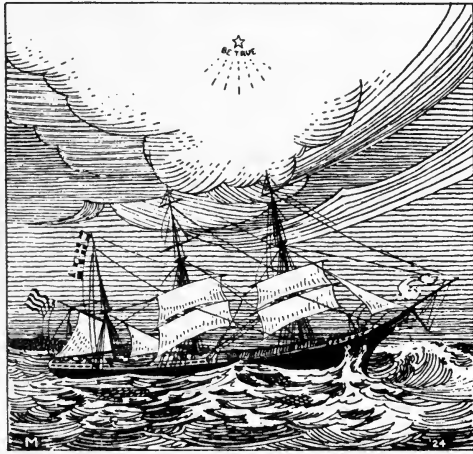


# Home Finance and Taxation

LOANS, ASSESSMENTS AND TAXES  
ON  
RESIDENTIAL PROPERTY



JOHN IHLDER

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THE PRESIDENT'S CONFERENCE ON  
HOME BUILDING AND HOME  
OWNERSHIP

*Called by*  
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PUBLICATIONS OF THE PRESIDENT'S  
CONFERENCE ON HOME BUILDING  
AND HOME OWNERSHIP

FINAL REPORTS OF COMMITTEES

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# Home Finance and Taxation

*Reports of the Committees on*

FINANCE      FREDERICK H. ECKER, *Chairman*

TAXATION     THOMAS S. ADAMS, *Chairman*

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*Edited by*

JOHN M. GRIES and JAMES FORD

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THE PRESIDENT'S CONFERENCE ON HOME  
BUILDING AND HOME OWNERSHIP

WASHINGTON, D. C.

*Acknowledgment is made to James S. Taylor and John E. Burton, the Secretaries of the Committees whose reports are incorporated in this volume, and to Arthur J. Mertzke, Research Assistant for the Committee on Finance, for preliminary editing and frequent help in the preparation of these final reports for publication; to John C. Leukhardt for the compiling of the Index and to Dan H. Wheeler for the detailed work of preparing this volume for the press.*

*Grateful recognition is also made here of the devoted and able work performed by Thomas M. Curran (deceased) who first served as Secretary of the Committee on Finance.*

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## FOREWORD

Most families have to borrow money when they buy or build a home. That is where the problem starts and it does not end until the family has retired the debt and owns its home free and clear.

The objectives of home financing can be stated in simple terms. A long term loan, amortized through regular instalment payments, should be available at all times to any family in a position to make an adequate down payment on the house and to continue regular payments of interest and principal. Interest charges should be reasonable. Loans should be made on a basis of sound appraisal and good judgment as to the borrower's capacity to pay to protect both the borrowers and the lending institutions which are trustees for the people's savings.

Full credit is due to the great number of building and loan associations, banks, insurance companies, and other lenders that have made possible a substantial increase in home ownership in many of our cities during the past decade. It is only too evident, however, that there are wide areas in which satisfactory conditions have not yet been reached. There is need for better appraisals, for more careful scrutiny of personal risks, and for conservatism when other groups are carried away by boom conditions.

The troublesome second mortgage stands out as a problem to be solved through public spirited cooperation within each community, a course which examples have shown to be practicable. At a number of points also existing state legislation appears to be a negative influence and deserves careful review. Our home financing system will nevertheless be needlessly weak until the individual institutions can derive added reserve strength through the establishment of a Federal Home Loan Bank System along the outlines suggested by President Hoover.

The subject of taxes is closely related to that of home financing because the manner in which government revenues are raised has a great deal to do with the chances of success or failure when a family borrows money with which to acquire a home. Every home owner is concerned not only with the total budget of the local, State and Federal Governments which must be raised by taxes, but especially with the percentage of State and local imposts

that are raised through taxes on real estate. Of the revenues so raised, he is particularly concerned with their fair apportionment through careful determination of assessed values and reasonable distribution of special assessments for public improvements of a strictly local character.

Inability of home owners to meet home financing charges because of special assessments and increases in taxes is listed by the Committee on Finance as among the most important causes of foreclosure. Both the Committees on Finance and on Taxation have rendered an immense service by making definite, practical suggestions which any member of the Conference or any citizen who wants to promote home ownership on a sound economic basis can use. The committees show how they have reached their conclusions and present valuable records of their past experience.

Once the way is pioneered by a well-reasoned statement of objectives and an outline of procedure, the road to accomplishment is clear. A challenge is offered to everyone who wants to play a part in enabling the families of America to provide themselves with better homes.

ROBERT P. LAMONT.

March 14, 1932.



## INTRODUCTION

President Hoover at the first meeting of the Planning Committee of this Conference outlined the problem of home financing in the following statement:

"It should be possible in our country for anybody of sound character and industrious habits to provide himself with adequate housing and preferably to buy his own home. The finance of home building, especially for second mortgages, is the most backward segment of our whole credit system. The whole process of purchase and finance involves a ceremony like a treaty between governments and yet the home is certainly as good collateral as an automobile; it depreciates more slowly, if at all, and its owner will make a harder fight to keep it. The home has tentacles of sentiment as well as bonds of practical necessity that bind the occupant to it. Part of the difficulty lies in inadequate financial organization and part of it you will find in obsolete laws."

Through the work of the Committee on Finance of the President's Conference on Home Building and Home Ownership, thousands of people have taken an added interest in our home financing structure. Many who once assumed that it was almost perfect have come to realize that it is highly imperfect from the standpoint of the home owner. Prior to the Conference, it was common for the inexperienced to assume that the only weak link was that of the second mortgage. The committee discusses present appraisal methods, notes the need for better methods in making appraisals, and refers to the establishment of central appraisal bureaus as a most promising development.

Notwithstanding the admitted weakness of our appraisals, they are used as the basis for legislation both by our Federal and State Governments. In order to assure safety for investments, legislation has been enacted that precludes certain financial institutions from investing in mortgages amounting to more than fifty per cent of the appraised value of the property. If security is considered, this would seem to be in line with sound public policy. On the other hand, this practice is the principal cause for most second mortgages with their exorbitant rates and frequent failures.

State legislatures have tried to keep State banks reasonably liquid and in some States mortgages made for a period in excess

of one year may not be held by State banks. National banks are not permitted to hold mortgages made for periods longer than five years. From the standpoint of liquidity, such legislation seems to be in line with sound public policy. On the other hand, the inability of the home owner to renew such short-time mortgages in times of depression results in heavy losses to home owners and the depression of real estate values below normal levels, and is not in line with sound public policy. The straight short-time mortgage is hazardous for the home owner so long as there are no discount facilities for such paper. Legislation permitting banks and other institutions to discount mortgages has been proposed as a means to keep them more liquid and to reduce the hazards of foreclosure during depressions. The Committee on Finance in its report "recommends to all home buyers the advantages of long-term amortized loans."

Long-term amortized loans serve most home owners best. Should mortgages be made up to seventy-five per cent of the appraised value of the property where needed and justified, and equitably amortized, the home owner would be much better protected than he now is, and much of the need for junior financing would disappear.

The committee calls attention to our foreclosure laws. In some States it takes about eighteen months to complete the foreclosures. This means that such costs must be considered by the lending agencies, and the borrower must suffer in increased costs or in earlier foreclosures. Again the "steel trap" foreclosure laws may work a hardship on the owners, but the period of redemption may be longer and in this way be better for the home owner.

Throughout the sessions of the President's Conference on Home Building and Home Ownership an intense interest was displayed in the problem of home financing. The Committee on Finance drew a larger attendance than any other meeting of the Conference except for the general sessions.

Frequent reference was made to the text of President Hoover's statement on the proposed establishment of Home Loan Discount Banks which was issued from the White House on November 13, 1931. That statement is reprinted in full as Chapter II of this volume. At the general session of the Conference held in Constitution Hall on Friday evening, December 4th, Mr. John

Sprunt Hill of Durham, North Carolina, presented the following resolution which was seconded by Colonel W. A. Starrett of New York City and by Mr. Samuel N. Reep of Minneapolis, Minnesota :

**“Whereas,** President Hoover has stated that he would propose to Congress the establishment of a system of home loan discount banks; and

**“Whereas,** in the opinion of this Conference, the establishment of such a system as the President proposes will operate not only to relieve the present financial strain upon sound savings banks, trust companies, and building and loan associations, but also will have a permanent value to the nation as a whole, as a means of promoting home ownership in the future;

**“Now, therefore, be it Resolved,** that the members of the President’s Conference on Home Building and Home Ownership, assembled in Washington this fourth day of December, 1931, heartily endorse the plan of the President and pledge their support to the Administration in its efforts to have Congress enact appropriate legislation to establish the system proposed.”

The resolution was adopted unanimously by a rising vote.

Closely related to the financing of home ownership is the subject of taxation. In these two fields the individual home owner is subjected to forces over which he has very little control and in both lie wide stretches of rocky soil in which it is difficult for healthy home ownership to flourish.

Home owners should not and do not expect to be relieved of their share of the burden of taxes, but there is a growing volume of evidence that their tax burden, in many communities, is greatly out of proportion to that of the owners of other types of real estate and that in addition the tax load in many instances is very unequally distributed among real property owners. Furthermore, there is an abundance of evidence of double, and in some cases multiple, taxation of real estate through the imposition of mortgage taxes, special assessments and other taxes in addition to an already excessive and unequal general property tax.

Property assessments for local improvements have been employed extensively on the theory that improvements, thus paid for, enhance adjoining property values in proportion to the cost of such improvements. In practice it has frequently proven to be

untrue and in some instances local property values have been injured rather than enhanced by improvements financed on this principle.

The subject of taxation is of such vital consequence that it deserves thorough, impartial and untrammelled inquiry. The wide range of experience with many forms of taxation employed by the Federal Government, the forty-eight States and thousands of local governments, affords a research laboratory in which we may confidently expect the discovery of measures which will lead to a more equitable distribution of the common burden of taxation. To the extent that home owners are relieved of unfairness and injustice in taxation, we will lower one of the most difficult hurdles to home ownership. In this respect the field of taxation occupies a companion-place to that of home financing. Experience in both these fields foreshadows the removal of some of the most serious existing obstacles to home ownership.

JOHN M. GRIES.  
JAMES FORD.

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# CHAPTER I

## FINANCING HOME OWNERSHIP

### INTRODUCTION

In considering the problem of financing home building and home ownership, the committee has

(a) Endeavored to survey existing facilities which supply funds on both first and second mortgage security.

(b) Studied practices in various localities with a view of determining those methods which have proved most successful.

(c) Looked into the legal aspects relating to legislative enactments intended to protect borrowers, but often resulting in preventing the ready flow of capital and hindering instead of helping prospective buyers.

(d) Reviewed carefully redemption periods, foreclosure costs, and the supervision and regulation of mortgage lending agencies.

These and other investigations have been undertaken by four divisions of the committee which were requested to report on

1. Statistics.
2. Legal Aspects of Mortgages.
3. Community and Successful Home Financing.
4. Mortgage Structure.

It is our purpose to review the general findings of the committee and the more detailed reports of these divisions. Throughout the investigations it was apparent that ill-conceived transactions lead to unhappiness and discontent. Accordingly the committee has sought to make practical recommendations which should promote successful buying and make for satisfied home owners.

### I. SUMMARY

#### THE SALE, AND SOUND HOME OWNERSHIP

The happiness of the buyer of a home is related directly to the soundness of the sale. While too much cannot be said about the value of stimulating home ownership because of its effect upon

good citizenship and the strengthening of family ties, likewise too much emphasis cannot be placed upon the importance of the sales transaction to the accomplishment of these objectives.

