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CHAPTER I

PURPOSE AND SCOPE

THIS volume has three objectives. The first is to measure and otherwise describe the formation and financing of capital in nonfarm residential real estate from approximately 1890 to 1950. The second is to identify strategic factors that have determined capital formation and financing in this sector of the economy. The third is to assess the present and prospective position of these forces as they bear upon the future course of residential construction and its financing.

Much of the literature on the behavior of residential building activity is concerned with cyclical fluctuations, particularly the long swings. In contrast, the purpose of this volume is to discern secular trends and to extract from them judgments on the long-term future. To determine secular trends, data describing long cycles from 1890 to 1950 are used along with other materials. But an interpretation of the forces that have *caused* cyclical fluctuations in residential construction is beyond the scope of this monograph. Consequently, no consideration is given to the question whether long swings in the volume of residential building have been due to factors inherent in the product or the operation of the market, rather than to external influences such as wars.

The study deals with new residential construction as an end product, rather than with capital formation of the firms that participate in the construction of residential building (the "construction industry"), or the short-term financing of building operations themselves. In this study, capital formation in physical terms is defined as new buildings with one or more dwelling units designed for housekeeping; in monetary terms, it means expenditures for the construction of such buildings and additions and alterations. Capital financing means the funds spent in the first acquisition of new residential facilities upon completion. Data are also presented for nonhousekeeping residential construction, such as that of hotels and motor courts, but conceptual and statistical considerations make it advisable to limit measures of capital formation to housekeeping construction.

The analysis of capital formation in residential construction in this volume excludes public housing. Public housing is built in response to a set of public decisions rather than in response to the market forces which historically have shaped the course of private construction. Moreover, public housing programs to date have been so small that their inclusion would not alter the historical record significantly. In the discussion of the future role of government activity, however, it will be necessary to touch upon public housing and urban redevelopment programs as they may affect private as well as total capital formation and financing in residential construction.[1] This monograph also excludes farm housing.[2]

The treatment of land poses particular problems in a study of capital formation and financing in residential construction. New real capital comprises not only the buildings proper but also the nonstructural site improvements associated with residential building, to the extent that they are privately financed, such as grading and landscaping, connections with sanitary and storm sewers, driveways, streets, and sidewalks. Land usable for residential (and other) construction is, in fact, a highly processed product requiring substantial inputs.[3] Fortunately, recent revisions of official estimates of private residential construction expenditures attempt to include these items to the extent that they are not covered in estimates of public and nonresidential construction (such as utility construction). An effort has been made to include them also in the estimates presented in this study for periods not covered by official statistics. Thus the definition of capital formation in new residential building is modified to include privately financed site improvements associated with construction.

Land is an even more important element in the analysis of capital

[1] At the end of 1953 a total of about 400,000 dwelling units had been completed or were under construction under federally aided low-rent public housing programs. Inclusive of state and locally financed projects, the number would still be below 500,000, or little more than 1 per cent of the total number of nonfarm dwelling units standing at that time. Additional publicly sponsored permanent projects were built under defense and war housing programs, but these have been or will be transferred to private ownership. During the period 1935-1953 the number of all publicly financed permanent nonfarm dwelling units started was about 600,000, or 5 per cent of all units started. Some of these have been sold to private owners. In accordance with common usage, the distinction between private and public construction is drawn on the basis of ownership. When title to new residential facilities is vested in private individuals or corporations or institutions, construction is designated as private, although it may be financed with mortgage loans insured by a federal agency or assisted by real estate tax benefits. When title is held by a public agency, construction is designated as public, although the funds may have been raised by selling bonds to private investors. Housing construction sponsored by public agencies, as well as other public construction, is conceptually included in another volume, part of the full study of trends in capital formation and financing, which will deal with capital formation in government.

[2] Housing on farms forms an integral part of capital in agriculture and is therefore included in the Study of Formation and Financing of Capital in Agriculture in this series. See Alvin S. Tostlebe, *The Growth of Physical Capital in Agriculture, 1870-1950*, National Bureau of Economic Research, Occasional Paper 44, 1954.

[3] For single-family house developments, for example, the cost of site improvements in recent years may be estimated at two to three times the cost of "raw" land. This relationship varies, of course, depending upon locality, legal requirements, and type and price class of development (cf. *The Community Builders Handbook*, Urban Land Institute, 1948, pp. 70-75).

funds used for the acquisition of new residential construction. Mortgage loans are typically secured by both structure and land. The amount of debt that may be incurred both in individual transactions and in the aggregate is conditioned by the value of land as well as of structures. Consequently, the analysis of capital funds necessarily departs from the concept of real capital as reproducible capital.

