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Ira. S. Lowry

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ABSTRACT

Dwellings that now exist will house over three-fourths of all Americans at the end of this century. How well this inventory is managed will have more effect on housing quality over the next 20 years than will new residential construction, which annually averages about 2 percent of the inventory. In growing regions, the private market will respond quickly to increased demand for housing by peripheral development and selective improvements in central areas. Outcomes could perhaps be improved by public intervention to force more compact peripheral development and to facilitate recycling urban single-family houses, now occupied by elderly persons, into family use. Overall growth in inventory will help adapt it to current preferences. Declining regions will have a general surplus of housing concentrated in their central cities. Two kinds of public intervention would help these housing markets adjust to their prospects: demolishing the redundant stock, and subsidizing rents for low-income households.

MANAGING THE EXISTING HOUSING STOCK: PROSPECTS AND PROBLEMS

Ira S. Lowry

INTRODUCTION

In 1980, the housing inventory of the United States included about 86.7 million year-round habitable dwellings with an aggregate market value in excess of $3 trillion. Dwellings that now exist will house over three-fourths of all Americans at the end of this century; indeed, if the past is any guide, half of these dwellings will still be in service in the year 2050. How well this inventory is managed will have much more effect on housing quality over the next 20 years than will new residential construction, which annually averages about 2 percent of the inventory.

In the United States, management of the existing inventory is highly decentralized. About two-thirds of the inventory consists of owner-occupied homes whose maintenance is governed almost wholly by the occupants' decisions. Depending on their resources and expectations for the future, they may improve their dwellings, maintain the status quo ante, or consume capital by undermaintenance. The remaining third are rental dwellings, whose owners must cater to the market; their maintenance policies are driven by their interpretations of consumer preferences and estimates of consumer purchasing power now and in the future. In most jurisdictions, both homeowners and landlords are subject to housing maintenance codes, but these are rarely enforced except against egregious violations of health or safety conditions.

Decentralized decisions need not yield socially optimal outcomes. Many people regard housing deterioration as a societal mistake that could be remedied by public intervention. Some believe that elderly homeowners occupy, through inertia, dwellings better suited for and needed by younger households with children. The configuration of

dwellings in space, often reflecting decades of parcel-by-parcel development decisions, rarely seems to us as good as results that could be obtained by starting over with large blocs of raw land and coherent plans for its development.

These problems have a common origin in the technology of producing housing services. That technology is capital-intensive, and the capital is both fixed as to location and transgenerationally durable. Over time, housing preferences change as households change in size, composition, wealth, and life-styles. Aggregate demand for housing shifts both locally (e.g., within metropolitan areas) and nationally (e.g., between regions) as people move and local populations grow unevenly. Each generation must either adapt an inherited capital stock to new conditions or abandon the portions of that stock that are least suitable. Housing shortages in one community commonly coexist with surpluses in others.

Most public intervention in response to these problems has operated at the margin of new construction, sometimes on raw land, sometimes demolishing existing dwellings and redeveloping their sites. The primary tools of such intervention have been land acquisition through the power of eminent domain, capital subsidies for development or redevelopment, and regulation of land use and structural characteristics by local authorities. Since the early 1950s, the federal government has provided small sums for selective rehabilitation of existing dwellings and to assist local governments with housing code enforcement, but these programs have never been large enough to have widespread effects. In the last few years, a number of local governments, perceiving a rental housing shortage, have regulated rents and restricted the conversion of multiple dwellings to condominiums. With these exceptions, managing the existing inventory has been left to its owners.

Would more or different kinds of public intervention improve the performance of the existing inventory? This essay looks ahead at the likely changes in housing demand between 1980 and 2000, assesses the technical adaptability of the existing inventory to these changes, and considers the institutional barriers to technically efficient adaptations. It concludes that decentralized decision-making serves us well in markets where aggregate demand for housing is growing, even though

tastes have changed; but that they serve us poorly in markets where aggregate demand is shrinking. Some specific suggestions are made for intervention policies in both cases.

PROSPECTIVE DEMAND SHIFTS, 1980-2000

Patterns of life and work are changing in the United States in ways that were not anticipated 20 years ago, and there is little reason to believe that in 1980 we are better at predicting the future than we were in 1960. Nonetheless, recent trends remain our best guide to the future, so are worth consulting as we look ahead; and in any case, those trends have generated as-yet-unresolved stresses on housing markets that will engage policy attention over the next few years at least.