Too often home buyers fail to realize that the satisfactory completion of sales contracts depends upon what might happen to the property and to themselves. If they understood that purchase of a home is a business transaction, undoubtedly more consideration would have been given to this point. The property itself is subject to fluctuations in value due to various factors, such as depressions, change in character of neighborhood, and depreciation. Their own net income may vary for many reasons, such as unemployment and sickness. Before a sales contract is made for the purchase of a home, the prospective buyer should understand these possibilities to the end that when estimating how much he can afford to pay monthly or annually for the enjoyment of his home, he will make proper provision for reserves in the form of savings to take care of any unforeseeable contingencies. Certainly many of the foreclosures and the consequent distress in homes today would have been avoided if such a prudent step had been taken.

The full significance of home ownership often is not appreciated by prospective buyers. As a result, they frequently enter into sales contracts under impressions which are almost certain to lead to weak ownership in many cases. For example, there are those who undertake contractual obligations upon the assumption they can buy their homes with the money usually spent for rent, without realizing the amounts which will be necessary to increase continually their equities and to make necessary improvements, as well as the unexpected potential demands arising from special taxes and emergencies. Then too, there are many purchasers of homes who pay the least amount of money possible at the time of acquiring possession and secure and maintain thereafter maximum mortgages. The motives underlying this type of home ownership vary—in some cases it is inspired by the possibility of speculative profits through sale of their properties in the thought that the higher the mortgages, the easier it will be to sell. Unwittingly this class of people assumes very real hazards due to the possible reduction in land values or income thereby reducing or eliminating their small equities. Furthermore, they make their problem of renewing mortgages more difficult because in times of depression and consequent deflation in land values, they cannot expect mortgage lending agen-



cies to renew their mortgages without a cash payment approximating the amount of depreciation in value. It would seem that every American who so desires and whose income permits should aspire to own his own home ultimately in fee simple, after considering home ownership from an investment as well as sentimental aspect. The terms of the sales contract should be predicated upon this basis.

**Lessons from Foreclosures.** A study of foreclosures is enlightening to home owners in that it indicates from actual experience pitfalls which they should be prepared to face. The three most important personal reasons for foreclosures were found to be unemployment, the financial circumstances of the borrower did not warrant the purchase of a home, and the inability to pay special assessments and increased taxation. The three leading external causes which contributed to these results were the general decline in home property values, the loan was too large a percentage of the value, and the change in the character of the neighborhood. More than eighty-five per cent of the lenders found that the personal causes of default had more to do with the foreclosures than the contributing external difficulties.

An effort was made to secure reasonably exact figures regarding the amount of foreclosures upon homes. The information available does not indicate a foreclosure situation by any means as bad as many believe. For example, replies from one type of lending agency with over \$1,250,000,000 of mortgages on homes indicate the percentage of these mortgages in process of foreclosure in comparison with the total outstanding mortgages on homes was .790 and the percentage of home properties reported as owned by these companies as a result of foreclosure proceedings compared with the total amount of outstanding mortgages on homes was .736.

The general incompleteness of foreclosure information definitely shows a weakness in our realty structure. It should be possible to secure from various localities a factual picture of not only home foreclosures, but other trends which would be helpful in guiding the sound economic development of the various communities along realty lines.<sup>1</sup> Such a current statistical control may be of assistance in avoiding situations like the one which exists in a Mid-West city where five times as many lots were subdivided and placed on

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<sup>1</sup> See dissenting statement by Mr. Harry S. Kissell, page 49.

the market in a year as would be required for sites for new dwellings, or the continued construction of dwellings even though there is a substantial percentage of vacancies. It would seem that interested business men in the various communities would be willing to set up the necessary local machinery to prevent as much as possible unsound building and the consequent detrimental effect upon the equities of home owners. Accordingly the following resolution was adopted by the committee:

To insure greater stability in home property values, and to help correct over-built or under-built conditions where they exist, the establishment of a permanent fact-finding bureau within the Department of Commerce is recommended to cooperate with local units of national organizations through the tabulation and distribution periodically, by districts, of dependable information regarding occupancy surveys, mortgages and trust deeds recorded, real estate transfers, new subdivisions opened, new construction, construction costs, rental trends, land value trends, interest rates, and foreclosures.

A review of foreclosures emphasizes the necessity of home owners understanding the real significance of home ownership and its responsibilities, as well as the importance of sound personal financial planning. The experience of the Finance Committee, which was verified by others, indicates that prospective home owners should be able to pay about twenty-five per cent of the purchase prices of their homes at the time they take possession, and approximately the same percentage of their annual income for the maintenance of the dwellings and reduction of the mortgages thereafter. The problem of maintenance is dependent upon the ability to save, and those who have not demonstrated to themselves that they have acquired the habit of saving may be assuming risks which will lead to unhappiness.

To facilitate sound financial planning, the committee adopted the following recommendations:

Countless home purchases are doomed to failure from the start owing to insufficient equity and lack of sound advice to the prospective home purchaser regarding the financial obligations of his undertaking, and the committee believes that a down payment of about twenty-five per cent of the purchase price should be established as the basis of a sound home purchase transaction. Further, that realtors, builders and mortgage bankers should join in a concerted effort to assist prospective home buyers in analyzing their financial ability to consummate the proposed purchase.

To safeguard the home buyer's ability to meet his payments of principal and interest, exclusive of annual taxes and insurance premiums, the committee recommends that twenty-five per cent of the buyer's assured income

be the maximum allotment for these payments. Where the principal and interest instalments are payable quarterly or semi-annually, a monthly sinking fund deposit in a separate account covering one-twelfth of the annual principal, interest, taxes, special assessments and fire insurance premiums, is strongly advocated. Where the principal and interest instalments are payable monthly, the deposit each month in a separate account of one-twelfth of the annual taxes, special assessments, and fire insurance premiums, is highly recommended. As a protection against temporary reverses such as illness and unemployment, home buyers are urged to maintain a special home protection reserve fund, for emergency use in meeting the payments on their home purchase.<sup>2</sup>

**Need of Neutral Appraisal Service.** Assuming a proper understanding of home ownership, every prospective home buyer is confronted with the question—is the house over-priced? Seldom is the home buyer able to determine the answer to this question with reasonable accuracy because he lacks the necessary training and experience to weigh intelligently the various factors entering into the answer. Yet there is scarcely a transaction which the average home buyer undertakes which involves such a large sum of money and the possibilities of loss.

There are facts which indicate that individuals or small institutions, which in the aggregate must place at the disposal of home owners a large sum of money for mortgages, have not had at times the benefit of sound appraisals. Certainly it is in the interest of both the home owners and these mortgagees to know just what is the real value of properties. In the course of considering this problem, the committee found an organized effort in Philadelphia to render a neutral appraisal service which has much promise. The principle underlying this service is that only sound building and sound values make for a solid growth of the community, and this agency will contribute towards this end. Accordingly the committee recommends:

The establishment of central appraisal bureaus in the various cities for the purpose of stimulating home ownership through sound appraisals.

Nothing discourages building as much as the results of unsound sales, because they dampen the enthusiasm of families for the attainment of what should be the birthright of every American who has the ambition to own a home commensurate with his income. Those associated with the building industry can help the

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<sup>2</sup> See dissenting statement by Mr. Harry S. Kissell, page 49.

home owner to attain this end through cooperative efforts which will enable the prospective buyer more intelligently to select a home, to understand the full significance of home ownership, and to negotiate the financial aspects of the sale on a basis which will insure strong ownership. The first fundamental factor in successful home ownership is therefore a sound and equitable sale.

### FIRST MORTGAGE SERVICE

Usually when a home has been purchased, the prospective buyer has not the necessary funds to pay for it. There is generally a first mortgage upon the property and usually a second. The buyer assumes both of these, but it is only a question of time when he may have to re-finance one or both. In the event he is building his own home, then he must arrange for his own mortgages. In both cases a better understanding of mortgage services and their proper adjustment to his financial status will make for greater happiness.

**Types of Loans Available.** Let us now direct our attention to first mortgages. Competition in this field is very keen, and when this condition prevails, the public profits. Accordingly there are various types of mortgage plans available to the home owner, which may be divided into straight and amortized loans or combinations thereof. A straight loan usually represents a mortgage for a short period of time, possibly three or five years, without reductions in principal. Amortized loans usually run for a much longer period, frequently up to fifteen years, within which time the principal of the mortgage has been eliminated or very substantially reduced through systematic payments. With these facilities available, there arises the question as to the type of mortgage service which will best suit the needs of the home owner. He alone, after consultation with local mortgage agencies, can answer this question.

Again the committee wishes to emphasize the necessity of developing a mortgage program which will be in accord with the purchaser's ability to save. Furthermore, it wishes to point out the advantages of long term loans both from the standpoint of saving renewal fees, as well as the security incident to knowing that the mortgage financing definitely is disposed of until the time when the first mortgage will be cancelled through complete, unencumbered ownership. While there are times when short term straight

mortgages are necessary, too often the motives underlying requests for such mortgages arise from principles which frequently lead to losses rather than profits. The committee, being mindful of the problems which sometimes arise upon the maturity of short term straight mortgages:

Recommends to all home buyers the advantages of long term amortized loans and, where there is a second mortgage, that the principal instalment on the first mortgage be deferred to the end of the second or third year.

**Proposal for Stimulating Building.** The American system of first mortgage finance has not only enabled our country to build a housing structure upon an unprecedented scale, but we find it even today during the depression financing new structures for which there is an economic need. Naturally there has been a material slowing down in building which has contributed to our unemployment situation, and it is not surprising to find those affected striving to develop ways and means for renewing activity in the home construction field. As a result, numerous suggestions have been received for encouraging easy credit through new first mortgage financing methods. While undoubtedly they would for a time provide employment, there can be little question that the price would be a further deflation of the values of existing homes.

During boom times the building industry experienced a tremendous growth. As the real needs of the public for housing were not only met but excess facilities provided in many communities, there is a normal period of time which must elapse before the sound rule of supply and demand will permit building to be resumed on a broad basis. We must recognize that the increase in population in the continental United States during 1932 is estimated at only 936,000 people. Therefore, until the increase in population or returned prosperity justify a broad building program, it would seem that any such proposal at this time would not be on a sound economic basis.

There is another viewpoint which is worthy of consideration and that results from the thousands of homes throughout the country which are held by a tenuous thread by their owners or have become owned involuntarily by mortgagees who are striving to sell them to home-minded citizens for acquisition cost or less and on most favorable terms. Furthermore, there are a surprising number of instances where occupants of residences are paying nominal

rents, to avoid vacancies with attendant vandalism, and many cases where rentals have been reduced to meet downward income conditions, with the result that little, if any, revenue remains after paying taxes, insurance and repairs. Certainly the economic status of these home owners must be stabilized before health can be restored to the home building industry.

**The Present Emergency.** Home owners are interested naturally in maintaining the solidity of their local financial institutions because this tends toward their own economic welfare. Various suggestions have been considered which relate to emergency assistance to financial institutions which make mortgage loans on homes. An analysis of certain reports of the Federal Reserve System and the Comptroller of the Currency indicates that national banks, state banks and loan and trust companies have about 8.41 per cent of their total deposits invested in city mortgages and only 3.99 per cent of their capital, surplus, and undivided profits in real estate, other than bank buildings. These figures, instead of revealing a crisis, should give us added confidence in the stability of our national financial structure. The query promptly arises—why the request for emergency assistance?

