 1974 was 1.07, and in 1979 it was .90. For the nine states which have passed mandatory escrow interest payment laws, the average ratio declined from 1.33 to .97. One effect of these laws is that SLAs respond by either lowering the average escrow payment or dispensing altogether with some escrow accounts.[15] Some other responses by the SLAs are that other terms of the mortgage may become more expensive or some risky loans may not be made.

SUMMARY

One of the risks by a mortgage lender is that the borrower may default on the property tax or fail to remit property insurance premiums. The lender must therefore derive a method to monitor these payments. The method of monitoring on each loan will be that which, when combined with the other terms on the loan, provides the maximum expected profit on that loan. Different combinations of terms may lead to the same level of expected profit on a loan. Any attempt to compute the "average profit" per escrow

TABLE 1
ESCROW ACCOUNT DATA

State	Column (1) Number of SLAs in each State	Column (2) Number of SLAs with Escrow Accounts	Column (3) Number of SLAs with Interest-Bearing Escrows	Column (4) Number of SLAs with only Interest-Bearing Escrows	Column (5) Estimated Avg. Yields on Escrow Accounts	Column (6) Avg. of Escrow Balance to Mortgages Outstanding on 6-30-79	Column (7) Avg. of Escrow Balance To Mortgages Outstanding on 6-30-74
Alaska	5	5	1	-	-	2.44	2.68
Alabama	62	46	-	-	-	.42	.48
Arkansas	75	69	-	-	-	.60	.73
Arizona	16	16	-	-	-	1.13	1.27
California*	174	159	115	45	2.26%	.24	.61
Colorado	47	46	1	1	-	.89	1.02
Connecticut*	38	38	37	23	2.64%	1.05	1.40
District of Columbia	16	15	14	1	5.13%	1.44	1.78
Delaware	5	4	2	1	2.98%	1.81	2.11
Florida	121	117	1	1	3.52%	.64	.73
Georgia	97	81	2	1	2.14%	.47	.48
Guam	2	2	-	-	-	1.33	1.07
Hawaii	7	6	-	-	-	.72	.80
Iowa	70	61	-	-	-	.44	.65
Idaho	12	12	-	-	-	.74	1.05
Illinois	383	319	6	3	3.71%	1.36	1.98
Indiana	151	81	-	-	-	.46	.69
Kansas	82	76	1	-	3.95%	1.01	1.10
Kentucky	105	67	1	1	0.00%	.54	.54
Louisiana	122	101	-	-	-	.53	.58
Massachusetts*	29	29	21	1	2.70%	.65	1.11
Maryland*	69	67	63	6	3.79%	2.32	2.79
Maine	20	18	-	-	-	.64	1.01

Michigan	64	57	-	-	-	1.52	1.36
Minnesota*	55	54	3	1	11.00%	.39	.53
Missouri	112	98	-	-	-	.84	1.16
Mississippi	60	54	-	-	-	.62	.64
Montana	12	12	-	-	-	.90	1.02
North Carolina	151	85	1	1	4.35%	.51	.55
North Dakota	11	11	-	-	-	.71	.90
Nebraska	38	36	-	-	-	.86	1.11
New Hampshire*	17	14	13	8	2.33%	.55	.69
New Jersey	174	149	7	1	2.07%	.88	1.14
New Mexico	33	33	1	1	2.75%	1.03	1.09
Nevada	8	7	1	1	1.50%	1.17	1.07
New York*	125	118	113	42	1.88%	1.57	1.58
Ohio	297	239	5	3	3.42%	.36	.41
Oklahoma	53	52	-	-	-	.84	1.08
Oregon*	29	27	21	7	2.21%	.75	1.66
Pennsylvania	262	198	83	63	2.45%	1.49	1.67
Puerto Rico	12	12	1	-	7.58%	1.81	1.83
Rhode Island	6	5	-	-	-	1.04	.68
South Carolina	75	53	-	-	-	.24	.37
South Dakota	16	16	-	-	-	.70	.89
Tennessee	97	79	2	1	5.00%	.75	.99
Texas	313	307	1	-	4.62%	1.40	1.50
Utah*	13	13	1	-	1.89%	1.19	1.61
Virginia	84	69	5	-	3.39%	.68	.55
Vermont	7	4	-	-	-	.24	.62
Washington	49	47	2	-	4.53%	.53	.82
Wisconsin	114	111	2	2	4.90%	1.07	1.39
West Virginia	30	22	-	-	-	.36	.30
Wyoming	13	13	-	-	-	.77	.83
Total/Avg	4038	3421	527	215		.90	1.070

*States requiring mandatory interest payments on escrow accounts.
Note: All data in this table are compiled from the semi-annual reports submitted by all FSLIC-insured SLAs as of 6-30-79.

account would likely lead to erroneous conclusions unless this substitutability of mortgage terms is considered.

Laws which require mandatory interest payments on escrow accounts will have a direct and indirect effect on mortgage lending. The direct effect, as shown in the Table, is that most institutions will either pay interest on escrow accounts or omit the requirement of escrow payments. The indirect effect is that the other terms of the mortgages may become more expensive or SLAs may cease to make high risk loans because the profit potential will no longer be commensurate with the risk of the loans.

