WORKING PAPER

COMMENTS ON THE PROPOSED URBAN DEVELOPMENT CORPORATION

1. Concept

In its proposal for the establishment of an Urban Development Corporation* HUD asserts, "The greatest domestic challenge that faces America today is the need to rehabilitate and rebuild the nation's slum neighborhoods and the 5,000,000 substandard and deteriorating dwellings in which 20 million Americans live. The problem exists in large and small cities throughout the entire country." The Proposal points out that neither government nor industry can do this alone, and proposes a nationally based, private, non-profit institution--UDC--which has access to substantial amounts of FHA insured mortgage credit, and the ability to offer major inducements to cities, industry, labor, and residents of slums. It proposes that UDC be directed at rehabilitation, with the objective of rehabilitating 500,000 slum dwelling units within the next decade. The proposed short term goal is rehabilitating 30,000 dwelling units during the first two years of its operation. For these first two years it is asserted the UDC will require a reservation of $200 million in 221(d)(3) below market interest rate (BMIR) mortgage credit funds, $200 million in FNMA special assistance funds for rent supplement dwellings, and $9 million in rent supplement funds. In addition, $12 million in working capital will be required for the first two years of operation which is to be supplied by foundation and corporate grants and loans, and HUD demonstration funds.

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*"A Proposal for a Nationally Based Private Non-Profit Urban Development Corporation to Rehabilitate and Replace Substandard Urban Slum Dwellings," HUD, Nov. 1966

The kernel of the UDC concept is that the large and orderly market it provides will produce an efficient, aggressive and technologically advanced rehabilitation industry. This new industry will serve the total rehabilitation market, private as well as public.

2. Feasibility

There appear to be four key questions concerning feasibility of this proposal:

- Technological
- Social
- Scale of operations required
- Acceptability

The technological feasibility of massive rehabilitation of many types of slum dwellings has been demonstrated. The most striking example is the 114th Street program in Harlem. There the buildings were largely gutted, and attractive, healthy, modern apartments created, one for each of the far below-standard units that were scrapped. HUD estimates that there are more than 5 million units in the nation's slums that are structurally sound and susceptible to such rehabilitation.

That many slum neighborhoods have potential to respond to the impact of rehabilitation is also strikingly demonstrated by the 114th Street experiment. The pride shown by the residents of the rehabilitated units, the low level of vandalism during construction, and the enthusiasm of the neighborhood for the project illustrate this. HUD estimates that 5 million units suitable for rehabilitation are located in slum neighborhoods with the potential to respond to the improvements offered.

The minimum effective scale is largely a matter of judgement. Experts consulted seem to agree that the scale proposed (30,000 units in the first two years, 50,000 units annually thereafter) is sufficient to provide the leverage needed with labor, contractors, the materials industry, and city administrations to achieve the innovations desired and to visibly affect the quality of life in the nation's slums. A commitment to only the first 30,000 units may be sufficient but on this opinions differ.

HUD has been in contact with industry, labor and city representatives and reports that in every case those interviewed were persuaded of the merits of the UDC idea. Organized labor's reaction was favorable to the suggestion of a national contract with UDC containing work rules appropriate to efficient rehabilitation and providing for crews which include labor from the slum neighborhoods. Builders and developers were pleased with the significant role the private sector could play. Manufacturers expressed interest in undertaking research and development of products for a new rehabilitation market.

3. Costs

In the UDC proposal the average total cost per dwelling units is estimated to be $13,000. This is a conservative estimate based on the very limited experience to date. There is reason to believe that UDC activity will bring the unit costs down due to economies of scale, improved contractor management, increased labor productivity, and to technological innovations induced by the new rehabilitation industry. That there will be cost reduction is highly likely, and that this reduction will spur private rehabilitation seems probable, but there is no basis for quantitatively estimating the degree of reduction possible and, in all likelihood, will not be until after a few years of UDC operation. It is possible that costs could go as low as $9,000 per unit.

The UDC proposal suggests that the initial 30,000 units be financed half with BMIR (Below Market Interest Rate) mortgage credit and half with FNMA special assistance funds for rent supplement dwellings. The annual rent supplement funds that would be required depends, of course, on the average ability to pay. If the BMIR funded 15,000 units were all rented to families with annual incomes over $4,000, the annual rent supplement required for the remaining 15,000 units would be between $12.2 million and $19.6 million, depending upon the tenants' incomes.

The mortgage credit and rent supplement funds required for the first five years of operation are shown in Table 1, based on the estimated cost of $13,000/unit. The average annual tenant income can be expected to be between $2,000 (which was the 1965 national average income of the 2.5 million slum families with incomes below $4,000/year) and $4,000 which is typical of incomes in Harlem.

The commitment to future rent supplement payments depends, of course, on the degree to which costs are reduced by the new rehabilitation industry and upon the changes in family income. Table 2 illustrates this. It can be seen that unless costs are reduced to below $9,000/unit

TABLE 1

Funding Requirements

(For Unit Cost = $13,000)

	YEAR				
	1967	1968	1969	1970	1971
Units Constructed During Year	5,000	25,000	50,000	50,000	50,000
Units Completed	5,000	30,000	80,000	130,000	180,000
Average Units Completed During Year	2,500	17,500	55,000	105,000	165,000
Annual BMIR Mortgage Credit ($,millions)*	33	167	325	325	325
Annual FNMA Mortgage Credit*	33	167	325	325	325
Annual Rent Supplement Funds($,millions)** (Tenant Income = $4,000)	1.0	7.1	22	43	63
Annual Rent Supplement Funds($,millions)** (Tenant Income = $2,000)	1.6	11.5	36	69	108

*Based on half the units being financed with BMIR 3%-40 year mortgages, the other half with 6%-40 year mortgages.