In some sections of the United States, we find banks with larger percentages of their deposits invested in mortgages than the foregoing averages. For example, these percentages in certain banks in two states are 27.54 and 30.67, while the percentage of real estate owned, other than bank buildings, to capital, surplus and undivided profits is 6.31 and 4.47. It is evident that these banks do not have enough foreclosed property to cause undue financial embarrassment and therefore their mortgage loans are in the main sound. The difficulty then must arise from the economic situation which has caused a demand for funds from depositors that cannot be fully met. Furthermore, on account of the condition of the banks in these areas, the local building and loan societies are unable to borrow as they usually can, and in addition they, too, are experiencing heavy demands from members and depositors.

These particular banks confronted with the unusual local demands for immediate funds must turn to their portfolios of investments, among which are included home mortgages, as a means of securing ready cash. On account of the economic conditions which have affected the markets for securities and the buying power locally, these banks frequently have difficulty in borrowing

upon sound collateral. The same situation often prevails among the building and loan societies in the areas served by these banks.

From a national standpoint, the foregoing picture does not justify any lack of confidence in our banking or building and loan institutions. In some sections of the United States, the local agencies are confronted with an urgent need for immediate cash and often have sound collateral, such as home mortgages, to assure repayment of loans. In the interest of the communities served by these local institutions, their present situation must be viewed as an emergency. Accordingly, the following recommendation has been unanimously adopted:

The committee recognizes the existing emergency and is in sympathy with the view of the President that it must be met.

Further, the committee unanimously records its support of the President in any remedial measures he proposes.<sup>8</sup>

## THE SECOND MORTGAGE PROBLEM

The home owner is confronted with a real problem in arranging for second mortgage financing. There is not only a scarcity of second mortgage money, but the home owner often is compelled to pay bonuses of eighteen to twenty per cent for the use of this money. There are good reasons for believing that the greatest hindrance to the sound development of home ownership in the United States is the lack of a well organized second mortgage service which can be offered at a reasonable cost.

The question promptly arises as to why capital does not flow into the junior financing field. The salient reason is because of the hazards incident to this type of investment. The interest of the purchaser of the second mortgage always is junior to that of the first and in the event of trouble, the second mortgagee is apt to find himself in the situation where, to protect his investment, he has to keep the first mortgage in good standing, pay the taxes, and carry the property until he can dispose of it. Then too, in the event of a decline in real estate values for various reasons, such as a change in the type of people living in a neighborhood or general economic depression, the indebtedness might exceed the decreased value of the property and again the junior mortgagee has

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<sup>8</sup> See dissenting statement by Mr. William E. Best, page 47.

the property on his hands if he is going to protect what remains of his investment. The usury laws are a constant threat to many potential investors, even though they are circumvented continually. As a result of these and other hazards, capital is timid about going into this field and when investors are willing, they insist upon a return which they consider commensurate with the risk.

A great majority of second mortgage companies which were operated on a purely commercial basis have failed to weather the depression. The companies which have survived appear to be those which do not as a rule lend above seventy-five per cent of the appraised value. It is plain that whereas the exorbitant rates paid by home owners for junior financing are imposing an undue hardship upon them, they were insufficient to insure the success of second mortgage companies generally. Spurred on by the need of home owners for junior financing facilities, the committee has adopted a program which it believes will meet the needs of junior financing upon a reasonable basis and this follows:

1. That those who desire to own homes shall have sufficient savings to give them an equity of about twenty-five per cent at the time of the purchase.

2. After consideration of the charges incident to the first mortgage, taxes, insurance and adequate reserves for contingencies, it is suggested that the home owner arrange for a second mortgage of sufficient duration to enable him to pay off this indebtedness before expiration and thereby eliminate the need of a renewal.

3. That the matter of home ownership is essentially a community matter and one which the community is best qualified to foster. As the American method of buying homes is predicated generally upon some junior financing, it is strongly urged that the respective communities and states undertake this opportunity for service as a means of further developing good citizenship through the following methods:

a. Through the encouragement of mutual junior mortgage organizations. The fifty years or more of experience in one city indicate that when they are operated in accordance with established principles, and in the public interest, they have rendered a satisfactory service to their members.

b. Through the formation of a community pool of private local interests. This will advance junior mortgage funds upon homes which are soundly built, well located, and prospective owners of which are known to be reliable citizens. That such projects can be conducted successfully in the public interest has been proved in Providence, R. I., Utica, N. Y., and Niagara Falls, N. Y.<sup>4</sup>

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<sup>4</sup> See dissenting statement by Mr. Harry S. Kissell, page 49.



c. Through the removal of usury laws in relation to second mortgages, with appropriate safeguards in the public interest. It is believed such action will tend to bring additional money into the second mortgage market and thereby help to relieve the home owner.

d. Through the encouragement of second mortgage agencies to try new methods and further experiments, it may be possible for private initiative to meet the needs of the public at lower expense. Certainly activities of this kind should be stimulated in every sound manner.

## LEGAL ASPECTS OF THE MORTGAGE

**Uniform Mortgage Act.** Every borrower must be impressed with the amount of verbiage contained in his mortgage and if he views this legalistic document with suspicion, one can hardly blame him. As mortgage forms frequently contain from one to four thousand words and recording fees are based upon the length, the home owner is penalized on account of this. Furthermore, if the home owner has lived in more than one state, he must have been impressed with the variations in the form and contents of mortgages. The National Conference of Commissioners on Uniform Laws, after investigating mortgage forms for more than fifteen years, adopted a Uniform Act in 1927 which was approved by the American Bar Association and the American Title Association. Although the proposal in principle has met with general approval, specific objections to details have been raised in certain states.

From a home owner's viewpoint, the proposed Uniform Act would require a statutory short mortgage form which would use about 160 words, with a consequent reduction in recording fees. Certain covenants and clauses would become by statute a part of each mortgage. From the standpoint of mortgage lenders, this short form of mortgage and the accompanying simplified procedure would facilitate the placing and handling of mortgages because of the uniformity possible thereby throughout the states, with a reduction of labor and other expense.

It is in the interest of home owners to encourage capital into mortgage investments. As institutions which have capital available for mortgage investment frequently do business in many states, they are greatly hampered by the diversity of laws in them. The National Conference of Commissioners on Uniform Laws has endeavored to review and to weigh these laws to the end that, while protecting the interests of the borrowers and the lenders, the

best laws would be recommended as parts of the Uniform Mortgage Act. Accordingly the Act proposes among other things, a simple, inexpensive method of foreclosure, provides an opportunity for a court hearing if there is a dispute, and a period of redemption for such states as may require it. These and other advantages in the interest of uniformity will contribute toward the elimination of many of the complexities and obsolete features of existing laws.

The committee believes the Uniform Mortgage Act would result in a beneficial way to borrowers and to lenders and facilitate the purchase and selling of mortgages by institutions doing an interstate business and thereby tend to make mortgages more liquid. The nearer the forty-eight states come to uniform mortgage practices, the greater will be the tendency of mortgage money to flow into the states most in need. Accordingly the committee recommends:

The general adoption of the Uniform Mortgage Act by the respective states, with the exception of those provisions which under existing laws are more favorable.

**Foreclosure Costs.** The agencies which place the largest amount of money in home mortgages invest the funds of their depositors, policyholders or shareholders, who are frequently home owners and therefore have a very real interest in the security of these investments. Let us assume a home owner is on the finance committee of one of these institutions and various applications for mortgage loans are before him. The first one is on a sound property in his own state where, if it should be necessary to foreclose, court action would be necessary. This frequently costs at least \$667. If he voted to approve this loan, he would be certain the security would be adequate to repay the principal and foreclosure costs. The next application is from another state, where foreclosure is under power of sale and therefore usually costs only \$95. In this case he would vote for a larger loan to the home owner than in the first case, even though the value of the properties were the same. The point to be emphasized is that in states where foreclosure costs are high, the home owner is the one who pays ultimately, in one way or another.

**Effect of Redemption Periods on Home Owners.** The third application may be from a state with a long redemption

period in the event of foreclosure. This legislation was designed in the interest of borrowers at a time when they may have needed this protection from lenders. Today borrowers themselves through their savings deposits, life insurance premiums, etc., provide a substantial part of the funds invested by lending institutions in home mortgages. It is only under the most exceptional circumstances that lending institutions start foreclosure proceedings on short notice, for in many cases the defaults may be due to circumstances which the borrower can overcome. From the borrower's viewpoint, it might appear advantageous to have an extended period, say a year and a half, within which to make good any defaults in payments. However, such a long delay frequently results in the property becoming badly depreciated through lack of care.

Certainly the home owner serving on the finance committee of any lending institution would view with more favor the applications from other areas within which, if his institution had to foreclose, it would get the property within a reasonable period of time so that the security would not be unduly impaired. In the event he did not vote to decline this application for a mortgage or recommend higher rates of interest to be charged, he would be inclined to reduce the percentage of the value that normally would be loaned with safety.

Much is said about giving liquidity to mortgage investments as a means of attracting funds which otherwise go into other channels. The complexity, multiplicity and lack of uniformity of the laws in the respective states, undue periods of redemption and unreasonable costs of foreclosure are responsible to a degree for this lack of liquidity and unattractiveness of mortgages as an investment to many people. In order to help correct this, it is the judgment of the committee:

That additional capital would become available if periods of redemption from sales under mortgage foreclosure were abolished in all states and the costs of foreclosure were reduced substantially.

## SUPERVISION OF MORTGAGE AGENCIES

Most of the various types of institutions making first mortgages are subject to some form of supervision by state agencies. The law is definite in various respects, such as the maximum amount

which may be loaned. Realizing that the investment portfolios of the lending institutions in certain areas are frozen, the question promptly arises whether a review of existing state supervisory laws, in light of the experience during the depression, might lead to improved methods which will tend to prevent a repetition of existing conditions. Such action may do much to introduce some liquidity in mortgage investments, although it must be realized that at best, first mortgages cannot be as liquid as other investments. Such a review should also consider the effect which taxation by the state and subdivisions thereof has upon sound home ownership and how this taxation might be rearranged on a more equitable basis to all parties concerned. The committee recommends:

That adequate statutes be adopted by the various states in the interests of sound home finance and the public, to the end there may be proper supervision over local mortgage lending agencies and adequate publicity to periodic financial statements of these agencies. The committee believes this recommendation will do much to insure the maximum amount of liquidity possible in mortgages.

### NEED OF INTEREST IN COMMUNITY

Previously in this report it has been noted that assessments and taxes were the third most important cause of foreclosure. The committee appreciates the value of continued improvements in the various neighborhoods and municipalities, but it urges strongly that the financial situation of the residents be taken into consideration before such improvements are authorized. Certainly it is not in the interests of the community, for example, to put in a storm sewer at the expense of the loss of the homes of a number of people who just barely are able to meet existing taxes and charges.

The home owners themselves can do much to prevent untimely improvements through active participation in their community life. Such civic activity also will result in the prevention of the unwise opening of subdivisions which frequently results in loss to both the purchaser of the lot and the home buyer. In some jurisdictions, laws have been passed under which the municipality refuses to authorize land subdivisions unless certain essential utilities have been installed or a bond provided for their installation.

## CONCLUSION

The buying or building of a home is usually an epochal event in the history of a family. Successful home ownership is worthy of every effort because it leads to an enriched family life and is evidence of proved habits of thrift and financial planning which usually place the family beyond a hand-to-mouth existence and in a position of relative security. To achieve this, there must be an appreciation of just what home ownership demands in the way of responsibilities and a realization that unhappiness may result from purchasing beyond the means available and without adequate reserves, as well as the need of eliminating obsolete and hampering legislation and greater uniformity of laws. The investigations of the four divisions of the Committee on Finance, copies of which follow, indicate that much can and should be done to place home ownership on a sounder basis than exists today, but nothing in the course of the deliberations of the committee has changed its view that

Every American family which so desires  
and is able financially should  
**OWN THEIR OWN HOME**

There follows the reports of the four divisions on Statistics, Mortgage Structure, Legal Aspects of Mortgages, and The Community and Successful Home Financing.