REFERENCES

1. *Wall Street Journal*, July 24, 1978, p. 6.
2. *Wall Street Journal*, July 23, 1979, p. 27.
3. These include California, Connecticut, Massachusetts, Maryland, Minnesota, New Hampshire, New York, Oregon, and Utah. The adoption of mandatory interest on escrow accounts is under consideration in Michigan.
4. See, e.g., "An Analysis of Mandatory Interest on Mortgage Escrow Accounts," by the Financial Institutions Bureau, Michigan Department of Commerce, September 7, 1979, "Study of the Feasibility of Escrow Accounts on Residential Mortgages Becoming Interest Bearing," by the Comptroller General of the United States (B-114860), or "Factors Governing the Economics of Escrow Accounts," prepared by the Department of Research and Economics, U.S. Savings and Loan League, January, 1973.
5. The reader should not infer that all of these 166 SLAs have obtained escrow exemptions. Some of these SLAs may capitalize their escrow payments.
6. See the *Standard Accounting Manual for Savings and Loan Associations*, United States Savings and Loan League, 1973, p. 104.
7. A fourth alternative is that the lender pay the property tax and charge the payment to the loan account. Under this procedure, the borrower is receiving loans for the property tax at the contract rate on the mortgage. Most SLAs do not use this procedure because the mortgages are then technically in default until the advance is fully repaid.
8. The variety of monitoring procedures by each lender has been documented with questionnaire surveys in the studies cited in Reference 3.
9. In addition to this conceptional error, several of the studies which have estimated the "average profit" per escrow account have used survey data to determine the "average cost" of the accounts. Yet the questions in the surveys fail to distinguish between marginal and average cost considerations, as well as the opportunity cost of alternative monitoring procedures and the allocation of overhead expenses.
10. To my knowledge, none of the surveys conducted on the use of escrow accounts have attempted to identify how the SLAs decided the loans on which they will waive the escrow payments. It is my contention that it is the low risk loans on which the escrow payments have been waived.
11. In addition to the 50 states, data for the District of Columbia, Guam, and Puerto Rico are included.
12. The numbers in Column 2 were based on a head count of the number of SLAs in each state which had a non-zero escrow balance on June 30, 1979. Nine of the included associations had negative balances in this account on that date.
13. The 1973 study by the U.S. Savings and Loan League estimated that 16.4% of SLAs used the capitalization method. If this is an unbiased estimate of the percentage that capitalize payments, then it is probable that most of the 15.3% of the SLAs in my sample that do not have escrow accounts, use the capitalization method.
14. Again, this column omits those SLAs which capitalize escrow payments, and thus understates the number of SLAs which provide interest on escrow payments.
15. The decline in escrow balances in one of these states with a mandatory interest law, California, may certainly be more a result of recent voter referendums rather than the consequence of the interest payment law.

Conceptual Lags in Retail Development Policy <u>or</u> can the Carter White House save the CBD?

By Brian J. L. Berry

The disparity between the federal concept of retail development and reality is reminiscent of the old farmer, blissfully unaware that things have changed and continuing to look for barn doors to close so the horses won't escape after the barn has already been demolished to make room for a new subdivision. As Figures 1 and 2 show, central business districts had been losing importance as the primary retail centers of American city life for more than twenty years when, in 1970, the Congress declared that rapid urbanization and rural decline were still problems.[1] It has taken yet another decade for it to admit that the nature of urban growth has changed. As the White House's 1978 urban policy statement says:

> Three major patterns of population change can be traced in the Nation today: migration from the northeastern and north central regions of the country to the south and west; the slower growth of metropolitan areas and the movement from them to small towns and rural areas; and movement from central cities to suburbs . . . Today's widespread population loss in the Nation's central cities is unprecedented . . . the thinning out process has left many people and places with severe economic and social problems, and without the resources to deal with them . . . Our policies must reflect a balanced concern for people and places . . . to achieve several broad goals: (to) preserve the heritage and values of our older cities; maintain the investment in our older cities and their neighborhoods; assist newer cities in confronting the challenges of growth and

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FIGURE 1
DECLINE OF THE CBD AS A RETAIL AND SERVICE NUCLEUS OF MID-WESTERN SMSAs BETWEEN 1954 AND 1967