Six trends are especially pertinent to the utilization of the existing inventory:

- Interregional population redistribution.
- Intraregional dispersion of residence.
- Racial succession within urban areas.
- Declining household size and related shifts in the age-distribution and marital statuses of household heads.
- Increased labor-force participation among females generally and married women specifically.
- Changes in tenure preferences that have resulted from a decade of rapid general price inflation.

Below, I briefly review these trends and comment on their implications for housing markets.

Interregional Population Redistribution

For over two decades, population growth has been shifting from the northeast and north-central regions of the United States to the south and west, following the locational preferences of new manufacturing and service industries that find the earlier industrial regions of the northeast and north-central states unattractive for a variety of reasons. The Bureau of Economic Analysis expects this shift to continue,

albeit abating as economic activity becomes more evenly distributed over the national landscape (see Garnich, elsewhere in this volume).

These population shifts imply rapidly growing housing demand in some regions and stasis, if not actual decline, in others. Thus, the BEA expects the Rocky Mountain States to double their populations by the year 2000, while the eastern seaboard states, from New York south to Maryland, will grow by only 1 percent. Taking these extremes as illustrative at least of possibilities, it is apparent that social efficiency in the growing regions implies both intensive utilization of the existing stock and rapid development of new housing; on the other hand, the existing inventory of a slow-growth region contains nearly enough capital to produce all the housing services that will be demanded over the next 20 years.

Intraregional Dispersion

Some of the forces that have caused interregional redistribution of population operate also at the intraregional scale; they have been inadvertently reinforced by federal policies with respect to local transportation, housing finance, and racial segregation.

Until about 1950, metropolitan central cities were the fastest-growing class of jurisdictions in the nation. By 1970, they were the slowest in growth, and about half (nearly all of those unable to annex suburban territory) lost population between 1970 and 1980. During that decade, population losses were also reported for 29 entire metropolitan areas, all but one in the northeast or north central regions. The jurisdictions that grew most rapidly as a group were nonmetropolitan cities and counties [1].

The housing inventory management problems posed by intraregional population dispersion are similar to those created by interregional population shifts, with the qualification that one plausible policy response is changing the balance of intraregional locational incentives--getting suburbanites and exurbanites to move back to the central city where the surplus housing is located, or at least channeling regional growth back to these central areas. The likelihood of reconcentration depends in turn on other trends, discussed below.

Racial Succession within Urban Areas

A major cause of central-city population losses has been the influx to those cities of racial minorities, principally black and Latin, leading to "white flight." During the 1960s, metropolitan central cities as a group annually gained 100,000-150,000 blacks, Latins and orientals due to net migration, and annually lost about 500,000 whites. During the 1970s, the minority influx tapered off, but the white exodus grew to more than a million persons annually [2].

Scholars do not entirely agree on the motivations for white flight, but the fact and the consequences for housing markets are clear. Nearly all central cities that have been through this process (some in the north central states have escaped it) have been left with a large surplus of unmarketable housing which, through neglect and vandalism, soon becomes uninhabitable.

Although net migration by minorities to central cities is no longer substantial and for some is negative, their natural increase is rapid and will doubtless be high for the rest of the century. By the end of the century, it is likely that the erstwhile white majority will be a numerical minority in central cities. Already, Gary, Cleveland, Newark, Detroit, Atlanta, Los Angeles, New Orleans, and Oakland have elected black mayors; as other cities lose white residents and their minority populations grow, the balance of political power will shift there as well.

Declining Household Size

Throughout the United States, in both metropolitan and nonmetropolitan areas, household sizes continue their longterm shrinkage. In 1980, over a fifth of all households consisted of only one person, and over half consisted of no more than two persons. Yet two-thirds of the national housing inventory consists of single-family houses, nearly all of which have two or more bedrooms. Including multiple dwellings, the nation has available 420 million rooms to house 220 million people in households, or about 1.9 rooms per person. Put another way, the existing inventory could accommodate nearly twice as many people without violating current notions of unhealthful overcrowding.

