HARNESSING THE PROFIT MOTIVE

TO HOME BUILDING

and

MEETING OUR HOUSING NEEDS

A Talk for The

HOUSING INDUSTRY PRESIDENTS CONFERENCE

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by

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I hope I am right in thinking that the quickest and surest way for me to get you interested in what I've been asked to tell you today is to start by assuring you that the No. 1 purpose of my talk is to help everybody in the building business make more money, including each and every man in this room.

I've been asked to talk to you about how the government could make it more profitable for you home builders to build more and better houses, more profitable for you building product suppliers to sell more and better building products to the builders, more profitable and less risky for you mortgage lenders to finance more and better homes. I've been asked to talk to you about the best way to harness the profit motive forward instead of backward (as now) to providing a lot more and better homes. And I've been asked to explain to you how all this could be accomplished without any subsidy at less than no added cost to the taxpaying public.

And I've been asked to make all this clear and believable in less than 20 minutes!

That's a whopping assignment. It's such a whopping assignment that I lay awake night after night wondering what and where would be the best place for me to begin my talk.

In the end I decided the best place for me to begin would be where my own understanding of your profit problem began. That was twenty years ago when my good friend, Tom Coogan, the Number 1 elder-statesman of the Home Builders Association, spelled out the problem to me in 17 words. Said he: "There is almost no profit at all in building homes. All the profit is in the land".

That started me asking questions, and almost everyone I questioned gave me pretty much the same answer. For example: Nat Rogg, who was then fast giving government a new multi-billion dollar problem. Why has our profit system failed to provide at least one decent home for every family needing to be housed, and why has the profit motive failed to give us, in the words of Jim Rouse, Urban America's first president, "Even one good city?

To that question the only answer I can suggest is the answer Tom Coogan offered when he said, "There is almost no profit at all in building homes. All the profit is in the land".

The big landowners and land speculators want you to believe that good land around our cities is getting scarce and that's why the cost of land for building has been skyrocketing more than six times as fast as other prices. If any of you here today believe that nonsense, I can only repeat to you the advice given by famed Realty-Researcher Roy Wenzlick, quote, "Just look out the airplane window as you fly home and see for yourself that there is no shortage of land ripe for development or redevelopment in and around any American City". Says equally famed Land-Economist-Statistician Homer Hoyt: "Even in our most densely developed urban areas there is more land than we will ever - repeat, ever - be able to use for housing, shopping, and industrial development". Says Professor Gaffney, America's most forward-looking land economist, "The biggest reason why land prices have soared so crazy high is that land is so lightly taxed that its owners can afford to hold vastly underestimated millions of acres in and around our cities off the market, waiting for an enormous community investment of other people's money and other taxpayers' money to multiply the selling price of what they are now refusing to sell".

As an example of the enormous investment of <u>other</u> taxpayers' money that is helping to multiply the price of land for housing, perhaps I should remind you that around New York the Regional Plan Association added up to more than $32,000 per lot the costs other taxpayers have to pay to provide the community facilities needed to make the land for one more home reachable and livable, and thereby enable the land owner to sell for say $40,000 an acre land he probably bought for well under $5,000 an acre. I hope you will agree that this gives land speculation and land price inflation a very juicy subsidy at the expense of other local taxpayers!

And now as a shocking example of how land is undertaxed, perhaps I should cite once again the case of Florida multi-millionaire Ed Wright, whose estate is about to auction at a minimum bid price of $18,800,000 his remaining land holdings. His tax for the past ten years on all of this land has been well under $20,000 net a year!

I hope you have noticed that in my talk today I have tried never to ask you to accept my own opinions. I've just quoted what Tom Coogan told me, what Nat Rogg said, what the president of the Mortgage Bankers said, what Roy Wenzlick said, what multi-millionaire land-owner Ed Wright said, etc., etc., and I've tried to keep all these quotes short. But now I'm afraid I'd better read you a longer quote to make sure all of you understand what's what with the property tax and what property tax reform is most urgently needed to make it much more profitable for you to build, supply, finance, and sell more and better homes.

So I'm going to read you an excerpt from the Consensus of the Urban experts at a round table I moderated for our magazines—a round table that was cosponsored by the Council of State Governments, the Conference of Mayors, the National League of Cities, and the National Association of

Counties—a conference whose panel members were hailed by New York's Mayor Lindsay as, quote "The Who's Who of Urban Development".

Said these urban experts:

"Too few Americans seem to understand that the property tax is not just one tax. On the contrary, it combines and confuses on one tax bill two completely opposite and conflicting taxes, and it would be hard to imagine two taxes whose consequences would be more different.