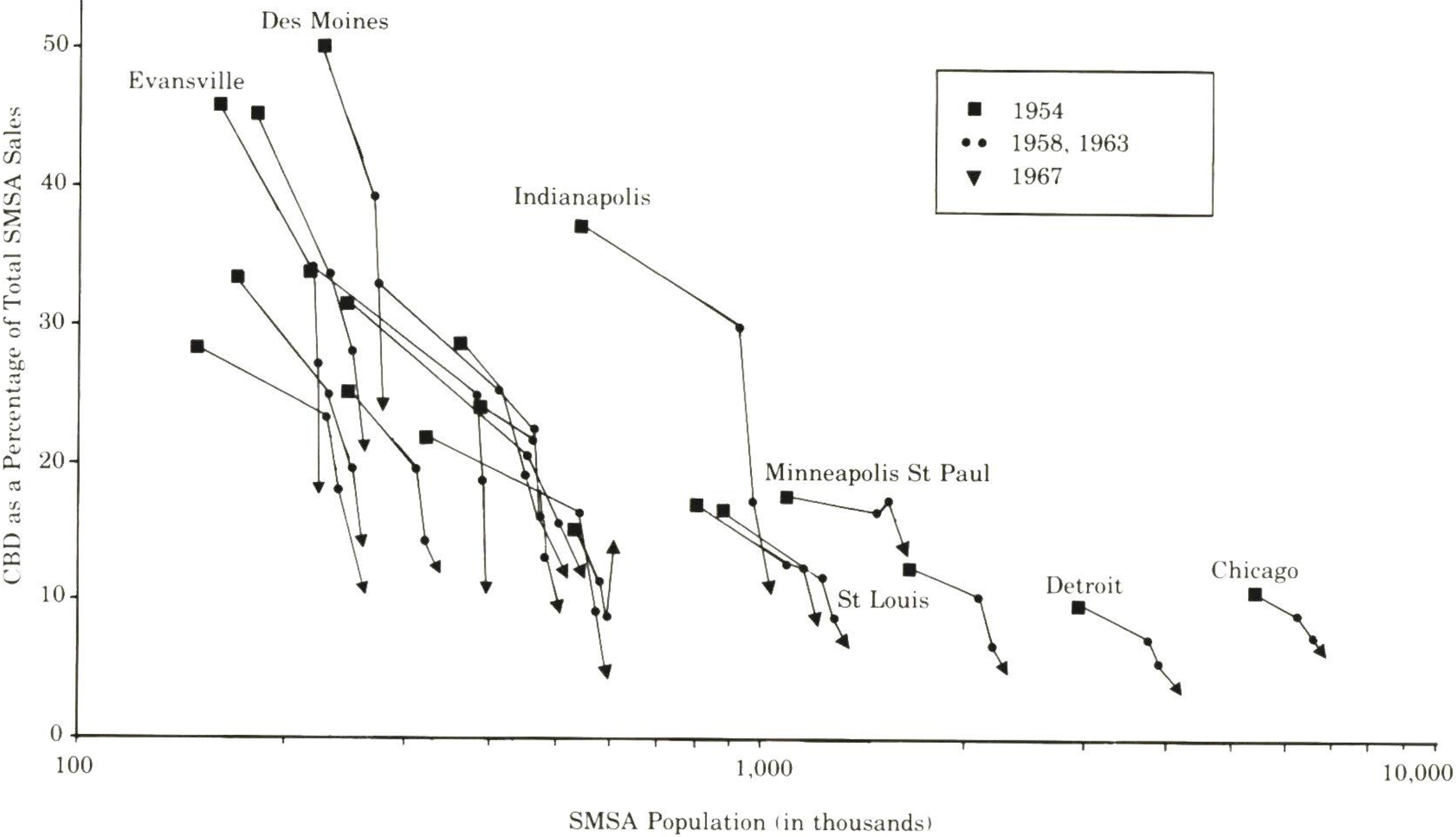
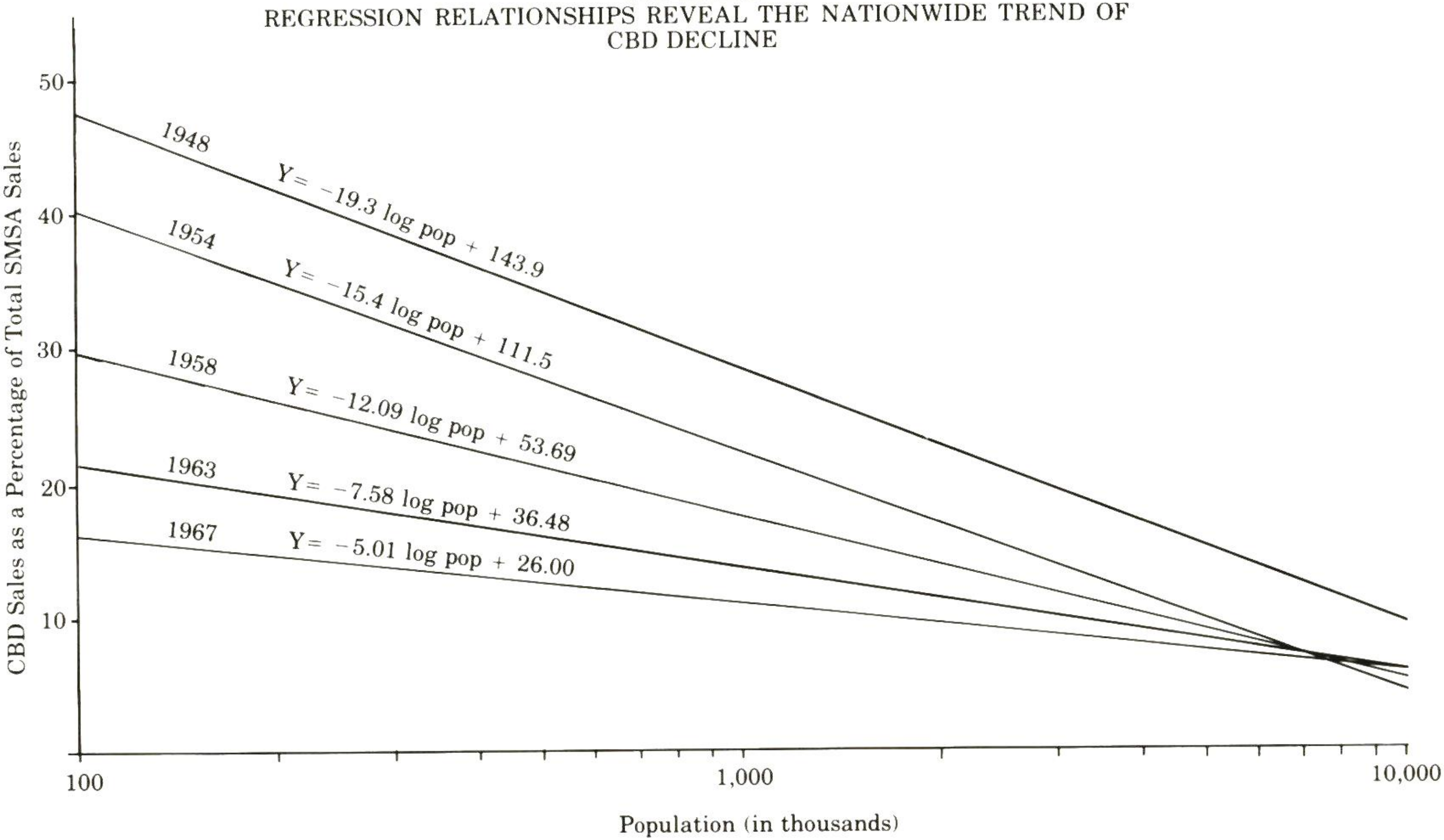