**Based on rent supplements applicable to the one-half of the units that are financed at 6%-40 years.

TABLE 2

Annual Rent Supplement in $ Millions,
After Five Years
(90,000 Units, 6% 40 Year Mortgages)

Average Tenant Annual Income	Average Unit Cost		
	$9,000	$11,000	$13,000
$4,000	23	48	73
$3,000	45	70	95
$2,000	68	93	118

or average incomes rise to over $4,000/year; rent supplements will be required indefinitely.

4. Additional Benefits

a. Cost Reduction for Private Rehabilitation

The total market for rehabilitation is far greater than the 500,000 units proposed for UDC action during the next decade. Even if half of the 5 million units presently suitable for rehabilitation are torn down, the private sector market for rehabilitation is 4 times larger than that proposed for UDC over the next decade. Cost reductions stimulated by UDC will therefore pay a large dividend in terms of reduced economic rent for slum families. This can be considered to multiply by 5 the savings which are reflected in the rehabilitation directly sponsored by UDC.

b. Slum Employment

Rehabilitation is, and probably will remain, a labor-intensive industry. Approximately one-half man year of on-site labor is required per rehabilitated unit. If half of this were to be provided by local labor, rehabilitation at the rate of 50,000 units per year will directly employ some 12,000 slum dwellers. Since, presumably, the same people would participate in the private rehabilitation market, the number of slum dwellers employed in the new rehabilitation industry might be 50,000.

c. Application of New Technology to New Construction

The degree to which technological innovation stimulated by rehabilitation will be effective in reducing the cost of new construction is uncertain. What is clear is that new products will be used when they become available market items, thereby improving the quality if not the cost of new construction.

d. Interaction With Other Programs

UDC-sponsored rehabilitation activities can strongly reenforce other programs. Among these are the Demonstration Cities, home ownership for slum dwellers, and neighborhood Service Centers.

5. Additional Problems

a. Mortgage Terms and Economic Life

The use of 40 year mortgages (and consequently an implied remaining economic life of 55 years) has been assumed by HUD. However, it is by no means clear that rehabilitation can provide either physical or economic lifetimes approaching this in a substantial fraction (perhaps most) of the neighborhoods under consideration. Reduction of the mortgage terms to 20 years would require an increased annual rent supplement of $330/unit.

b. Property Acquisition

Limited experience suggests that it is possible to assemble properties for rehabilitation, using only the threat of rigid code enforcement to keep prices from rising. Alternately, or in conjunction, condemnation proceedings can be used in Urban Renewal Areas.

c. Rehabilitation vs. New Housing

While rehabilitation has well known social advantages over slum clearances followed by new construction, it offers far less opportunity for cost reduction through technological innovations and raises the thorny problem of the wisdom of investing heavily in obsolescent properties. An intriguing proposal for neighborhood redevelopment using a mix of rehabilitation and new housing was developed in a working session on UDC*. UDC's concern with rehabilitation to the exclusion of new housing could become a block to the kind of federal effort needed to obtain cost reduction through major innovations in construction technology and project management.

It has been suggested that the reason the Proposal selected rehabilitation rather than a mixed rehabilitation/new housing objective for the UDC was the concern that labor in particular (and perhaps the construction and materials industries as well) would strongly oppose the UDC unless it clearly restricted its activities to rehabilitation. This is a matter of judgment and could very well be correct. It must be noted, however, that acceptance of UDC might be forthcoming if these groups realize that new construction based on improved and economizing technology is inevitable and UDC can provide a sympathetic client with which they could cooperate to gradually modernize traditional practices. This is a subject that future staff work might illumine.

d. Effect on Equity Holders

If the costs of rehabilitation remain high, the federal government, UDC and the cities involved will be predisposed to use all means at their disposal to drive down the costs for acquiring the properties for rehabilitation. Rigid code enforcement has been suggested as the major tool for this. It is not clear that a self-avowed policy of liquidating the equity holders by code enforcement won't develop a fatal backlash.

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*Interim Report: Study of the Feasibility of an Urban Development Corporation

e. Relationships

The proposed relationships of UDC with the local government, various national groups, and the neighborhood (including the question of continuing responsibility for maintenance and upkeep of the rehabilitated buildings) are largely undefined.

6. Conclusions

a. While very many details of UDC remain to be worked out, it appears highly likely that the major objectives will be met if a strong Presidential commitment is given.

b. This is the only practical mechanism that has been found for visibly improving the quality of slum housing within the next few years.

c. The minimum effective scale of the UDC is one which can stimulate a new industry in the U.S.--the rehabilitation industry. Without the UDC this industry will probably not develop. The proposed level of UDC effort appears to be the minimum needed if it is to be successful.

d. The costs--in terms of below market interest rate mortgage credit and rent supplements amount to a subsidy of a substantial fraction of the total rent. The rent supplements involve a firm long term commitment, which is uncertain.