## II. STATISTICS

In the following analysis of the operation of the home-financing system, this division has drawn not only on published material and the general background of experience of its members, but upon a number of recent studies. These include a field study undertaken in Cleveland, Ohio, by Robinson Newcomb, of the Division of Building and Housing, in conjunction with several local groups; a survey of conditions on the Pacific coast, conducted during the past summer by the chairman of the division; questionnaires sent out for the committee by the Division of Building and Housing to building and loan associations, life insurance companies and banks, and field trips by staff members to numerous cities.

**Cost of Obtaining Loans.** The customary rate of interest

ranges ordinarily from 5 to 7 per cent, with 6 per cent as the prevailing standard, but extends in certain areas up to 8 or 9 per cent. The various state laws usually control the maximum interest rate on first mortgages, although there are exceptions in most states in regard to building and loan societies. A typical first mortgage loan transaction involves incidental expenses of (a) commission or service charge, (b) title examination, (c) recording fees, (d) plat of survey when not furnished by the borrower. In some instances, as with banks investing their savings deposits and trust companies investing trust funds, no commission is charged but there is a nominal fee for appraising and preparing the loan papers. In some construction loans the borrower is required to furnish a bond to guarantee completion.

On a typical \$3,000 residential loan, these charges would amount to \$35 to \$50, exclusive of interest or commission, or approximately 1.5 per cent of the loan. Where a commission charge is made, this generally ranges from 1 per cent to 3 per cent and usually includes appraisal fee and all office charges. On loans running ten to fifteen years, these charges are at the rate of one-fifth to one-third of 1 per cent per year.

While the practice of making amortization loans for long terms is growing, the fact remains that many lending institutions make first mortgages for terms not exceeding three years. On the expiration of this term the borrower is required to repeat some if not all of these expenditures. Practice varies widely on this matter and ranges all the way from no renewal charge whatever to payments covering all the initial financing costs, including the full commission. The repetition of these charges on the renewals on one to three year mortgages adds materially to the cost of home financing wherever this practice is followed, and is a factor of which borrowers should be made clearly aware. The borrower in the final analysis has to make the decision as to whether he wants a long time amortized loan or a straight loan for three years.

Far more serious, however, is the problem of junior or second mortgage financing costs. Due to the increased hazards surrounding second mortgage loans, second mortgage money is not ordinarily available to home buyers at interest rates permitted by law, and hence second mortgage financing in ordinary times generally involves discounting second mortgages at rates ranging from 5 to 10 per cent per year. When to the discount are added the

various service charges customary in making mortgage loans and a brokerage fee which generally averages higher on second mortgage loans than on first mortgages, the total initial charges for obtaining a second mortgage loan for one to three years may range from 15 to 25 per cent, in addition to annual interest, which sometimes is paid on the full face value of an amortized loan to maturity.

**Defaults and Foreclosures.** Where home buyers and home builders have to give up their equity in their homes, either with or without foreclosure proceedings, it is a sign that something is wrong. In some subdivision developments, a substantial number of the buyers have failed to carry through. Sometimes the causes lie outside the control of even the best conceivable management, but when they are as numerous as during the past few years, they indicate a need for analyzing the causes. The Division on Statistics, accordingly, has undertaken to determine the most important factors contributing to foreclosures.

In each case of foreclosure the borrower fails to meet obligations that are legally binding upon him regardless of decline of property values or similar external factors. Failure to do so is attributed, in answers to questionnaires filled out by several hundred first mortgage lenders, to the following causes, in order:

1. Borrower was unable to pay because of unemployment.
2. Financial circumstances of borrower did not warrant purchase of a home.
3. Borrower was unable to pay because of special assessments and increases in taxation.
4. Borrower had contracted for too many other instalment purchases.
5. Borrower had sustained business or stock market losses.
6. Borrower was a speculative builder or a holder who failed to find a purchaser.
7. Domestic troubles of borrower.
8. Borrower was dishonest.

A question as to the number, in order of importance, of external difficulties contributing to default, gave the following results:

1. General decline in home property values.
2. Loan was too large a percentage of value.
3. Intrusion in neighborhood of incompatible elements, or other change in the character of the neighborhood.
4. Home out of keeping with neighborhood.
5. Poor construction of building.
6. Loan was made on property in a subdivision not yet developed.
7. Zoning law was inadequate.

More than 85 per cent of the lenders found that the personal causes of default had more to do with the present situation than the external contributing difficulties.

**Foreclosure Statistics.** Foreclosure totals are usually by counties, and include first, second, and third mortgages; farm and city loans; vacant property; all types of improvements and all sizes of loans; executions on mechanics' liens and personal judgments; frequently, as in Portland, Oregon, all sales of personal property and collections under execution, and enforcement of liens on automobiles; often, as in Cuyahoga County, Ohio, collection of delinquent taxes and partition suits; and in Detroit, Michigan, items reported under "Foreclosure of Land Contracts" include all landlord and tenant cases, representing 80 per cent of the total, with miscellaneous items representing another 10 per cent, leaving only 10 per cent for actual land contract foreclosures during 1931.

Foreclosure totals do not include cases of voluntary surrender by the mortgagor, or forfeiture of land contracts through a Justice of the Peace, as in Davenport, Iowa.

Bearing these facts in mind, we note a marked increase during 1929 and 1930 in the number of foreclosure proceedings of all types, but we are glad to observe that in 1931 the total number has increased less than 2 per cent over 1930.<sup>1</sup>

For comparison, we note that the volume of city mortgages owned by 40 leading investors and amounting to \$4,865,000,000 increased in the past year 2.44 per cent over the preceding year, and that the population of the United States increases at the rate of 1.35 per cent per annum.

Noting the decreases in some centers and the increases in others, we find some interesting examples, as in Washington, D. C., where the total trustees' deeds for 1931, projected to December 31, show an 18 per cent decrease from the total for 1930 which was but 2 per cent over the 1929 total. And in Cook County, Illinois, which includes the City of Chicago, where the *number* of first mortgage foreclosures of all types, under \$10,000, as compared to the number of all first mortgage foreclosures, has declined during 1931 as follows:

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<sup>1</sup>These figures were obtained by the National Association of Real Estate Boards from 40 cities with a total 1930 population of 12,175,324.



First quarter .....	38.76%
Second quarter .....	34%
Third quarter .....	27.96%

In the same nine months in Cook County, the *amount* of first mortgage foreclosures under \$10,000 represented less than 4 per cent (3.631 per cent) of the total, and only a portion of these foreclosures under \$10,000 were for loans on homes as explained in the opening paragraph. An analysis of foreclosures in Cook County, Illinois, in April, 1931, by the Chicago Title and Trust Company shows that 32 per cent of the total *number* under \$10,000 were junior mortgages and 27 per cent of the total *amount* were juniors.

The Department of Commerce reports that a group of large investors owning mortgages on homes totalling several hundred million dollars on July 1, 1931, shows an investment in home properties acquired under foreclosure *and* in process of foreclosure amounting to approximately 1.5 per cent of the total, with a probability of some redemptions before completion of the pending proceedings. The percentage of investment in home properties actually owned was about three-quarters of 1 per cent.

These facts disclose the predominating influence of the larger bond issue foreclosures in the total figures and the danger of misleading deductions as to home foreclosures when only the total number and total amounts are considered. No one should minimize the seriousness of foreclosures. On the other hand, their significance should not be wrongfully exaggerated by the use of "lump statistics" of which no proper analysis has been made.

**Security to Lenders.** Failures in home financing institutions carrying on the greater part of first mortgage financing for homes have been almost negligible from the point of view of serious ultimate loss to investors. Life insurance companies, mutual savings banks, and numerous building and loan associations have been outstanding sources of strength in the financial structure during the current depression. Failures of building and loan associations have been much fewer and of smaller consequence than failures of commercial banks. The inability of some of them to meet withdrawals without exacting a time notice has inconvenienced, or has been a source of hardship to some depositors, although such steps are necessary to protect the interests of the depositors or members as a group.

**Terms of Loans.** The life or the term of the loan varies ac-

ording to the type of institution, the region, and the custom of the particular locality or of the specific institution. Some amortized loans of insurance companies and building and loan associations run for as long as fifteen years. The usual loan period for building and loan associations varies from about seven years to eleven and a half or twelve years, the latter term in cases where regular monthly payments of 1 per cent a month are required during the life of the loan, and cover both interest and complete retirement of principal. On the other hand, many insurance companies make their loans for periods of three to five years, occasionally without amortization, and some building and loan associations make amortized loans for shorter periods, such as from three to five years, with only partial amortization during the term.

Loans by the mutual savings banks, which are found mostly in certain northeastern states, are in some cases similar to those of building and loan associations. In certain areas they are made for one year and are customarily renewed more or less automatically. Mortgages made by banks of deposit ordinarily run not more than five years and frequently from one to three years.

Second mortgages ordinarily run for shorter periods, one to three years being the commonest. They usually carry heavy amortization payments, often being retired in from one to three years. In some localities, we find second mortgages running for five years where the first mortgage, being held by a bank, runs for from one to three years. This creates a handicap upon the home owner if the first mortgage is called at maturity.

**Dependability of Mortgage Lenders.** Dealing with an established institution with a reputation for fair dealing is an advantage in case a temporary reverse, such as long continued sickness, makes it impossible for the owner to continue full instalment payments. It also carries assurance against deceptive clauses and careless dealing during any phase of the transaction. The borrower may also favor, and with reason, an institution that will give him competent and frank advice as to the reasonableness and fairness of his home purchase agreement, warning him of any pitfalls of which he may not be aware, and aiding him in complying with necessary formalities of all types with the greatest possible convenience, economy, and assurance against risk.

**Insufficient Down Payments.** It is found that two-thirds

or more of all home purchase transactions require junior financing. Dangers arise where the junior financing is excessive, and the down payment correspondingly inadequate. The risk inherent where the owner's equity is small requires a high rate of return to the second mortgage lender or the contract holder so that he may make good on the losses that are bound to occur. This results in a "padding" of the original purchase price; for example, a house sold for \$8,000 with a nominal down payment, say of \$200 to \$400, might be obtained in many cases for nearer \$7,000 cash, or cash and a conservative first mortgage. By deferring the purchase of a home for three or four years until larger savings could be accumulated, a family might not only save a thousand dollars on the purchase price, but be in a much more secure position once the purchase was made, because of its greater equity and consequent ability to weather a period of unemployment, costly illness, or other adversity.

The Pacific coast study confirms reports from all parts of the country that down payments of 10 per cent, 5 per cent, and even nothing down, are now common practice. This shows definitely that first mortgage institutions have found themselves, through no fault on their part, with a rôle in transactions that, from the point of view of the borrower, represent unsound financing. Acting individually, these institutions could not reasonably have been expected to restrain every purchaser from entering unsound transactions. This suggests the need of concerted action by real estate dealers and builders in cooperation with mortgage lenders, to warn prospective home purchasers of the dangers involved in assuming the responsibilities of home ownership before an adequate down-payment can be made, with reasonable assurance, also, of being able to meet the subsequent payments of principal, interest, taxes, special assessments, insurance premiums, and repairs.