FIGURE 2

REGRESSION RELATIONSHIPS REVEAL THE NATIONWIDE TREND OF CBD DECLINE



pockets of poverty . . . and provide improved housing, job opportunities and community services to the urban poor, minorities, and women . . . If the Administration is to help cities revitalize neighborhoods, eliminate sprawl, support the return of the middle class to central cities, and improve the housing conditions of the urban poor it must increase the production of new housing and rehabilitation of existing housing for middle class groups in cities . . . We should favor proposals supporting: (1) compact community development over scattered, fragmented development; and (2) revitalization over new development.[2]

Just as there was a reactive response to try to reverse rural to urban migration and rapid urban growth in 1970, today there is a reaction to outmigration and urban decline. The following appears in the White House's proposed Urban Conservation Policy:

> The primary objective . . . is to encourage through appropriate Federal, State and local action, the redevelopment and/or development by the private sector of healthy central business districts in distressed communities (and to) reduc(e) insofar as possible the likelihood (sic) that major Federal actions will directly and strategically lead to the construction of large commercial developments that clearly weaken established central business districts in distressed communities or promote unnecessary urban sprawl.[3]

Growth, so it appears, is to be inhibited when urban impact analyses show that older central business districts can't withstand the competitive impact of proposed new regional shopping centers! If the current White House urban conservation policy is as perceptually laggard and as conceptually bankrupt as the declarations of the 1970 Housing Act, which I believe is the case, then implementation of the policy will once again be the wrong thing in the wrong place at the wrong time.

This article will (a) review the changes in the nation's settlement patterns that are unfolding today; (b) propose an alternative concept of spatial organization to the CBD-focused model that apparently remains central to the White House policymakers' thinking; and (c) suggest the emerging patterns of commercial organization that are consistent with this alternative concept. One can then address the key question of the proposed urban conservation policy: will the attempt to undergird central business districts in distressed communities work?

CHANGING SETTLEMENT PATTERNS: THE EVIDENCE

Since World War II, there has been a breakdown of the nation's traditionally core-oriented settlement patterns on two scales. Interregionally, the heartland-hinterland organization of the economy as a whole is now giving way to a preeminence of the sunbelt. Intraregionally, the center city is withering in contrast to the suburbs and the rural periphery.

This is a result of the changing location of industry and of jobs. For the first half of the twentieth century, the northeastern manufacturing belt accounted for some 70% of the nation's industrial employment. Between 1950 and the mid-1960s, manufacturing jobs continued to grow in the northeast, but the growth was more rapid in other regions of the country and the manufacturing belt's relative share fell to 56%. By 1970 relative decline had been replaced by absolute losses. From 1969 to 1977, the manufacturing belt lost 1.7 million industrial jobs, almost exactly the job growth of the former hinterlands.

Similar shifts have taken place intraregionally. Between 1947 and 1958, central cities of the New York region lost 6.0% of their manufacturing jobs whereas the suburbs gained 37.2%. In other heartland cities comparable figures were: Chicago, city −18.5% and suburbs 49.4%; Philadelphia, −10.4% and 16.4%; St. Louis, −21.1% and 41.7%. Continuing from 1958 to 1967, the figures are: New York, −10.3% and 36.0%; Chicago, −4.0% and 51.6%; Philadelphia, −11.6% and 30.0%; and St. Louis, −14.9% and 41.4%.

Traditionally, the major central cities of the manufacturing belt were the centers of innovation. They were able to introduce new industries to offset losses of standardized industries to cheap-labor areas elsewhere. But this is no longer the case. The economy's rapid growth industries (electronics, aerospace, scientific instruments, etc.) are dispersed throughout the former interregional and intraregional peripheries. It is the older slow-growth industries that remain in the former cores. Employment in these remaining industries is extremely sensitive to cyclical change in the economy, compounding the distress of northeastern central cities when the economy is in recession. But what is even more critical is that the central cities of the former manufacturing belt appear to have lost their traditional seedbed function. The locus of innovation and growth has shifted elsewhere.

MIGRATION — IMPORTANT SOURCE OF POPULATION CHANGE

Job shifts have been accompanied by population shifts. Following the bulge in the population pyramid formed by the post World War II baby boom, there has been a decline in fertility rates to less than replacement levels. As natural increase has diminished, migration has become an increasingly important source of population change, which has been intensified by the movement of the baby boom cohort into its most mobile years. In all urban-industrial countries, a certain minimum amount of geographical mobility is a structured part of the life-cycle, with the greatest rates associated with the stage at which young adults leave the parental home and establish an independent household shortly after formal schooling is completed. The baby boom cohort is now passing through this stage, and through the subsequent period in which spatial differences in real wage rates and in employment opportunities provide signals that encourage economically-motivated migration. This migration not only increases the well-being of the movers themselves, but also results in improved resource allocation. Thus, job shifts in a period of maximum potential mobility have resulted in increased net migration from manufacturing belt to periphery, for both majority and minority members of the U.S. population.