Household sizes have shrunk for several reasons. One is that married couples now have fewer children than those of preceding generations. Another is that life spans have lengthened and more of our population is elderly; furthermore, social security benefits enable more of the elderly to maintain separate households rather than moving in with their adult children. Finally, children now usually leave their parental homes before marrying, living alone or with friends.

The evidence is clear that both the young and the elderly usually prefer to live apart from their parents in the first case and from their children in the second. Increasing prosperity has enabled them to afford separate dwellings, and housekeeping has been greatly simplified by mechanization (washing machines, refrigerators, automatic heating systems) and commercially preprocessed foods (frozen dinners, instant coffee). But some observers believe that housing tenure arrangements impede efficient reshuffling of people and dwellings as household circumstances change. They point especially to "empty nesters," elderly household heads who continue to live in the large homes they bought while they were raising children; and to the complaints of younger parents that they are unable to find rental accommodations that are suitable for raising children.

Female Labor-Force Participation

Since World War II, married women have entered the labor force in rapidly increasing numbers. By 1976, married couples in which both husband and wife worked outnumbered those in which only the husband worked, and 46 percent of all children had parents who both worked [3]. The mechanization of domestic chores, mentioned above, clearly eased the way for this transition; but it remains a surprise to me that, in 1978, 44 percent of all mothers with children under 6 years of age were employed.

When all adults in a household are employed outside the home, housekeeping and home maintenance are likely to be regarded as burdensome chores rather than opportunities to exhibit domestic skills and good taste. Although I have yet to see systematic evidence, many observers infer that dwelling preferences have or will shift in favor of smaller homes and apartments that require less attention from the

occupants; and more centrally located dwellings that reduce commuting time.

Tenure Preferences

Whatever the effect of growing female labor-force participation on housing preferences, it has not visibly altered tenure preferences: We are becoming a nation of homeowners. In 1950, about half of all households owned their homes; today, the proportion approaches two-thirds. Between 1970 and 1980, the incidence of home ownership rose at every level of real income above $10,000 (1978 purchasing power) [4].

Home ownership offers some practical advantages over renting in that homeowners have more control over (but also more responsibility for) property maintenance and operating policies. But the national shift in housing tenure is also driven by financial considerations. A homeowner's mortgage interest payments and real estate taxes are deductible from taxable income, and the housing services yielded by equity investment are likewise untaxed. Even more important during the 1970s was the general expectation of capital gains in a rising real estate market; nationally, home values rose by 10 percent annually throughout the decade.

The market for home ownership was further broadened in the 1970s by the perfection of legal instruments for the ownership of apartments in multiple dwellings. Owning a home no longer necessarily entails a commitment to mow the lawn or arrange for deliveries of fuel oil; those who prefer apartment living in urban environments can also have the financial benefits of ownership tenure.

Because of these events, households that previously were inclined to rent have entered the home purchase market in large numbers. A national study of new conventional mortgages reports that single people accounted for 0.5 percent of all homebuyers in 1970, but 24 percent in 1980. Whereas only 6 percent of all homebuyers were childless in 1970, 78 percent of the 1980 home purchasers had no children [5].

Meanwhile, the rental market has floundered [4]. The more prosperous tenants bought homes, and the others split into smaller households, each with fewer earners. Between 1970 and 1980, the median

income for renters fell by about 20 percent in real terms. The rents they were willing and able to pay have lagged far behind the costs of supplying rental housing services. I estimate that the average revenue from a fixed bundle of rental housing services increased by 87 percent during the decade, but operating expenses rose by 141 percent. Net operating return fell by 37 percent in constant dollars.

When feasible, landlords have converted rental dwellings to condominiums, often reaping large capital gains in the process. Others whose properties were poorly designed for conversion or located in unpromising neighborhoods have been less fortunate. They have responded by under-maintenance and, in some cases, outright abandonment.

MANAGING THE EXISTING INVENTORY, 1980-2000

If recent trends continue, there is every reason to anticipate a poor fit between the existing inventory of dwellings and the preferences of consumers in the year 2000. The inventory is badly located with respect to the emerging spatial configuration of demand, is designed for larger households and more home-centered life-styles than are in prospect, and has too many rental dwellings in it. Some of the trends that lead to these conclusions could moderate or even reverse, but it is nonetheless useful to ponder the inventory management policies that would best cope with the most probable future.