**What Is an Adequate Down Payment?** Asked the question, "What minimum initial cash investment should the home buyer or home builder have as the basis of a sound transaction?" the replies were as follows:

	<i>Average</i>
199 real estate dealers.....	21%
111 first mortgage lenders.....	31%
58 builders .....	20%
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368 average of 368 replies.....	24% of purchase price.

**Safe Allotments from Income.** Replies to the question "What maximum monthly payment of principal and interest in relation to his assured monthly salary or income should the home buyer or home builder (with an average income and a family of average size) contract for?" were as follows:

	<i>Average</i>
193 real estate dealers.....	23.4%
91 first mortgage lenders.....	23.5%
50 builders .....	25.8%
<hr/>	
334 average of 334 replies.....	23.8%

**The Problem of Stability.** Instability in home property values was confirmed as a major difficulty by the committee's studies, and the Division on Statistics undertook to explore the possible contributions that could be made towards assuring greater stability through the collection and use of well-rounded statistics.

Financial institutions have a vital stake in stability of real estate values in any territory where they operate. The degree of responsibility that they may practically and properly exercise in controlling the character and volume of real estate developments is debatable. However, knowledge of elemental facts at any time may definitely indicate policies that should be pursued by real estate developers, builders, and the institutions that finance them.

When, as in Cleveland, five times as many lots were subdivided and placed on the market in a year as would be required for sites for new buildings, and average and total lot values had increased in a few years by 50 or 100 per cent in relation to the total income of the inhabitants, it is apparent that an unhealthy condition is being fostered that no mortgage banker can afford to encourage. The same is true when vacancies in a given class of dwellings or in a given neighborhood are increased by 50 or 100 per cent, or more, above average figures for several preceding years. Other danger signals include substantial increases in defaults or foreclosure proceedings, and construction of considerably more than an average number of houses in a year, where there have been no extraordinary additions to population.

**Appreciation of Assistance.** The division is greatly indebted to the United States Department of Commerce and to the many organizations serving with the division, especially the National Conference on Construction, the National Association of Real Estate Boards, the United

States League of Building and Loan Associations, the American Title Association, and the Mortgage Bankers Association of America, whose local units have already undertaken the collection of local statistics on a considerable scale.

## RECOMMENDATIONS

**Fact-Finding Bureau.** To insure greater stability in home property values, and to help correct over-built or under-built conditions where they exist, the division recommends establishment of a permanent fact-finding bureau within the Department of Commerce to cooperate with local units of national organizations through the tabulation and distribution periodically, by districts, of dependable information regarding:

- a. Occupancy surveys.
- b. Mortgages and trust deeds recorded.
- c. Real estate transfers.
- d. New subdivisions opened.
- e. New construction.
- f. Construction costs.
- g. Rental trends.
- h. Land value trends.
- i. Interest rates.
- j. Foreclosures.

**Sufficient Down Payment.** Countless home purchases are doomed to failure from the start owing to insufficient equity and lack of sound advice to the prospective home purchaser regarding the financial obligations of his undertaking, and the division believes that a down payment of about 25 per cent of the purchase price should be established as the basis of a sound home purchase transaction. Further, that real estate dealers, builders and mortgage bankers should join in a concerted effort to assist prospective home buyers in analyzing their financial ability to consummate the proposed purchase. ✓

**Safe Allotments from Income.** To safeguard the home buyer's ability to meet his payments of principal and interest, exclusive of annual taxes and insurance premiums, the division recommends, on the advice of one hundred and ninety-three real estate dealers, ninety-one first mortgage lenders and fifty builders, that 25 per cent of the buyer's assured income be the maximum allotment for these payments. ✓

Where the principal and interest instalments are payable quarterly or semi-annually, a monthly sinking fund deposit in a separate account covering one-twelfth of the annual principal, interest, taxes, special assessments and fire insurance premiums, is strongly advocated.

Where the principal and interest instalments are payable monthly, the deposit each month in a separate account of one-twelfth of the annual taxes, special assessments and fire insurance premiums, is highly recommended.

As a protection against temporary reverses such as illness and unemployment, home buyers are urged to maintain a special home-protection reserve fund, for emergency use in meeting the payments on their home purchase.

**Long Term Amortized Loans.** Mindful of the problems presented on the maturity of short term "straight" mortgages, the division recommends to all home buyers the advantages of long term amortized loans, and where there is a second mortgage, that the principal instalments be deferred to the end of the second or third year.

### III. MORTGAGE STRUCTURE

**Lending Policies.** Whatever the mortgage structure, it never can be satisfactory unless its lending policies are sound. They must be based upon security and adequacy of return to lenders, and both of these are interrelated with various factors, two of the more important being the personal risks and appraisal methods.

A loan that may be regarded safe from the point of view of security may be unsound if the borrower has over-extended himself, or is placing too much trust in an uncertain future or does not merit a good credit rating. No institution can long command public confidence if its delinquent borrowers become too numerous. Defaults represent not only frustrated plans and loss of savings to the borrowers, but are apt to tie up the funds and energies of the lending institution in taking over and reselling the properties and thus subject it to decreased confidence on the part of depositors and to loss of principal. Use of good judgment in regard to personal risk factors is important and especially so where the percentage of the value loaned is high.

Many local institutions should be able to gauge a man's standing with certainty through the information gathered from his past

record and knowledge of his net income. It is feasible for institutions of a centralized type to make such investigations. The weakness of neighborhood institutions may arise from control by men who are too easy-going in their requirements or who allow optimistic hopes or selfish interest to govern their decisions.

**Appraisals.** Aside from the increasing importance that the division believes should be placed upon personal risk factors, the fact remains that it is the property securing real estate loans that underlies their security and investment rating. There has been occasional dissatisfaction with appraisal practices, usually arising when they were made without sufficient care and study by well informed men and when they tended to follow too closely the extremes of the ups and downs in local real estate values.

There are instances when a disinterested man of wide experience knows that high real estate values in a given town have no sound foundation but are the product of boom psychology which warps the judgment of appraisers. The division believes appraisals should not follow a boom market up to the top, nor a distress market to the very bottom, and commends a saner point of view, such as could be followed by adoption of the recommendations presented by the Division of Statistics.

The division has received reports of appraisals made from running-boards of automobiles, made by incompetent or untrustworthy men who have not given their own honest judgment based on their knowledge and experience. While it has no means of determining the extent of such practices, it knows existing well organized mortgage institutions can and do insist on sound appraisal methods. However, the establishment of central appraisal bureaus operating in various cities appears to be a most promising development. Once well established and having the confidence of leading lending institutions, such a bureau would help borrowers as well as lenders, especially when it becomes known that no leading lending institution will make a loan without first receiving an appraisal from the central bureau. This would encourage prospective buyers to secure an appraisal from the bureau before making a commitment.

**Percentage of Loan.** The maximum percentage of appraised value that may be loaned by institutions, such as banks, life insurance companies, building and loan associations, and banks of deposit usually is regulated by law. Most of the savings institutions

that lend on first mortgages operate on conservative principles, and it has been customary for them to limit their loans to from 40 to 60 per cent of appraised value. In addition, the possibility of a decline in the value of the property is also commonly taken into account in determining the amount of the first mortgage loan. Possible foreclosure costs also must be considered. While conditions vary from one state and city to another, there are a considerable number of places where, in case the borrower defaults, the lending institution may have to face very material foreclosure costs, which include not only attorney's fees and various legal charges, but loss of income during the period of foreclosure and statutory redemption, payment of back taxes, and various other items.

**Life of Mortgages and Amortization Terms.** When a borrower is planning a mortgage upon his home, he should have definitely in mind the necessity of arranging one which will be sufficiently long to enable him to substantially reduce the principal. The division recognizes there are times when a short term straight mortgage is necessary, but it also realizes that only too often these loans are selected by the borrower when he would be better off with a longer loan. A borrower who selects a short term straight loan because he thinks he may be able to sell his house at a profit, or does not wish to be acquiring a greater equity in it, may find himself in a situation wherein he may have difficulty in renewing his loan. This may come about through the shrinkage of value in his property during a depression and the justifiable unwillingness of the mortgagee to renew the mortgage for the former amount, or because the local mortgagee, as sometimes happens, is in a situation where during boom times he has over-extended the amount of investments in mortgages and, therefore, in times of depression desires the borrower to place the loan elsewhere. It has been demonstrated that a long term mortgage, say from 11 to 15 years, that provides amortization of the entire principal, is the most satisfactory to both borrower and lender. The amortized plan is quite universally used by building and loan associations and many life insurance companies.

Mutual savings banks and insurance companies have been tending toward the amortized long term loan and the division believes this tendency should be encouraged. In some states the Division on Statistics found that mutual savings banks made their loans for one year, or payable on demand. This custom gives a measure



of protection to the lender but is uncomfortable to the borrower. While there may be reasons for continuing such practice in communities where the institutions are of exceptional strength and their practices with regard to renewals are well established, it can hardly be recommended for general adoption.

**Supervision of Quality of Construction.** Numerous suggestions have been brought to the division in regard to the quality of new building construction for whose financing they are responsible. A number of progressive lending institutions provide for regular inspection of buildings for which they make construction loans, and in certain cities central bureaus are maintained by groups of lending institutions, most of which could not maintain independently a competent inspection force.

The division believes such practices and organizations afford distinct advantages, and that home financing institutions can do much to cooperate with organizations of builders and others that are also interested in the same problems.

**Control of Volume of Construction.** Proposals are advanced from time to time that financing institutions should claim and exert authority for determining the amount of new construction to be undertaken in a given city each year.

The division believes that financing institutions should not assume such authority. However, as stated in the report of the Statistics Division, it believes that with a better factual background, financing institutions can aid the other groups concerned in securing better balanced programs than have existed in the past, and when conditions are demonstrably unsound, can refuse to finance new undertakings that would contribute to further difficulties. The latter is just what many mortgage financing institutions have done in the past and are doing now.

**Handling of Delinquent Accounts.** Numerous suggestions have been received to the effect that in periods of depression like the present, mortgage lending institutions should be more lenient. The division is impressed with the practices and methods used by many lending institutions throughout the country in being considerate of the plight of delinquent home owner mortgagors. To prolong indulgence where restoration of mortgage delinquencies is hopeless is neither a kindness nor fair to the depositors whose money is at stake. Home financing institutions cannot assume

blanket liability for all the difficulties in which home owners may find themselves.

### STATUS OF THE MORTGAGE STRUCTURE

The borrower would find it to his advantage to deal with a single responsible agency in financing his home. He can do this now whenever he does not have to borrow more than 40 to 60 per cent of the value, and in some places he can borrow up to 65, and in some instances up to 75 per cent of the value from a building and loan association. However, in a majority of cases he is confronted with the necessity of dealing with two lenders. The mutual savings banks, insurance companies, banks of deposit, and most building and loan associations have a primary duty to serve as trustees of their depositors' funds, placing safety of principal above high returns based on speculative investments. Accordingly, in order to meet borrowers' needs above the limits usually available with the first mortgage, a second mortgage structure, of a sort, has developed. In most cases it is not a part of the organized financial system of the locality, nor subject to control by law, and has no established institutional relationship to the borrower.

**The Second Mortgage System.** Experienced mortgage men who have been consulted indicate that the greatest deterrent to sound home ownership may be found in the second mortgage field. Therefore, the division has placed great emphasis upon its investigations of the second mortgage system, in the hope that after getting its facts, some solution may be developed which will be helpful to home owners. The importance of the second mortgage is evident from the fact that it is not unusual for the home owner to pay a bonus of 15 to 20 per cent for this junior financing service. When it is realized that often it is necessary to renew these junior mortgages, the extent of this burden is obvious.