"One of the two conflicting taxes fused and confused in the property tax is the tax on the improvement—the tax on what past, present and future owners of the property have spent or will spend to improve it. And it should be obvious to anyone that heavy taxes on homes and other improvements are bound to discourage, inhibit, and often prevent private investment in improvements.

"The other levy confused in the property tax is the land tax—the tax on the location value of the site, the tax on what property in that location would be worth if the owners had never done anything or spent anything to improve it, the tax on a value that derives mostly from an enormous investment of other people's money and other tax-payers' money. And it should be obvious to anyone that heavy taxes on the locations cannot discourage or inhibit improvements; on the contrary, heavy taxes on locations could put effective pressure on the owners to put their sites to better use so as to bring in enough income to earn a good profit after paying the heavier tax.

"All this is so obvious that you would think every community would try to tax land heavily and tax improvements lightly if at all; but just the opposite is the case. Almost every community collects two or three times as much money from taxes on improvements as from taxes on land. In fact, many communities tax improvements more heavily than the combined local, state, and federal taxes on any other major product of American industry except hard liquor, cigarettes, and perhaps gasoline.

"A 3-per-cent-a-year tax on improvements may not sound big compared with an income tax that scales up to 70%, but it sounds small only because it is expressed as a percentage of capital, whereas the income tax, as its name makes clear, is expressed as a percentage of income. The enormity of the improvement tax becomes self-evident when we restate it in income tax, in sales tax, and in consumer tax terms:

"First in income tax terms:

"A 3-per-cent-of-true-value tax on improvements is apt to tax away 75% of the net income the improvement would otherwise earn on the equity investment.

"And now in sales tax terms:

"The Federal Advisory Commission on Intergovernmental Relations has calculated that a 3-per-cent-of-true-value tax on improvements is the instalment plan equivalent of a 57% sales tax; i.e., it will cost the improver as much as a 57 per cent single-payment sales tax would cost him if he could finance it at 5 per cent interest over the 60-year life of the improvement.

"And finally in consumer tax terms:

"A 3-per-cent-of-true-value tax on improvements will cost the consumer more than a 25 per cent consumption tax; i.e., it will add more than 25 per cent to the rent a tenant must pay or more than 25 per cent to the carrying costs an owner must meet."

Said the Douglas Commission report: "It seems inconceivable that we would knowingly impose such a tax penalty on such a necessity as more and better shelter, but we have!"

Conversely, in an economy in which it is hardly too much to say that everything else is overtaxed, we tax idle and under-used land needed now for home building so lightly that its owners can hold it off the market at a net tax cost seldom if ever exceeding 1/2 of 1% a year, waiting for inflation and the enormous investment of other people's money and other taxpayers' money to double its selling price (i.e., to increase the selling price 200 times as much as the net yearly tax cost of not selling!

All this explains why Fortune said way back in October 1963 that "Land is set apart from the market action of supply and demand by preferred tax treatment". That's why Time said long ago that "Today's property tax with its weight on the improvement harnesses the profit motive backward." That's why Professor Lowell Harriss, the eminent economist for the Tax Foundation, says "Practically all competent economists who have studied the problem are now agreed that land should be taxed much more and private investment in houses and other improvements should be taxed much less if at all." And that's why every property tax study I know of, from Wellington in New Zealand to San Francisco on our West Coast to Washington on the East Coast to Whitstable in England has confirmed the urgency of uptaxing the community-created locational value of land and down-taxing the owner-created and owner-paid for value of improvements. Concludes the Castonguay Report to the Provincial Government of Quebec: "The land tax is an ideal instrument to enable the entire community to share the increase in land values that results from economic and population growth and from investments paid for by the community rather than the owner."

The building industry and its customers are the first and biggest losers by the way today's misapplication of the property tax harnesses the profit motive backward. Specifically:

The high price of land which has been so profitable for land speculators is bad for land developers. They are, in fact, its first victims, and often its biggest losers, for the more they have to pay for raw acreage the bigger their risk, the bigger their cost for interest paid or interest foregone, the less money they have left to pay their development costs, and the less their chance of making a good profit on their investment.

The high price of land is bad for architects because the more money their clients must pay for the site the less they have left for creative quality design, quality features, and quality construction. Today's land costs are the No. 1 reason we could afford a far richer architecture when America was much poorer than we can afford now that America is so much richer.