I suggest a basic division in inventory management problems between markets experiencing rapid population growth and those experiencing decline. In the former, the problem is to get more housing service out of the existing inventory while augmenting that inventory as demand grows. In the latter, the problem is to manage housing surpluses so that excess dwellings do not injure the financial prospects of the part of the inventory that should be retained. In both cases, one might say that the market, unhampered by public intervention, is capable of finding a solution; but I think that the social costs of the market solution differ for growth and decline.

INVENTORY MANAGEMENT IN GROWING REGIONS

Where population is growing rapidly through net inmigration, the demand for housing should increase commensurately. Except at the beginning of a growth episode when vacancies are abundant, the existing inventory cannot absorb the extra demand without price increases that impel individual consumers to economize on housing (e.g., by doubling up to form larger households occupying less space per person). In a market economy, those price increases (higher rents and property values) are the signals that encourage developers to build additional housing.

Given a responsive building industry, the price increases would be self-limiting except for the near-absolute scarcity of building sites in desirable locations. The characteristic American experience in growing regions has been a speculative increase in land prices greater than the market will sustain over the long run, and a development "rush" that often gets ahead of the rate of growth in aggregate housing demand. Casual observation suggests roughly a three-year cycle of frantic development alternating with pauses during which excess supply is absorbed by further growth in aggregate demand.

It seems unlikely to me that inventory growth could be better managed by central planning of its pace. The reason for overbuilding is not that builders are unaware of other builders' activity, but that they collectively overestimate the pace of demand growth. Such overestimates are also characteristic of city and county planning agencies. In any case, the social costs of fluctuations in construction activity are not large; the industry does not carry a heavy burden of fixed capital that stands idle in slack times, and building tradesmen are versatile as to alternative employment, for example, repairing or remodeling existing homes. *

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* The housing slump of 1980-81, for example, seems to be having that result. A survey of member firms, conducted by the National Association of Home Builders early in 1982, finds that "more than two out of three residential building firms are either diversifying to non-residential construction or have plans to do so within the next 12 months.... About one-third of the respondents indicated that they have switched or plan to do so to the rehabilitation and remodeling business. Another 48% are going into the non-residential construction business." Los Angeles Times, 7 February 1982.

A much better case can be made for regulating the location and design of subdivisions because these aspects of development quite directly affect the cost of public services and congestion in the use of public facilities such as streets. Economies of scale in site assembly and development characteristically cause developers to prefer fairly large tracts of raw land, leading to leapfrog peripheral development. To city planners, it often seems more desirable to redirect growth from peripheral development to infill of unused sites within the built-up area, or to redevelopment of obsolete neighborhoods at higher densities.

One of the advantages of growth is the opportunity it offers for restructuring the composition of the housing inventory to achieve a better match between what consumers want and what is available. If small apartments, or large single-family houses, are in short supply, builders will concentrate on dwellings of that type, which will then become a larger share of the total inventory. During the remainder of this century, it seems likely that small dwellings configured so as to be suitable for owner-occupancy will be the most readily marketable; these could be either single-family houses or apartments in multiple dwellings.

Cities in growing regions often have a substantial supply of older single-family houses on small lots that might accommodate the prospective demand for small owner-occupancy dwellings if problems of neighborhood quality could be resolved. Some are now occupied by elderly persons and will come on the market irregularly as their owners die or move into nursing homes; others have already passed from owner-occupancy into the low-income rental market. Most of these dwellings need more maintenance than they get, simply to continue in service. Nearly all would need redecorating as well as substantial remodeling of kitchens and baths to appeal to prosperous working couples or single persons.

Such rehabilitation has occurred in some places [6]. Currently called "gentrification," it is greeted with mixed emotions by public officials and civic leaders. On the one hand, it seems to realize their fond hopes of attracting the middle class back to central cities overburdened with poor residents; on the other hand, it displaces those poor residents from some of the best housing that is available to them.

A key ingredient of gentrification during the 1970s was amateur real estate speculation. Although quality-controlled comparisons are difficult, single-family homes in central cities were selling for substantially less than their suburban counterparts, but property values generally were rising. Both young couples and single persons with good jobs saw home purchases as highly leveraged investments for their savings, with rates of return that far exceeded those of savings accounts, stocks, or bonds [7]. Without children, they were unconcerned about school quality; and being young and vigorous, were less concerned about street crime than were older persons. Small, centrally located dwellings were therefore appealing to the young even in uncomfortable neighborhoods.