The ultimate holders of second mortgage notes frequently do not enter the transaction at all until after the borrower has made his commitments. Hence the investor in a second mortgage has to rely mainly on guesswork or on second hand reports as to the degree of risk involved in each piece of paper that he purchases. Rather than make detailed investigations, the custom has been for such lenders to be guided by general rules, simply deciding to make or not to make purchases in a given class at a given rate of dis-

count, in the hope that profits from cases where the transactions are carried through will be sufficient to offset losses.

The second mortgage lender does not have the benefit of the investigational work done by the first mortgage lender, and there is apt to be duplication of fees and charges. Payments during the first few years while there is still a second mortgage, which has to be amortized, may prove to be heavy. The holders of second mortgages may not be as strong, nor so considerate as the holders of first mortgages. If they "carry along" an honest but unfortunate borrower for a period of months, they may lose their only chance to foreclose and save their investment. Rates of interest are apt to be high and their activities are not openly conducted in some states because their operations are frequently tainted with usury.

The land contract succeeds in avoiding some of the disadvantages of the first and second mortgage method because it simplifies the system of payments on the part of the owner. Under it, the seller retains the title until the purchaser has an equity sufficiently large to enable him to obtain a first mortgage for the remainder. This method works satisfactorily so long as the seller is thoroughly honest and financially responsible. However, it cannot be recommended for universal adoption, partly because of the possibility that the seller may become involved financially and not be able to carry through his covenant to deed over the property under the agreed conditions at the time stated, and partly because the seller in effect acts as a trustee usually without the supervision and opportunity for examination of accounts by the buyer and by public officials that has been found by experience to be advisable for trustees. Possibly a system of trusteeship can be worked out that would obviate all or most of these dangers.

The division cannot too strongly emphasize that many of the disappointing results of the second mortgage financing arise in cases where the down payment is below the minimum advised by the Statistical Division.

The great majority of second mortgage companies set up on a purely commercial basis have failed to weather the depression. The inevitable conclusion is that, having been established on a speculative basis with no special regard for the borrowers' interests, they over-reached themselves. The institutions that have survived appear to be those which did not, as a rule, lend above

75 per cent of the appraised value, and which, either by the nature of organization or established practices, were organized to serve borrowers, and primarily on a non-speculative basis, that is, they did not go in heavily for mortgages which as a class involved a higher percentage of risk and unreasonable exactions from borrowers who, as was proved later, could not meet their obligations.

The development of reputable second mortgage companies is essential. Appendix III,<sup>1</sup> following, is devoted to an account of institutions of several types that have met with more or less success. Many of them appear to be coming through the present depression in good shape, and their methods are commendatory. However, there arises a question as to the wisdom of encouraging a mutual institution dealing in second mortgages to solicit deposits of small savings funds, if its nature is not clearly distinctive from its title.<sup>2</sup>

In a certain city, a second mortgage company has been set up under the direction of officers of a number of savings banks and other financial institutions. It appears to have been run conservatively and to have had a salutary effect on the whole second mortgage situation there. In one city of medium size in New York State, a second mortgage company has been set up through the efforts of building material dealers. In another city in New York State one was organized by a group of employers who felt that their employees were paying exorbitantly for second mortgage money.

The practice of having some institution take a first mortgage up to 70 or 75 per cent and borrowing about 50 per cent of the value from some regular first mortgage institution appears to have advantages, since the borrower deals with a single institution. Such schemes have usually proved too cumbersome or have afforded too few advantages in return for the efforts involved to meet with considerable success. Nevertheless, such a plan is being used on fairly large scale by certain mail order concerns which are developing careful methods of appraising personal risk factors, and have immediate control of the plans, material, and quality of construction. Of course, these companies are in effect guaranteeing the first mortgage and retaining the second mortgage.

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<sup>1</sup> See Appendix III, "Special Types of Second Mortgage Companies," page 72.

<sup>2</sup> See dissenting statement by Mr. William E. Best, page 47.

Still another line of development is allied with the principle of the instalment credit business, namely, that of a centralized concern employing a specialized technique to deal with a particular type of credit. Various groups of retail material dealers and sub-contractors, sometimes in collaboration with building material manufacturers, are attempting to build up, or ally themselves with, organizations for meeting secondary financing requirements, sometimes with a particular attention to the financing of remodeling and modernization.

The division believes that all of the types of institutions described afford possibilities of further development. They suggest the groups that may take a public spirited interest in their organization and advancement. There are many business and financial institutions in every city which stand to gain directly or indirectly from a proper organization of the second mortgage field. Among the advantages that may be derived from such organization are the possibility of close cooperation between first and second mortgage lenders, and a much better opportunity for educating prospective home owners and advising them against unsound attempts to buy beyond their means.

**Joint Handling of First and Second Mortgage Payments.** For a few localities the device has been worked out by which a mortgagor makes one payment each month. The money paid in is credited to the several accounts including first mortgage interest, second mortgage amortization and reserves for taxes, insurance premiums, and emergencies.

As it is worked in some localities, a payment is made at a bank which acts as trustee for all the interests who have claims on these various accounts. The money is deposited to the joint account of a mortgagee and the agency that sold the property, but is held in trust by the bank for the interests above listed. No charge is ordinarily made for this service, as no interest is paid on the money between the time deposited and the time payments are due; bookkeeping expenses are said to be relatively light, because the distributions credited to each account monthly are simply made; and the service brings potential new customers into the bank.

In case payments are not made when due, both the first and second mortgagees know at once and arrangements can be worked out more readily than where payments are made annually or semi-

annually to separate organizations. In the latter case delinquencies are discovered late, and possibly one organization discovers it before the other and may take actions which may prove detrimental to either.

**Construction Loans.** Usually the simplest and least costly procedure for handling construction loans is for the borrower to deal with the institution that will carry the mortgage on the finished home, preferably combining the construction loan and mortgage in a single transaction. Many building and loan associations and other institutions make a feature of such loans, the owner using his equity in making the first progress payments to the contractor, and the lending institution making the remaining progress payments. A number of progressive institutions review the plans and specifications and inspect the building as it goes up. This gives them assurance of the character of the houses on which they lend, safeguarding both themselves and the owner against inadequate specifications or slighted workmanship or quality of construction. Even where such service is offered, the owner is too apt to go as far as he can with his own money before he applies for a loan, and thus fails to take advantage of the full value of the service offered. Sometimes the owner has to obtain a separate construction loan for which he must pay a commission.

In the larger cities, a majority of new houses are erected by operative or speculative builders who sell them after completion. Some of these builders are strong financially and are able to obtain the necessary credit at ordinary commercial rates. An important factor in competitive conditions, however, is apt to be the builder who has to borrow a considerable percentage on the value of the property. Such builders are under many of the same handicaps as individual owners seeking construction loans.

Under present circumstances, banks and other lenders must carefully study local conditions. If the builder miscalculates the demand for the particular type of house which he is putting up, it may not sell and he may be forced into bankruptcy, with the homes being thrown back to the lenders. Here again the development of accurate information as to location, price, and types of houses that are being sold and that remain unsold on the market must have influence. Central inspection bureaus also would help to improve the quality of construction, especially if it were recognized among the lending institutions as well as the

public that well built houses would be granted better credit. In many cases where lenders have had to take over unsold homes—sometimes only partly finished—it appears that the quality of construction is deficient.

**Financing of Apartment Houses.** The Committee on Finance has not undertaken any special research into the financing of apartment houses, although it recognizes the widespread character of grave abuses that developed during the boom period culminating in 1928. The public sale of numerous issues of mortgage bonds purporting to be on a conservative basis, but which were for such a large percentage of any reasonable appraised value as to have a large speculative element, has had wide public attention. Steps necessary to correct the situation are under consideration by the National Conference on Construction, and other bodies, including the Mortgage Bankers Association of America, and the Investment Bankers Association.

**Proposals for Stimulating Building.** A large number of suggestions have been received from real estate developers, builders, manufacturers of materials that enter into home construction, and others, urging new financing methods or financial agencies to stimulate a widespread resumption of home building operations. These would be helpful to their proponents and create a slight wave of benefit to unemployed artisans, but would only result in an increase of residences for sale in a market already demonstrably oversupplied, and have an adverse effect upon the already deflated values of existing homes.

There are thousands of homes in every state of the Union that are either held by a tenuous thread by their owners, or have become involuntarily owned by mortgagees who are striving to sell them to home-minded citizens for acquisition cost or less, on terms that give a new meaning to instalment purchasing in its most favorable aspect to the buyer. There are a surprising number of instances where occupants of residences are paying nominal rents to avoid vacancies with attendant vandalism. There are many cases where rentals have been reduced to meet downward income conditions, with result that little if any revenue remains after paying taxes, insurance, and repairs. To the foregoing must be added the tens of thousands of vacant residences which are for rent at greatly reduced figures. Generally speaking, these groups must be stabilized before health can be restored to the home building in-

dustry, and there also must be taken into serious consideration the tendency for occupancy of apartments.

**Need for Emergency Relief.** Various suggestions have been considered which related to rendering emergency assistance to certain financial institutions which make mortgage loans on homes in the United States. Certainly nothing has been found in the investigation to indicate any cause for lack of confidence in our banking structure because of mortgage loans. The national picture of mortgage activities of our banking institutions indicates an appreciation of the long term credit nature of these investments, and the investment of a relatively small percentage of assets in them. Likewise the building and loan associations throughout the country were found, nationally speaking, to be in a sound position.

There are cases where local banks and building and loan associations of certain areas do need some type of emergency relief. This need arises from unusual local demands by the public for immediate funds. Ordinarily building and loan associations would secure accommodations from their local banks or through other financial institutions. In the present situation, the banks in the sections where there is trouble find it difficult to dispose of some of the securities in their portfolios, which include a substantial volume of mortgages on homes, and therefore are in or near a frozen condition. This need of some banks and building and loan associations for ready cash reflects an emergency situation in their respective communities.

The committee recognizes the existing emergency and is in sympathy with the view of the President that it must be met.

Further, the committee unanimously records its support of the President in any remedial measures he proposes.

#### IV. LEGAL ASPECTS OF MORTGAGES

On September 15, 1931, the President said that one of the purposes of the Home Building and Home Ownership Conference was "the removal of influences which seriously limit the spread of home ownership, both town and country."

The financing of homes is affected at many points by state laws and regulations of one type or another. Most of the loan institutions are subject to general supervision of the state banking department or some similar agency. The rates of interest they



charge are commonly limited by usury statutes, and the terms of mortgages and methods by which properties may be foreclosed are prescribed to a greater or less degree in practically all states.

Delays and expense involved in collection of delinquent mortgage debts greatly restrict the volume of capital seeking investment in both first and second real estate mortgage securities. The whole system of obtaining credit upon the security of real estate is surrounded by so much legal formality and excessive cost that great and continuing financial burdens are carried by the owners of all types of real estate throughout the country, including the home owner.

A substantial proportion of capital seeking investment demands not only security, but also liquidity; and while it is generally possible to obtain reasonable real estate security, liquidity is difficult under existing laws. Mr. William H. McNeal, chairman of a committee of the Mortgage Bankers Association, states:

"When money is loaned on real estate, the laws of our various states and the practices which have grown up under them, put the burden on the lender to collect, rather than on the borrower to pay.

"Nothing will liquefy real estate securities except and until the laws of the various states are so amended as to make real estate quickly and inexpensively amenable to the payment of the debt against it. No commodity which is the subject of world trade and commerce is so bound by tradition, obsolete laws, and maudlin sentimentalism as is real estate. No form of investment bears the burdens of government as does real estate, by reason of the ever mounting tax rate for the support of municipal, state and county governments."