Another phase of land development has been of some historical importance to capital formation and financing in this sector of the economy: the use of real resources and capital funds in the development of "premature" or "defunct" subdivisions. These are subdivisions which were laid out without either construction of buildings at the time or such construction later.[4] Resources were expended for plotting, grading, utilities, streets, and so forth. Large amounts of equity and borrowed funds were sunk into these developments. Financial intermediaries were involved through mortgages and other debt instruments. The frenzy of speculation in more or less improved lots during real estate booms in the nineteenth century and through the twenties in this century at times attracted perhaps an even wider nonprofessional participation than the speculation in stocks.

Thus inclusion of site improvements of defunct subdivisions would be desirable for neatness in definition, and it would cover an important and colorful phase of financial history. Nevertheless, the temptation to deal with this aspect of capital investment must be resisted. Although general descriptions and analyses of some local situations exist,[5] there is no comprehensive statistical record of these operations.

Moreover, there is some question whether the record would have meaning for the future. Neither the recovery of building during the late thirties nor the high volume of construction since the end of World War II has produced speculative subdivision activity of the magnitude and character observed in comparable earlier periods. There

[4] Some of the premature subdivisions of the twenties have been used for housing since. However, suburban development has in most cases jumped over these subdivisions because the multiplicity of small-lot ownership, abandoned property, clouded titles, accumulated tax arrears, and outmoded street patterns have made land assembly for new building operations difficult if not impossible. In cases where defunct subdivisions were used it has often taken twenty to twenty-five years before the use has occurred.

[5] Cf. A. M. Sakolski, *The Great American Land Bubble*, Harper, 1932, and the literature quoted there; Homer Hoyt, *One Hundred Years of Land Values in Chicago*, University of Chicago Press, 1933; Ernest M. Fisher, "Speculation in Suburban Lands," *American Economic Review*, March Supplement, 1933; Philip H. Cornick, *Problems Created by Premature Subdivision of Urban Lands in Selected Metropolitan Districts*, Division of Planning, State of New York, 1938; Helen C. Monchow, *Seventy Years of Real Estate Subdividing in the Region of Chicago*, Northwestern University, 1939; and Homer B. Vanderblue, "The Florida Land Boom," *Journal of Land and Public Utility Economics*, May 1927, p. 119.

has been a considerable volume of transactions and uptrading in tracts sought by builders for construction operations. But subdivision for sale of small lots to individuals is much less frequent, partly because of the growing importance of operative builders who combine land development and house construction in one operation. Other influences restraining speculation in lots are the greater caution of municipalities in undertaking or financing the extension of facilities, the spread of subdivision controls, and perhaps a more sober public attitude.

Under these circumstances it must suffice to identify premature subdivision activity as historically important in the development of residential real estate in this country. Real capital and large amounts of funds were invested in it without adding to the permanent stockpile of real assets. Yet if the changes in land development practices observed over the past twenty years or so hold, residential construction and its financing should be less exposed to the disturbances that were often created by excessive subdivision operations.

Finally, a word on the vast amount of data presented in this volume is in order. The accuracy of the statistical record leaves much to be desired. The reader will not need to look hard for definitional difficulties or weaknesses of data. On the other hand, both the quantity and the quality of data in this field have greatly improved over the past twenty years. An analysis along the lines attempted in this volume can be undertaken with greater confidence than would have been possible some time ago. At various points during the course of this study, data or estimates were developed that make some modest contributions to the improvement of the factual record—in particular, new estimates of the volume of residential construction before the twenties.[6] Nevertheless, the reader should be wary of the deficiencies of knowledge in an area in which economic and statistical research is of fairly recent vintage.

The manuscript for this volume was completed in the summer of 1954. Because the question may arise as to whether data becoming available since that time warrant revision of the basic record of capital formation and financing in residential real estate, or of major conclusions drawn from the record, a postscript was prepared in early 1956. Also, the sections dealing with the role of the federal government in housing and mortgage finance were revised to reflect major changes in legislation and policies since completion of the original study.

[6] For a detailed description of these data and their derivation see David M. Blank, *The Volume of Residential Construction, 1889-1950*, National Bureau of Economic Research, Technical Paper 9, 1954.