In growing regions, the stimulus of rising property values should continue to encourage such central-city investments, with the result that the supply of rental housing will shrink. Restricting peripheral development by growth control ordinances, moratoria on sewer connections, and the like, would reinforce incentives for increased utilization of central city housing and redevelopment of central city sites.

The other side of gentrification is a narrowing of the rental market for lower-income households, especally those with children. From a landlord's perspective, families with children are not preferred tenants; by and large, children are physically more active, noisier, and more destructive of property than are adults. Because of the noise problem and the absence of outdoor play space, owners of multiple dwellings often refuse to rent to families with children; but in default of better prospects, small single-family houses in marginal neighborhoods are commonly rented to such families. Gentrification removes these homes from the rental market.

The competition for such dwellings could be eased by bringing more of them on the market. If urban "empty-nesters" could be persuaded to give up their single-family homes sooner rather than later, more dwellings would be available for both the "gentry" and the blue-collar and single-parent families. One promising scheme is to construct small apartment buildings on scattered sites in these same neighborhoods and trade them to elderly couples for their single-family houses, which

could then be rented or sold to families. Such transactions would probably not "pencil out" without subsidy; the urban elderly may have enough equity in their homes to trade it for a life-interest in newer albeit smaller apartments with more services; but low-income families would already own single-family houses if they could afford them.

To sum up, unfettered market forces in a growing region will respond quickly to increased demand for housing, by a combination of sprawling peripheral development and selective improvement or redevelopment in central areas. Outcomes could perhaps be improved by public intervention to force more compact peripheral development and to facilitate recycling urban single-family houses, now occupied by elderly persons, into family use. Overall growth in the inventory will help adapt it to current preferences.

INVENTORY MANAGEMENT IN STATIC AND DECLINING REGIONS

Some regions of the United States now have enough dwellings to accommodate their foreseeable populations without significantly increasing the density of occupancy. For example, the Bureau of Economic Analysis expects the population of the Mideast states (eastern seaboard, New York to Maryland) to grow by only 1 percent between 1978 and 2000. Most metropolitan areas within that region are expected to lose population, as did the New York and Philadelphia SMSAs during the 1970s.

Within these static and declining regions, the older urban centers have already lost substantial shares of their peak populations, and already have more dwelling space than their residents are able and willing to pay for. Although the recent intraregional dispersive movement will probably taper off, no one expects reconcentration within declining regions. Through the 1980s at least, an increasing number of central cities in the northeast and north central states and a few elsewhere will find themselves with an embarrassing surplus of housing, while residential construction continues in their suburbs and exurbs.

What should be done with all those empty dwellings? Conceptually, there are several options. One is to seal them up and hold them as potentially valuable capital resources to be reused in the event of unexpected population growth. Another is to keep them on the market as

a price-depressing surplus. A third is to convert them to offices or other commercial use. Finally, we could demolish them and grow vegetables or play baseball on their sites.

Arguments for stockpiling vacant dwellings seem thin in the face of the persistent shrinkage of housing demand in declining regions and the technical difficulties of maintaining empty dwellings. In most neighborhoods where surplus housing is concentrated, draining the pipes and boarding up the windows is not enough; armed guards on 24-hour duty would be needed to prevent break-in, vandalism, and arson. In any event, the stockpiling strategy lacks an effective constituency: The current generation would bear the storage costs for the benefit of a future generation.

Keeping vacant dwellings on the market also entails protecting them while they are vacant, but may otherwise offer advantages to homebuyers by keeping prices low; the advantages to renters are less clear. A case in point is South Bend, Indiana, which has been losing population since about 1960. In 1974, the inner-city vacancy rate for homeowner dwellings was 4.2 percent and the average vacancy duration was 26 weeks. A two-bedroom house in reasonably good repair could readily be purchased for $10,000, far below replacement cost. However, commercial banks and thrift institutions could rarely be persuaded to finance such a transaction; either the seller financed the purchase on a land contract, or the buyer raised money from unconventional sources.*

Homes that are hard to sell drift into the rental market, where they also prove to be hard to rent. In the same part of South Bend, the rental vacancy rate in 1974 was 12.3 percent, and the average vacancy duration was nearly 11 weeks. With so much rent loss, it is not surprising that rental property values were also far below replacement cost, but we were surprised to discover that contract rents were only about 2 percent below those commanded by comparable suburban dwellings.