The high price of land that has been so good for acreage owners is bad for homebuilders because the more the builder has to pay for his lots the less money he has left to build more sales appeal into his houses, the greater his risk of having to price his product out of the market, and the less his chance of selling his houses at a good profit.

The high price of land has been equally bad for subcontractors, building material dealers, and building product manufacturers. When a builder has had to pay thousands of dollars too much for his land he has to take that money out of his houses somewhere or go broke, so he passes.

the squeeze on to his subs, he passes the squeeze on to his dealers (or tries to eliminate the dealer and the dealer's mark-up entirely), and he passes the squeeze on to the building products manufacturer, too often by buying the cheapest products he thinks he can get by with.

The high price of land that has been so good for acreage owners is bad for the mortgage lenders and mortgage holders, because the more water there is in the land price the less real value the mortgage will represent and the less the mortgage holder's security. As for home buyers and the building industry's other customers, they are the final victims of the high price of land, for they end u p paying the entire bill. They are also the first victims of the way the product they bought from the building industry is now overtaxed.

Ever since 1960 all levels of government - Federal, state and local - have been trying to solve this profit-incentive problem by pouring billions of subsidy and tax-abatement dollars into the housing market. Biggest of these outpourings was under Housing Secretary Romney, and the saddest government report I ever read was his admission to Congress that his subsidy program had been, quote "a hundred billion dollar failure". In the fading light of that enormous failure, I dare not hope the present administration's subsidy program will do much better. Says the Tax Foundation economist, quote: "Much if not most of the benefit of subsidies has inured to landowners. They are not the persons the subsidies were designed to benefit". In New York, to cite a specific example, the city's housing director told me that when the state government enacted the Mitchell-Lamo subsidy program for middle-income housing, the price of land suitable for middle-income housing doubled overnight.

Many cities from coast to coast have been trying to encourage in city redevelopment by offering property tax exemption and property tax abatements for new construction, but most of these exemptions and abatements have been very quickly capitalized into higher land prices. New Hampshire has done a much better job of holding down its government costs than any other state, and the sad result is that land price inflation is worse in New Hampshire than in any other eastern state! California voted to cut property tax collections 43%, and the first result of this tax cut was to send land prices soaring still higher in a state where land price inflation was already so crazy high that this year the Irvine heirs were able to sell for $413,000,000 the land their grandfather had bought for $90,000.

These multi-billion dollar payouts and abatements have not availed, so perhaps I should remind you of the conclusion reached by Gurney Breckenfeld's 1977 study for FORTUNE that our cities are hastening their decline by so mis-applying the property tax that it creates a multi-billion dollar self interest in doing what's bad!

So much for my assigned topic of how to harness the profit motive forward instead of backward to building more and better homes and thereby make home building more profitable for every one in the housing industry.

But before I close I think perhaps I should tell you that left to choose my own topic, I would have spent this half hour trying to make all of you understand the disastrous consequences to our whole economy of the crazy inflation in land prices that we are now subsidizing by gross underassessment and undertaxation, by abatements and tax exemptions, by wild tax cuts like Jarvis-Gann, by direct state and Federal payments, and by making other local taxpayers pay most of the capital cost of the community facilities needed to multiply the landowners' unearned increment on their land holdings.

Five years ago Fortune published an outstanding article by Max Ways headlined "Land: The Boom that really hurts", and Time laid it on the line that "The land-price spiral is raising the price of everything we buy". Packing plants, bakeries, super markets, filling stations, widget makers all pass on to their customers the rising price of the land on which they set up shop. The rising price of farm land is reflected most directly in the price of food! And the New York Times ran a story that spelled out that at 1973 land prices farmers can't afford to buy land unless they can count on $6 a bushel for soy beans, 55 cents a pound for cotton, and $2.50 a bushel for corn.

That was in 1973. Since then land prices have nearly doubled. In 1973 Max Ways told me his best estimate of the total price of land was one trillion three hundred billion dollars, quote "A total greater by far than all our vaunted investment in industrial production". Today the figure must be close to two trillion dollars. At two trillion dollars the landowners' unearned increment in land prices must be imposing a three times as heavy a burden on our National economy as the Federal debt!

Now the soaring price of land is enabling homeowners to multiply their mortgage debts. At last month's meeting of the National Tax Association one speaker reminded us that mortgage debt is soaring at least four times as fast as the increase in the Federal debt that everyone recognizes as a major factor in our overall inflation.

My time is up, so I can't pursue this question any further.

But I hope I have at least made all of you give thought to the National urgency of reversing or at least halting the land price inflation that may well be a bigger factor in our overall inflation than government overspending or the soaring price of oil.