Tax laws, both Federal and State, present inequalities affecting both lenders and borrowers. In some states, mortgage taxes are an added expense to borrowers, such as the one-half per cent recording tax in the State of New York and the four mill annual tax in the State of Pennsylvania. Tax exempt bonds issued by the members of the Federal Land Bank system were designed to provide cheaper interest rates for borrowers on farm lands.

Many loans that are less secure than mortgage loans on improved real estate yield a lower interest return, solely because the security for such loans may be promptly sold for the benefit of the lender upon the failure of the borrower to meet his obligation. It has been pointed out frequently that it is easier for one to purchase an automobile on the instalment plan than to acquire a home.

Primarily, this is because a failure on the part of the purchaser to meet his instalments gives the seller the right to repossess himself of the automobile, whereas the holder of an instalment purchase money mortgage on a home is obliged to incur heavy expense and sometimes suffer long delay before the real estate may be resold in satisfaction of the mortgage debt. Fundamentally, therefore, the legal procedure of mortgaging real estate as security for a loan of money presents one of the greatest obstacles to "the removal of influences which seriously limit the spread of home ownership."

In order to present some of these problems, the Division on Legal Aspect of Mortgages has made its study under four general divisions: The need of greater uniformity in mortgages in the various states; foreclosure practices and costs; usury laws, their effect on the distribution of mortgage funds; the state regulation and supervision of mortgage lending institutions.

**Uniform Mortgages.** Many years of study have been given to the desirability of uniform mortgage laws throughout the United States. The National Conference of Commissioners on Uniform State Laws, after investigating and making a study of the subject for more than fifteen years, had adopted a draft of such law in 1927, and this was approved by the American Bar Association and the American Title Association. It has been considered by various authorities since that time. The idea in principle has met with general approval, but in detail, specific objections have been raised in individual states.

The Uniform Mortgage Act, if adopted, should accomplish at least two purposes. It should facilitate the placing and handling of mortgages, because of the uniformity possible thereby throughout the states, and reduce labor and expense, in that it provides for a short form of mortgage and simplifies foreclosure. The uniform mortgage law is not so important to one who deals only in mortgages locally. Today, however, business transactions are scattered widely. Billions of dollars are invested in mortgages throughout the land. Large companies are loaning money on mortgages, not only in one state, or half a dozen states, but frequently in practically all states in the Union. Bonds widely distributed are secured by mortgages on property located in different parts of the country.

Mortgage investments are greatly hampered by the diversity of laws in the different states. A table furnished by the Committee

on the Uniform Mortgage Act in 1922 showed that in seventeen of the states a mortgage was considered an estate in the land; in twenty-seven states it was considered as a lien on the land; while in four states it was treated as both an estate and a lien. In twenty-five states a mortgagee secured possession of the land upon the completed foreclosure of the mortgage; in six states upon the completion of the foreclosure but subject to stipulation between the parties; in one state upon the execution of the mortgage; in nine states upon the execution of the mortgage but subject to stipulation; in seven states upon default; and in two states upon default but subject to stipulation.

In thirty states the form of instrument used was an ordinary mortgage without power of sale; in ten states an ordinary mortgage with power of sale; in one state a trust deed without power of sale; and in eight states a trust deed with power of sale. The usual method of foreclosure in sixteen states was by action in court not required by statute; in twelve states by action in court but required by statute; in eleven states foreclosure was by sale under power without a period of redemption; while in seven states foreclosure was by sale under power but with a period of redemption. In two states foreclosure was by entry followed by possession for one year and in one state by executory process and *ex parte* court order followed by notice to the debtor. In seventeen states no period of redemption is allowed. In the remainder of the states the period of redemption varied from six months to eighteen months. The approximate time required after default under the mortgage in which to complete foreclosure and acquire clear title varied from a few weeks in some instances, being simply the days required to advertise for sale, to as much as two years.

The statute of limitations on the foreclosure of mortgages in the different states varied from a period of four years to twenty years; and in a number of instances there is no statute of limitations applicable solely to the mortgage, but the mortgage is simply barred whenever the debt it secures is barred by the regular statute of limitations. In fifteen states there are no statutory short forms of mortgage or trust deed. In the remaining states there is a statutory form of either one or both.

This lack of uniformity of the law in regard to mortgages in the various states hampers and interferes with interstate mortgage investments. All parts of the country are benefited by a free flow

of capital from one section to another as the need may require. This would be greatly facilitated under the Uniform Mortgage Act. The many benefits of the Uniform Mortgage Act will be readily appreciated by anyone who has to do with investing money in mortgage loans in the several states.

Among other things, this proposal contains a simple inexpensive method of foreclosure. It gives a chance for a court hearing if there is a contest and provides a period of redemption for such states as may require it. The Uniform Act avoids unduly long foreclosure proceedings. It provides a good marketable title after foreclosure and gives possession and right to rents and profits to the mortgagor prior to and pending foreclosure, thus giving him an opportunity to redeem. By agreement of the parties, the mortgagee may be put into possession at any time as further security. The mortgagor must keep the premises in repair and not commit waste. A short form of mortgage and trust deed is provided with statutory construction which will fully protect the rights of both parties. Other provisions may be added by marking them "not statutory." An effective Statute of Limitations is provided. The present unsatisfactory condition of mortgage laws has been brought about very largely by customs and local differences and is not based on any fundamental difference or methods of business.

The Uniform Mortgage Act has adopted the theory of foreclosure under power of sale found in a few states, with provision for court action either as an alternative remedy or following an injunction restraining a foreclosure by power of sale. The Act sets forth what the notice of sale shall contain and regulates the publication of notice and mailing to interested parties. It requires that the notice of sale shall be published three times, once in each of three successive weeks in a newspaper, the first publication to be not less than forty-two days prior to the date of sale. It gives to the mortgagor and subsequent lien holders the right to redeem. The period of redemption is not fixed by the Act because of the diversity of redemption provisions in the different states. The drafting committee has suggested a period of one year. Redemption by the mortgagor has the effect of annulling the sale, leaving the premises "subject to all liens which would have existed if no sale had been made, except the lien of the foreclosed mortgage which is discharged by the sale."

The foreclosure provision of the Uniform Mortgage Act gives

adequate length of notice and the method of notice is reliable. Ordinarily, notice by mail would duly reach the borrower, inferior lienors, and other interested parties. The Act makes it possible to avoid the delay and expense of court action. The foreclosure provisions of the Uniform Act probably give more protection to the borrower and cause less delay and expense to the lender than any other law now in operation, except those in states having no equity of redemption after the foreclosure sale.

The division believes general adoption of the Uniform Act by the respective states, with the exception of those provisions which under existing law are more favorable, would result in a vastly improved situation from the point of view of the broad interests of borrowers and lenders; and that it would leave the states having short periods of redemption free to retain them and certain other advantages which mortgagees are now granted. It should help to make mortgages more liquid because it would facilitate their purchase and selling by institutions doing an interstate business. The nearer the forty-eight states come to uniform mortgage practice, the greater will be a tendency of mortgage money to flow into the state most in need, with a consequent effect upon interest rates.

**Foreclosure Practices and Costs.** While it appears advantageous to be able to compel the sale of mortgaged property upon default of payments due under the mortgage, it is only under the most exceptional circumstances that the lending institution wishes to institute such proceedings on short notice, for in many cases failure to make payments may be due to no fault of the borrower. From the borrower's point of view, it might appear advantageous to have an extended period, say two years, in which to make good any default in payments. However, such a long delay reduces the security of the holder of the mortgage, and if it does not actually result in keeping money away from the mortgage field or cause higher rates of interest to be charged, it at least tends to cut down the percentage of the value that normally can be loaned with safety.

One of the greatest hindrances to the availability of mortgage money in some states is the right of redemption from sale under foreclosure. During the period of redemption, foreclosed property is rendered practically unmarketable, may suffer serious damage or depreciation, and presents in a high degree a type of frozen

asset. Investment capital naturally shrinks from lending under such contingencies.

A questionnaire was sent to an extended list of life insurance companies, inviting an expression of views on the foreclosure laws in the various states. Eighty-four companies responded. The consensus of opinion expressed by the companies most extensively engaged in making investments in real estate mortgages was that unnecessary delay and expense were experienced in connection with foreclosure actions. The companies that appeared satisfied with existing foreclosure laws were those that either make loans in a small number of states, or have a relatively small volume of business. Some companies having no complaints of foreclosure laws in the past, state they will have in the future. It is significant that the companies which are influenced, or will be influenced, by foreclosure laws, are those which have had a wider and more recent experience with foreclosures in states having unfavorable foreclosure laws.

Costs of foreclosures taken from examples given in twenty-three states on small home loans indicate expenses ranging from \$95 in Missouri where foreclosure is under power of sale, to \$667 in the State of New York, where mortgages are foreclosed by court action. Seven insurance companies drew attention to objectionable escheat laws, particularly in Kentucky and Oklahoma.

The judgment of this division is that additional capital for mortgages on homes would become available if equities of redemption from sales under mortgage foreclosure were abolished in all states and the costs of foreclosure were substantially reduced.

**Usury Laws.** Statutory maximum interest rates are commonly fixed in the several states at from 6 to 8 per cent. In many cases they do not apply to building and loan associations, or they are in practice "dead letters" so far as real estate lending is concerned. However, they do stand nominally, at least, in the way of the development of second mortgage companies. The cost of handling second mortgages, which are commonly of small denomination, and the risks involved, make it virtually impossible for them to operate within the statutory limits.

There is no law against selling a mortgage, second or otherwise, for less than its face value. Hence it is possible for second mortgage companies to operate legally on a discount basis, buying second mortgages after they have been made. This method is ad-

mittedly unsatisfactory, if not impractical. It does not bring the ultimate holder of the mortgage into the picture at the time it is being made, and as a matter of practice, many second mortgage companies in effect make loans directly without regard to the usury statutes. Hence, they have the stigma of doing an illegal business. This appears to add to the cost of their obtaining capital and makes it difficult for them to be closely tied up with any other institutions of well recognized standing.

The State of New Hampshire for over 100 years had a maximum statutory rate of interest. In 1921 the market rate for money went above six per cent, and money therefore flowed out of New Hampshire at such a rapid rate that the Legislature rescinded the statutory maximum and has not found it necessary to restore it since then. The legislation formerly in force prevented the local adjustments necessary to the current money market conditions which recognize no state boundaries and thus tended not only to the depletion of funds in New Hampshire, but also prevented money from flowing into the state. Various authorities also have been referred to upon the matter of usury laws in so far as they deal with interest rates on mortgages and two are hereby cited. Ryan, in the preface to his work on *Usury and Usury Laws*,<sup>1</sup> says:

"All usury laws in the United States have been enacted by legislatures on the juristic theory that, where the two parties to a loan are in unequal bargaining positions, the state is justified in interposing its police power to correct the situation.

"These impossible, unreasonable general statutory maximums which can never have any power over the market rate of pure interest, still remain, like dead timber in a forest, to obstruct the progress of business."

Reep, in *Second Mortgages and Land Contracts in Real Estate Financing*,<sup>2</sup> points out that usury legislation has made the second mortgage a discount business, and that statutory maximums have placed a barrier in the way of direct lending:

"thus has usury legislation in investment loans made the second mortgage and land contract business a discount business with added cost to the borrower and no more profits for the lender, since the additional cost goes to the middleman."

It is the view of a number of other well informed men that some modification of the application of the usury laws, as applied to second mortgage lending, might help to attract capital and bring

<sup>1</sup> Ryan, Franklin W. (Hart, Shaffner and Marx Prize Essay), Boston, Houghton Mifflin Company, 1924.