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* These data are from the Housing Assistance Supply Experiment, conducted by The Rand Corporation in Green Bay, Wisconsin, and South Bend, Indiana, from 1974 to 1979. See [8], [9].

Renters benefited from the housing surplus only in having more choices, and even that benefit is largely an illusion.*

Whatever the immediate benefit to tenants, a local surplus of rental housing is hard on landlords. Because of turnover, vacancies occur throughout the stock; and in loose markets they last longer, reducing revenue even if rent levels are maintained. Property values are depressed, and long-term investment yields look bleak. A common response is disinvesting by undermaintaining rental properties. In extreme cases, such as New York City or St. Louis during the 1960s, buildings are abandoned by their owners, or burned down for the insurance money.

On balance, a local housing surplus is a public nuisance, and the market's devices for disposing of it are slow, messy, and even dangerous. There is much to be said for quick, surgical removal of redundant dwellings by public action. Vacant dwellings that are unfit for habitation are obvious candidates for prompt condemnation and demolition; those in arrears on taxes can also be seized and removed from the inventory. Finally, the power of eminent domain can be invoked for land clearance and redevelopment in neighborhoods where the incidence of vacant dwellings is high. Whatever the method, the removal of the surplus will improve the financial prospects of the rest of the inventory and probably lead to better maintenance of it.

Both spot and neighborhood clearance generate relocation problems. Not all buildings that are obvious candidates for spot demolition are

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* According to the conventional wisdom, renters have more choices in a market with a high vacancy rate because there are more vacant dwellings at any given time to choose from. The proposition is true as far as it goes, but assumes that an apartment hunter spends just one day at that task. A much better measure of the availability of alternatives is the turnover rate--the fraction of all dwellings that become vacant during a specified period of time. In central South Bend, where the rental vacancy rate was 12.3 percent, the annual turnover rate was 60 per 100 dwellings; in Green Bay, with a rental vacancy rate of only 5.1 percent, annual turnover was 65 per 100 dwellings. The national average rental turnover rate is about 60 per 100 dwellings annually [8].

vacant, and their remaining occupants are usually poorly equipped, because of poverty or age or household circumstances, to find other housing even when vacancies are abundant. Neighborhood clearance broadens the relocation problem by demolishing many occupied dwellings; yet, by closing down an entire neighborhood (instead of every fourth house), neighborhood clearance reduces the need for territorially allocated public services (street cleaning, trash collection, police protection) and broadens the alternatives for reusing the site.

These considerations suggest that, where housing is abundant, the humane policy would be to select some declining neighborhoods for improvement, others for demolition, and to schedule these operations so that an inventory of refurbished dwellings was always ready for those displaced by demolition. The idea is not new, but has seldom been smoothly executed; in the massive clearance programs of the 1950s, those who were displaced usually just vanished into the general milieu.

Aggressive demolition could remove the embarrassing surplus of housing in declining cities, but would leave them with another embarrassment, parcels or tracts of unused land. Many of us can remember the vast and dreary expanses of urban land cleared in the 1950s for redevelopment, some of which lay idle for a decade or more. No one is anxious to repeat that experience unless the alternatives are worse.

Eventually, most of those sites were redeveloped and now sport convention centers, industrial parks, luxury apartment blocks, and even some middle- or lower-income housing. Redevelopment was slow because it was attempted in the context of a massive exodus of population; and because the slow pace of redevelopment was not usually anticipated, no plans were made for the interim use of vacant land in ways that would make it a public amenity rather than an eyesore.

That problem could be avoided by deliberate landbanking. No one expects our older central cities to flourish in the 1980s. Instead of following the bulldozers with anxious negotiators seeking to entice a consortium of developers with land-write-downs and tax breaks, I would suggest landscaping the site and installing recreational facilities that require minimal capital investment, such as playing fields and picnic grounds. The cleared land might be firmly dedicated to public use for a

decade or even 20 years, whereupon the city fathers would be free to sell it off to developers.