The South has experienced a dramatic and accelerating migration reversal. Within regions, the balance of migration flows is away from central cities to suburbs and exurbs and from metropolitan to non-metropolitan areas. Throughout the nation, migrating workers have left jobs located in major metropolitan cores for workplaces in smaller urban areas, suburbs, and non-metropolitan America. Since 1970, the Northeast as a whole has lost population, a result of decreasing natural increase and of the net migration reversal; in the South continued high levels of growth have occurred, despite declining natural increase, because of increasing in-migration.

As a result, nonmetropolitan areas are growing more rapidly than metropolitan areas and central cities are declining, especially within the largest metropolitan regions. Thirty of the nation's fifty largest cities have lost population since 1970; one in five registered a loss of at least 10% between 1970 and 1975. Because the incomes of outmigrants were greater than those of immigrants, the income loss of metropolitan areas (gain of nonmetropolitan areas) was over $17 billion between 1975 and 1977 alone.

MARKET-ORIENTED ECONOMIC ACTIVITY

Retail and service shifts have characteristically *followed from* population and income shifts; such is the nature of market-oriented economic activity. Indeed, the high mobility rates characteristic of the retail and service sectors of the economy make these sectors extremely sensitive barometers of changing market conditions and of shifts in business organization and practices. Where markets are growing — as in the sunbelt, in smaller towns and cities, in new suburbs and in nonmetropolitan areas — births of new businesses and expansions of existing ones exceed business deaths and contractions. The trade and service sector is also expanding in these areas. Where markets are declining, as in the snowbelt and in larger central cities and older suburbs, deaths and contractions exceed births and expansions and the trade and service sectors are declining.

In growing markets the concentration of business in larger establishments has been increasing. Chain stores and nationally-advertised franchise businesses have been better able to respond to the changing market opportunities by joining with real estate developers to use new planned business centers as instruments for structuring new residential growth. They gain the advantages of better corporate planning, national advertising, easier financing, and an ability to withstand temporary market perturbations. In many markets, major new enclosed shopping malls primarily house chains and franchises and have replaced traditional central business districts as the retail foci of rapidly dispersing metropolitan regions, setting the tone for surrounding residential areas.

Meanwhile, traditional shopping streets and classical unplanned business centers continue to wither away in older urban neighborhoods as populations dwindle and the relative incomes of those left behind decline. Yet the thrust of the White House urban conservation statement is that the most market-dependent sector of the economy should become the instrument of neighborhood and inner city revival. If only new shopping center developments can be contained, the argument apparently continues, central business districts will once again assume their proper role as the hearts of high-density cities, the centers of innovation and control, and the middle class will once again want to live in the city.

This, surely, puts the cart before the horse. Job shifts have joined with a successful national housing policy — oriented to promoting household wealth through homeownership, improved living conditions via new construction, and increased efficiency by means of mobility — to facilitate the emergence of low-slung, far-flung metropolitan regions and a new force of counter-urbanization: the transfer of new growth to some of the most remote and least urbanized parts of the country. The settings where this growth is now occurring are exceedingly diverse. They include regions oriented to recreation in Northern New England, the Rocky Mountains, and the Upper Great Lakes; energy supply areas in the Northern Great Plains and Southern Appalachian coal fields; retirement communities in the Ozark-Ouachita Uplands; small manufacturing towns throughout much of the South; and nonmetropolitan cities in every region whose economic fortunes are intertwined with state government or higher education. Other contributing factors appear to be changes in transportation and communications, removing many of the problems that constrained the growth of the periphery, thus permitting decentralization of manufacturing on the inexpensive land and benefitting from the low wage rates of non-metropolitan areas. The trend toward earlier retirement has lengthened the interval during later life when a person is no longer tied to a specific place by a job. An increased orientation at all ages toward leisure activities has been caused in part by rising per capita income, centering on amenity-rich areas outside the daily range of metropolitan commuting.

EFFECTS OF TRANSPORTATION AND COMMUNICATION DEVELOPMENTS

These are but symptoms of more profound forces. The concentrated industrial metropolis only developed because proximity meant lower transportation and communication costs for those interdependent specialists who had to interact with each other frequently or intensively. One of the most important forces contributing to counter-urbanization is the erosion of centrality by time-space convergence. Virtually all technological developments of industrial times have reduced the constraints of geographical space. Developments in transportation and communications have made it possible for each generation to live farther from activity centers, for these activity centers to disperse, and for information users to rely upon information sources that are spatially more distant yet temporally more immediate. Large dense urban concentrations are no longer necessary for the classical urbanization economies to be present. The time-eliminating properties of long-distance communication and the space-spanning capacities of the new communication technologies are combining to dissolve the agglomeration advantages of the industrial metropolis, creating what some now refer to as "an urban civilization without cities". The edges of many of the nation's metropolitan systems have pushed one hundred miles and more from declining central cities. Today's urban systems appear to be multi-nodal, multi-connected social systems sharing in national growth and offering a variety of lifestyles in a variety of environments[4]. What is being abandoned are those environments that were key in the traditional metropolis-driven growth process: the high-density, congested, face-to-face center city settings that are now perceived as aging, polluted and crime ridden, with declining services and employment bases and escalating taxes.

THE RETAIL RESPONSE

Already there has been a retail response, far ahead of White House thinking: theme centers are multiplying in special locations; older structures are being rehabilitated for use as specialty retail centers, as in Utica where the former UNIVAC building (now Charlestown) was transformed into a mall containing factory outlet shops; and, where conditions are right, some CBDs are being privately regenerated. Contrary to common expectation, energy fears have not slowed shopping center development. *Shopping Center Digest* reported earlier this year that 63 new malls with over 400,000 square feet of gross leasable area will have opened during 1979, 77 more are scheduled for opening in 1980, and 100 are already committed for 1981 and beyond.