Even those simple improvements to vacant land would cost money that strapped city governments cannot easily afford. However, it would be interesting to calculate how much they would save in public services as a consequence of demolishing redundant dwellings. Probably, the savings would not pay for a first-class park but might well pay for a pleasant playground.

Removing surplus housing would concentrate the urban population in the remainder of the inventory, thereby improving landlords' revenues by reducing their vacancy losses. In central South Bend, for example, reducing the vacancy rate from 12.3 to 5 percent would increase revenues by 8.3 percent. Unfortunately, that would not be enough to make rental housing an attractive investment.

As I noted earlier, rental revenues have been lagging the cost of supplying rental housing services at least since 1970. Both because of an excess supply of rental housing and the declining real incomes of renters, landlords have been unable to pass their cost increases on to their tenants. Although some investors are misled by nominal increases in property values as all prices rise, the investment performance of rental housing has been dismal for at least a decade. To make rental property a generally attractive investment, most industry sources believe that rents would have to rise by 25 to 30 percent in real terms--that is, in addition to any annual increases needed to offset inflation.

Low-income renters in urban areas typically spend 35 to 50 percent of their gross incomes for housing (contract rent plus utilities), and are unlikely to spend more voluntarily. Absent public intervention in the market, I expect the rental inventory to shrink and standards of rental property maintenance to fall.

Aside from the demolition program discussed above, what forms of public intervention would ameliorate this bleak prospect? The conventional remedy for low-income housing problems is subsidies for new construction, which would be irrelevant in markets that already have too much housing for their populations. The most likely intervention, rent

control to protect tenants from rent increases, would only encourage the decline of the rental industry [10]. Rent increases on the scale needed to cure a sick industry are likely to be achieved only by a general entitlement program of rent subsidies for low-income families.

During the 1970s, the Section 8 Existing Housing program served that function on a limited scale. By 1981, over 600,000 rental dwellings were occupied by participants who paid a specified fraction of their incomes for rent, while the U.S. Department of Housing and Urban Development contributed the balance under a contract with the landlord. An evaluation of this program, conducted by HUD in 1976 [11], revealed that when dwellings entered the program, their rents rose sharply. For dwellings that did not change tenants and did not need repairs in order to qualify for the program, the average rent increase upon entry was 26 percent. That increase was borne entirely by HUD, and resulted in an annual transfer (at 1979 program levels) of $218.5 million to landlords over and above the market rents of their dwellings [12].

In October 1981, the President's Commission on Housing recommended that "consumer housing assistance grants," also known as "housing allowances" or "housing vouchers" be substituted for future commitments to subsidize construction of rental housing. It also suggested that continuing subsidies to existing projects, including both public housing and the Sec. 8 Existing Housing program described above, might eventually be transformed into an allowance program [13]. HUD Secretary Samuel R. Pierce, Jr., has indicated his general agreement with the commission's recommendations, and is preparing a legislative proposal for an allowance program.

If large enough* such a program could considerably improve the prospects of the rental housing industry for the rest of this century. The main problem, aside from the cost of such a program, is finding the

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* Khadduri and Struyk estimate that "an open enrollment program using existing units exclusively would cost about $1,701 per subsidized household in 1979 dollars, or about $4.4 billion per year, for the 2.5 million additional households [renter households not now receiving assistance] that would join the program.... By the seventh year of the entitlement program, outlays [would] be lower than they would have been if current programs were continued." [14], pp. 19 and 23.

appropriate balance between desirable rent increases, needed to improve the yield of rental property investments, and desirable decreases in the rent burdens of participating households. In short, how should a federal subsidy be split between landlords and tenants?

To summarize, the main foreseeable housing problem of declining regions is a general surplus of housing that will be most conspicuous in their older urban centers. Single-family homes that cannot be sold to owner-occupants will drift into the rental market, adding to the excess supply of rental dwellings that already exists. The renter population, creamed of upper-income families who can shift to home-ownership, may decline numerically and will certainly have lower average incomes than in the past. For all these reasons, the revenues from rental properties are unlikely to rise to levels that would encourage investment in or even maintenance of the existing inventory. Two kinds of public intervention would help these housing markets adjust to their prospects: demolishing the redundant stock, and subsidizing rents for low-income households.

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