Many markets are saturated today, and developers are looking for such things as bypassed infill opportunities. Much of the current exploration relates to possibilities for reconstructing deteriorating suburban CBDs or older downtown areas with viable surrounding trade areas. There is an increasing emphasis on mixed use, including recreation, community and cultural services, art, music, and food, catering to evening and weekend activities in appealing enclosed environments.

Some industry spokesmen suggest that at least 10% of new mall activity will be in older central business districts in the next few years, clearly demonstrating that the industry is way ahead of the White House. Unfortunately, the Carter conservation policy's focus on communities in distress may distort private market activity in ways that remind us of Gresham's Law of Urban Policy with which we are all too familiar. Meanwhile, in certain metropolitan areas — where too great an excess supply of new housing has not been created and where a modern office sector has created new jobs for young professional members of the post-World War II baby boom generation — private market reinvestment has been taking place in certain older neighborhoods and has supported specialized retail and service growth.

THE CHANGING FAMILY

The essence of this has again been on the demand side. New higher-income young homeowners not pressed by child-rearing, with two workers (one or both of whom may be a professional) prefer neighborhoods in the inner city with geographic clusters of housing structures capable of yielding high quality services, a variety of public-good amenities within safe walking distance of these areas and a range of high-quality retail facilities and services including restaurants, theaters, etc. These preferences follow directly from life style and compositional shifts. The continued development of American society has resulted in increased economic parity for women; this enables them to have the option of roles other than that of housewife and mother. Consequently men and women lead more independent lives, and are able to exercise more options in life. Increasing numbers of couples live together without the formal ties of marriage. The direct and opportune cost of child rearing is rising, birth control technology has improved and abortion laws have been liberalized; hence the birth rate is dropping. There are increasing numbers of families with two or more workers.

CONCLUSION

Revitalization, then, has been taking hold first in superior neighborhoods in those metropolitan areas which have the tightest housing supply and which also have a sizeable cluster of professional jobs that support the youthful college-educated labor force most likely to evidence life-style shifts. Smaller households require less space. The fluidity of households and the looser legal links among their members are contrary to the rigidity of tenure associated with ownership. The maintenance of a house and its grounds is too time consuming and for people who must work, there is a growing preference for apartments, row, or town houses and innovative forms of design, as well as experimentation with forms of tenure such as condominiums and cooperatives which preserve some of the tax advantages of ownership but provide greater liquidity and increases in new forms of contracting arrangements for the operation and maintenance of housing. The growing attractiveness of more central locations in the core city and the older suburbs follows; there is an appropriate stock of housing and access to services as well as locational convenience for the journey to work. Since many of these households have no children, the racial factors of school integration do not act as they have in the white flight to the suburbs. And out of the new life style being created in old neighborhoods a new environment of opportunity for retail growth has occurred and is being realized.

An important principle of retail and service development is thereby illustrated. The older hierarchies of retail centers were a product of access-constrained market orientation of facilities of different scales. As access variables have declined in relative significance, the advantages of specializing to meet the particular needs of particular local markets, or of particular metropolis-wide market segments, have increased. As the metropolis has spread and differentiated, so has the retail and service opportunity. And as for the years to come, so long as a high degree of mobility is maintained there will be a continuing responsiveness to the changing nexus of opportunities and of constraints. If a principle is at work, it is one of opportunity-seeking and constraint-avoidance, which leads directly to the conclusion that the negatively-formulated Carter conservation plan can only result in everyone becoming worse off!

A creative policy shifts incentives, creating attractive market opportunities that, if realized, also achieve the sought-after goals. This has been the example of the nation's housing policy for the last 50 years. Negatively-formulated systems of regulation, on the other hand, lead only to avoidance, and avoidance by private developers of distressed communities can only deepen the malaise afflicting the CBDs that the White House conservation policy is supposed to alleviate.

REFERENCES

1. The rapid growth of urban population and uneven expansion of urban development in the United States, together with a decline in farm population, slower growth in rural areas, and migration to the cities, has created an imbalance between the nation's needs and the resources and seriously threatens our physical environment . . . The Congress . . . declares that the national urban growth policy should — favor patterns of urbanization and economic development and stabilization which offer a range of alternative locations . . . help reverse trends of migration and physical growth . . . treat comprehensively the problems of poverty and employment . . . associated with disorderly urbanization and rural decline. Quoted from Section 702 of Title VII of the Housing and Urban Development Act of 1970 (Public Law 91-609, 84 Stat. 1791; 42 U.S.C. 4501).
2. Quoted from President Carter's Urban and Regional Policy Group's March 1978 report, *A New Partnership to Conserve America's Communities. A National Urban Policy.*
3. Quoted from a White House staff paper entitled "An Urban Conservation Policy" circulated in the fall of 1979.
4. In contemporary theories of land use, three sets of variables are joined to explain the bid-rents of potential occupants that ultimately set the pattern of land values and create the land use map. The first of these is accessibility, traditionally measured as distance from the CBD. One of the distressing features of contemporary urban economics is that the models taught to new students seldom stray from this particular case. The second set of variables relates to qualities of the site itself. The case is clearest in Ricardian theories of land use, but also is relevant in urban land use as observers from Hurd to Hoyt have emphasized, although not independently of the third set, externalities. To the extent that traditional centrality has been eroded by time-space convergence, variables in these other two sets — environment and amenity — have increased in importance in determining the structure of the emerging metropolis. What is important today are relative qualities of amenities and externalities within the whole rather than relative access to an historical center. Hence the multi-nodal, multi-connected quality of contemporary urban systems.

Are We Overbuilding: Is Large Gobbling Up Small?

By Bruce P. Hayden, C.R.E.

At the time this article was put together, the word "is" was certainly good and appropriate. By mid-December 1979, two months after Paul Volcker and the Fed changed their whole attack on inflation and in the process substantially dried up the long-term mortgage market, the question might better have been asked, "Will large gobble up small?" As for "is" — currently "is" is not. As Daniel Rose, CRE says, "Money is the one building material for which there is no known substitute."

This country seems to have a profound fear of the BIG whether referring to big oil, big labor, big corporations, or big shopping centers. On the one side of the coin, continued growth to mammoth size can be most accurately regarded as the ability of an enterprise to serve its market well — and on the other side, the bigger the operation gets, the more vulnerable it becomes to the younger, the smaller, the faster afoot, quicker to respond and less well tied up in red tape.

MARKET FOR THE MINI-REGIONAL

The day of the superregional shopping center has come, is here, and is starting to wane. To be successful, the five- and six-department store center of 1,500,000 square feet more or less needs to find an underserved and rapidly growing market area. There will continue to be such areas, and there will continue to be new superregionals created — but today the smart developers and the smart money who are thinking regional at all are thinking about a category the ULI has not invented yet — the mini-regional. These mini-regionals, incidentally, are not going into Houston,

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This paper was presented at the Shopping Centers USA conference and will be published in a forthcoming book by the Center for Urban Policy Research, Rutgers University.

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Los Angeles, Chicago and northern New Jersey — they are going into Columbia, South Carolina; Danville, Virginia; Eugene, Oregon; Springfield, Missouri; Temple, Texas; and other good smaller to intermediate-sized cities that were largely passed over the first time around. This is where the demand and the market are often unsatisfied.

The big regional, and in some cases even the smaller regional, seems to have strikes going against it in all directions. They are a pet hate of the environmentalists, as are the superhighways at whose intersections the superregionals have tended to develop. They are feared and detested by the big city mayors — not necessarily the biggest city mayors, but the mayors of Hartford, Lansing, Fort Wayne, Toledo, Des Moines — all of whom see further development of such centers as further nails in the coffin of their hopes for downtown renewal.

EXECUTIVE ORDER 12044

For the present Administration at least, these mayors have new influence. Witness the recent White House paper on the federal role in shopping center development in the future issued under the heading, "An Urban Conservation Policy." In accordance with Executive Order 12044, the major agencies are ordered to subject major programs and activities to new urban impact analyses aimed directly at strengthening the Central Business Districts by preventing the development of outlying competition. An interagency coordinating committee is to create a task force composed of representatives of HUD, EDA, DOT, the Treasury, and the Small Business Administration. Its efforts are directly to support revitalization efforts, retail and otherwise, in downtown U.S.A. and indirectly, under the guise of fighting urban sprawl, to do everything reasonably possible to discourage regional shopping center development that might threaten or seem to threaten established Central City Business Districts in distressed communities. Everything from highway programs, sewer programs, mass transportation agencies, etc., will be involved with the required urban impact analysis. It will be generated at the request of any city that feels itself threatened, with strong encouragement in the direction of almost a veto power in the hands of the existing city against new centers outside its limits or outside its CBD.

APPEAL OF THE SUBURBAN SHOPPING CENTER

There may be a strong hand of "big brother knows best" in this. After all, the suburban shopping center age has blossomed and prospered not because developers had any power to make people come to their doors, but because they were smart enough to know what the public, particularly the woman shopper, wanted — and then made it available. Even in the late Thirties, the president of a lending institution came to the conclusion that "women do not want to go downtown to shop. They want to shop close to home. Get us into the shopping center business." These were his wise instructions to the Mortgage Loan Department. Most women — from coast to coast — deplore the fact that there is not much good shopping downtown anymore; but, with few exceptions, they would not use it if it were there. Al Taubman's West Farms Mall in the southwest section of West Hartford, Connecticut, for example, has practically destroyed retailing in New Britain, seriously harmed the older West Hartford center, and been a major deterrent to retail revival in downtown Hartford. The women say they do not like West Farms Mall because it is so big, hard to find stores there due to the lack of mall directories, and tiring to walk in; but they can find what they want in the convenience of one-stop shopping.

There are a variety of reasons why shoppers tend not to go to Downtown U.S.A. anymore — traffic congestion, paid parking, perceived threats to personal safety — but the federal answer to all of this is similar to the federal attempts to force the Susan B. Anthony dollars on the public: "We will just give them no alternatives. Big brother knows best."

DOWNTOWN U.S.A.'S FUTURE

Is there a retail future for Downtown U.S.A.? Downtown has been doing a good job recently of finding out what its future is and should be for the last two decades of the twentieth century and the first three of the twenty-first. Successful downtowns are not trying to re-create the downtown retail dominance of the 1920s. Central cities are finding new roles — as centers of community, cultural, recreational, and meeting activities; as governmental and major corporate business centers, with the clubs, the good restaurants, the specialized retail, and the main department store that, much more so than its suburban branches, still carries the flag.

Not only is the pace of creation of new superregionals slowing substantially, but stores of all kinds and, therefore, the centers in which they are located, downtown or suburban, are getting smaller.

The reason for this is very simple — COST. Construction costs have long been leading the cost-of-living index and continue to, and all space users are having to cut back in order to be able to afford new construction. Merchants are finding that they can more effectively use their sales space and personnel in smaller units: a 50% bigger store which may or may not generate 10% more business is a very expensive thing.

TREND TOWARD SHELL SPACE

In an effort to keep costs in line and lending institutions happy, developers of centers big and small are more and more turning over shell space to their tenants, with the tenant responsible for storefront, floors, ceilings, mechanical and lighting distribution, and even the demising walls and their finishes. After this, the merchant has to fixture his store, get his inventory, and provide the working capital necessary to get the whole thing going. This is becoming harder and harder to do not only for the little guys, but for the national chains. Today's money rates, if long continued, change "harder" to "damn-nigh impossible."

Costs are hitting the major department stores as well. They tend to think now not in terms of "bigger is better" but in terms of "less is more." They are going back to 80,000 and 120,000 square-feet stores, whereas before they were thinking of 140,000 to 180,000 square-feet. They do not do quite as much volume, but they take a lot less capital and generate a better return on investment. Even the major department store chains find their resources for expansion severely limited. They may be able to find money for five major stores and ten smaller ones scattered nationwide in a given year. Most have priority lists going several years into the future on things they would like to do, and must select the most promising each year.

COST OF RED TAPE

Aggravating the expense problem is the increasing cost of regulation and approvals for all types of construction. It is a foregone conclusion today that a zoning application will be bitterly fought with the nearby neighbors who do not want it *here* and the environmentalists who do not want it at all, both noisy allies before the zoning board and the courts. Environmental impact statements, which should be but are not yet accompanied by economic impact statements, are time consuming, expensive, and again subject to challenge.

HOW FARES THE NEIGHBORHOOD?

How do the neighborhood strip centers, new and old, compete with the regionals? Very well, by and large. It has long been apparent to students of the shopping center industry that the regionals and superregionals, as a rule, do not affect the neighborhood strip centers too much, unless the latter allow themselves to run out of control and become too big. It has been twenty years or more since the regional center included a supermarket — earlier they had two or three. There may be a superdrug operation, but the neighborhood-style drugstore, still doing a huge business across the country located near a good supermarket, is not found in the regional center.

The tailor, the shoe repair shop, the small gift store, Carvels, Friendly Ice Cream may or may not appear in the superregional or regional center, but they are the service facilities which, together with the market and the drugstore, keep people coming back to the neighborhood strips.

The centers to worry about are those in the metropolitan areas that are classified as community centers — 200,000 or 300,000 square feet, with a supermarket and a discounter or two. If the mass merchandiser is K-Mart and the center is not very large (as the K-Mart centers seldom are), it will probably do fine. When it gets up to 200,000 or 300,000 square feet though, it is far too big to hold its own against the neighborhood center for the everyday needs — and far too small and weak to lock horns effectively with a regional.

CONCLUSION

Two of the most knowledgeable people in the shopping center industry shared these views. The first one limited his comments on the general subject of "Are we overbuilding?" to saying, "I have been asking myself that for the last forty years, and I think at last the answer is clearly yes — but the big are not going to swallow the small."

The second was the late Sidney Greenberg, a trustee of Corporate Property Investors, who said, "Smaller stores and smaller centers generally in smaller cities are the clear trend. I think our shopping center industry is headed for salvation not of its own choice. We are going to be saved not because we are smart, not because we are unselfish, not because we exercise any self-restraint — but by the fact that the cost and lack of availability of money will tend to keep our greed and stupidities under close control."

Tips from Tycoons!

Real Estate Issues introduces its new column with the remarks of renowned real estate financier, developer and entrepreneur, Arthur Rubloff, C.R.E., of Chicago. In this and coming issues, "tycoons" will respond to questions asked by Editor-in-Chief Jared Shlaes. They'll share a few of their past "secrets" and make some future predictions.

REI: How do you think the real estate market will perform during the coming decade?

ARTHUR RUBLOFF: I am not optimistic about the real estate market for 1980 because of high interest rates, spiraling costs of construction and the general increase in operating costs. Assuming that interest rates reach a normal level and worldwide conditions do not have any serious effect on our economy, the demand for real estate in the coming decade will be brisk, especially for first-rate properties well located in our larger cities. The demand for this type of real estate will be much larger than the supply.

REI: What new opportunities do you see on the horizon? What danger?

AR: There is a very great need for housing throughout the country. Assuming we reach more normal conditions and financing is available, I look for an improvement in housing and especially with government financing available, which is indicated. The danger has to do with our worldwide conditions and what effect they will have on our economy. Tremendously increased costs for armaments, by virtue of the Middle-East situation, and our energy problem, plus inflation would be very detrimental not only to our business but others as well.

REI: Which forms of real estate investment do you think will do (1) best? (2) worst?

AR: Shopping centers are the best type of real estate; office buildings and industrial properties would be next, and housing would be last, perhaps with the exception of condominiums where the market is justified, especially as to conversion and/or rehabilitation.

REI: Where do you plan to concentrate your own investments?

AR: We are concentrating our investments in downtown cities. We are interested in acquiring large size shopping centers in the Sun Belt and tropical areas.

REI: How would you advise young people thinking about real estate as a career?

AR: I believe opportunities exist for all people in real estate. Firstly, young people should become as well grounded as possible in the fundamentals of real estate. My suggestion for them would be with a few thousand dollars consider buying two or three story flats, in what you might call a Class B or Class C neighborhood, not entirely run down but rather aged. Purchase the property with relatively little cash, assuming a mortgage is available. Make minor repairs so that the premises are habitable, not the best but not the worst either. Then rent the flats. If you do it right, you might be able to get a 20% or more return on your investment.

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