<sup>2</sup> Reep, S. N., New York, Prentice-Hall, Inc., 1928.

the business out into the open. The division believes that this is an important consideration. It has been much interested in the suggestion that second mortgage companies operating under special statute and subject to special supervision (somewhat after the analogy of personal credit companies under the *Uniform Small Loan Act* developed by the Russell Sage Foundation) should be allowed to charge a maximum rate of interest higher than the legal rate applicable elsewhere. There is precedent for this in existing laws applying to building and loan associations; many of these agencies that lend above the limits of first mortgages handled by other institutions avail themselves of the privilege to charge higher than the regular statutory rates, the initial character of most of them ordinarily serving as a regulator to prevent abuses.

The division recommends that this subject of usury and maximum statutory interest rates in so far as mortgages are concerned be studied by legislative committees with particular reference to removing legal barriers which prevent the natural flow of money at current market rates. The division particularly recommends the removal of usury laws in relation to second mortgages, with proper safeguards in the public interest, and believes that such action will tend to bring additional money into the second mortgage market and thereby relieve the greatest problem confronting the home owner.

**State Regulation and Supervision.** Most of the various types of mortgage institutions are subject to some form of supervision by state agencies, frequently the state banking department. As the technique of mortgage lending is more highly developed in some states than in others, there necessarily would be some differences in the methods of supervision. Regardless of this though, this supervision is in the interest of the lenders who entrust their savings to local institutions and to borrowers.

The present frozen condition of some local institutions indicates the need to review state supervisory laws for the purpose of seeing to what extent they might be improved to prevent a repetition of existing conditions in certain localities. Such action by the states will do much to introduce liquidity in mortgage investments, realizing that this type of investment at best cannot be as liquid as various other forms. In the course of the recommended review of state supervisory legislation, the division suggests that particular attention be paid to the extent to which long and short term credit operations have been properly conducted by local institutions, as



well as the effect which taxation has upon the stimulation of sound home building.

In some states it appears that the financing of homes is subject to a double burden of taxation. The owner pays taxes on his property, and there are also taxes on the mortgage. This is in direct contrast to the policy of the Federal government which allows the home owner to deduct the interest paid on a mortgage from his income in computing his income tax. On the other hand, many states exempt building and loan associations from certain tax burdens, and the Federal Income Tax Law grants exemption from normal taxes to personal income up to \$300 a year derived from mutual building and loan association dividends. There has been some complaint that Federal Income Tax Laws discourage the setting aside of adequate reserves by second mortgage companies during prosperous years.

The division recommends that adequate statutes be adopted by various states in the interest of sound home finance and the public to the end there may be proper supervision over local mortgage lending agencies and adequate publicity to periodic financial statements of these agencies. This division believes this recommendation will do much to insure the maximum amount of liquidity possible in mortgages.

## V. THE COMMUNITY AND SUCCESSFUL HOME FINANCING

The Division on Community and Successful Home Financing has considered the ways in which certain types of community activities influence the economic aspects of home ownership and home financing. The matters considered are practically all the primary concern of other committees but, inasmuch as they have a direct and important bearing upon the economics of home ownership and finance, they have been considered and studied by this division in the hope that some benefit might be derived from the emphasis that would be placed upon the economic aspect of the subjects in question and upon the important place they bear in connection with home financing.

**Sound Taxation and Assessment Laws and Policies.** Annual taxes and special assessments constitute an important, and often a very uncertain, factor in the cost of home own-

ership. The report of the Division on Statistics of the committee calls attention to the importance of both real property taxes and special assessments among the causes of foreclosures. Replies from more than eleven hundred building and loan associations name taxes and special assessments next to unemployment and financial circumstances of the borrower as the most important cause of foreclosure directly affecting the individual's capacity to meet his mortgage obligation.

In considering the difficulties brought about by excessive taxation and special assessments, it was pointed out that the problem was partly one of municipal administration. Certain activities of the municipality and certain public improvements may be good and may increase property values and the security of mortgages. Others may have a contrary effect. Obviously no improvement should be undertaken which is not wisely planned and well conceived but irrespective of the desirability of the improvement, it should not be undertaken if its cost is too great to be borne by members of the particular community affected.

(a) It is unwise to adopt a policy of indiscriminate discouragement of public improvements. If improvements are well conceived and proper, they enhance the value of the property and the security of the loan.

(b) The time at which public improvements are carried out should be carefully considered with reference to costs at the time in question, ability of the community to pay at that particular time, relationship of public work to stabilization of employment, and prevailing rate of interest.

(c) Other things being equal, public work should be undertaken by that branch of the government which can obtain lowest interest rates for work in question.

(d) If possible, willingness of property owners to have improvements carried out should be considered.

(e) Relationship between the value of improvement and the assessed value of the property affected should be carefully considered, as well as proper safeguards for retirement of bonds, etc. These matters have all been discussed in reports of the Finance Department of the Chamber of Commerce of the United States. These reports contain excellent suggestions covering the entire field.

**Proper City Planning and Zoning Legislation and Administration.** These subjects are primarily the work of another committee. They have, however, a distinct bearing upon the economics of home ownership and financing.

(a) The proper planning of the city safeguards the investments made in real estate therein. It is a protection against waste in public improvements

and eliminates a certain element of risk in regard to undesirable developments in a given neighborhood.

(b) The same is true to an even greater extent in regard to zoning legislation and administration. The stable values of residential property require protection against the erection of buildings or uses of property that will prove a nuisance to the particular neighborhood. Here again, statistics are lacking as to the damage done through the absence of proper zoning regulations, but those who have been interested in the subject know that in communities where zoning is lacking, severe damage has been done to otherwise desirable homes by the erection near them of buildings of an undesirable character. Depreciation in property value in cases of this kind may go so far as to be followed by foreclosures of mortgages.

**Subdivision Control.** The same considerations apply to this subject. The proper planning of subdivisions and the proper installation of public utilities are essential if the investment of the home owner and mortgagee is to be protected.

Governmental control over subdivision should be exercised to protect the interest of the lot and home buyer. In some jurisdictions laws have been passed under which the municipality refuses to accept land subdivisions unless certain essential utilities have been installed or a bond provided for their installation. The Department of Commerce is at present working on a proposed uniform regulation as a suggestion to municipalities covering this subject.

**Adequate Building Regulations.** These are also extremely important as a means of safeguarding the owner's investment in his home as well as the interest of the mortgagee. Details are being taken care of by the Department of Commerce Building Code Committee. Not only are building regulations important in this connection, but it is equally important that the construction of new buildings be properly supervised so as to make sure that workmanship and materials will be of the proper kind. In this connection various plans have been advanced for the issuance by private or semi-public bodies of certificates attesting to the fact that the building complies with proper regulations and is satisfactory as to materials and workmanship. Some method of reliable certification and appraisal would be extremely useful both to the home buyer and to the mortgagee. The difficulties are proper administration at relatively low cost, as well as absolute reliability. In cases where these requirements are fulfilled, a very useful service is performed.

**Deed Restrictions.** Deed restrictions have been widely and successfully employed to supplement building and zoning regulations. They help to safeguard residential values and the security of residential investments against the harm resulting from in-harmonious types of building and incompatible ownership occupancy. Undoubtedly the utility of deed restrictions could be increased by greater uniformity as to duration, and by provisions against their abuse. The principle of deed restrictions being now well recognized, their improvement and wider adoption would undoubtedly lead to beneficial results.

**Efficient Administration of Governmental Functions Affecting Property Values, such as Maintenance of Educational Facilities, Parks, Playgrounds, Streets, Etc.** The relationship of proper governmental administration to property values is obvious. It is important to bring to the attention and knowledge of home owners as well as tenants the fact that the security of their home ownership as well as the cost of their rent depends to a considerable extent upon the efficiency and honesty of the government of their municipality as well as upon its willingness to give reasonable service in respect to schools, parks, playgrounds, streets, etc.

**General Responsibilities for Adequate Home Financing in Each Locality.** A review of the reports of the other divisions of the committee suggests many points at which something more than good management within single home financing institutions is required in order to solve problems of grave concern. Many of them already recognize this by going beyond their sphere of day-to-day activities in order to help provide a community structure—economic, social and governmental—that will enable them to do their work most effectively.

Some finance institutions have a record of creditable achievement in the development of more adequate statistics, occasionally improved facilities for financing beyond the customary first mortgage, changes in legislation, more equitable distribution of tax burdens, better city planning and zoning administration, and more adequate education in family budgeting and provision of competent disinterested advice for the guidance of prospective home owners. Many more mortgage lenders should take an active part in such efforts. The committee feels that the lending institutions may look forward with the most confident expectations to coopera-

tion from the public spirited civic, business and professional groups represented in the Conference which have been formulating programs along these and many other related lines.

Above all, the present home financing agencies must seek to see their local home financing problems in all their aspects, knowing that their responsibilities do not end with good internal management.

**Community and Large-Scale Housing Operations.** Tentative reports of other committees indicate that certain types of large-scale community housing operations, which may be of great importance and value from a public point of view, are not ordinarily executed by organizations operated for profit. Among these would be included economically well-conceived slum clearance projects and experimental projects designed as demonstrations of certain ideas or principles, and quasi-philanthropic projects. The financing of such projects presents a problem extending beyond the activities of regular home financing institutions.

Large-scale commercial housing operations involve a type of financing similar to that employed in general corporate financing of large commercial enterprises, and to which reference has already been made in another section of the committee's report. This type of financing occupies an entirely different field from that involved in financing individual home owners.

#### DISSENTING STATEMENT OF MR. WILLIAM E. BEST

(Member—Committee on Finance.)

January 29, 1932.

As a member of the Committee on Finance of the President's Conference on Home Building and Home Ownership, speaking particularly for the building and loan interests, I cannot approve the report of the committee in two particulars. This is not entirely a personal opinion as I have had the entire report before the officers and directors of the United States Building and Loan League, and they have taken action by resolution. I respectfully request that this communication and this resolution be made part of the committee report and footnote reference to this statement be made in the text of the report which, I assume, it would be considered improper to alter. The two points of disagreement are:

1. The United States Building and Loan League and myself, as

the president of this organization, dissent from the recommendation of the committee which appears on page nine of their report and is as follows:

"The committee recognizes the existing emergency and is in sympathy with the view of the President that it must be met. Further the committee unanimously records its support of the President in any remedial measures he proposes."

Part I of the resolution of the directorate of the United States Building and Loan League states their action on this matter.

2. The Division on Mortgage Structure of the Committee on Finance made the following statement:

"There arises a question as to the wisdom of encouraging an institution dealing in second mortgages to solicit deposits of small savings funds, especially if its nature is not clearly distinctive from its title."

Building and loan leaders emphatically feel that the savings of the working classes should not be placed in this type of speculative or semi-speculative investment. The recommendation of the committee appearing on page ten, No. 3a, recommending "mutual junior mortgage associations" is a veiled approval of a principle or procedure with which building and loan leaders cannot concur and on which, as shown, the Division on Mortgage Structure does not concur.

The resolution of the United States Building and Loan League follows:

"Part I—In times of depression when unemployment impairs the ability of our people to save systematically and causes them to draw heavily on their accumulated reserves, not only is the capacity of the building and loan associations to fully serve their patrons severely taxed but the heavy calls to refinance resulting from the demands for repayment by institutions holding straight mortgages, whose funds are subject to immediate withdrawal, create a situation *which makes necessary the establishment of a home financing reserve system not only for temporary emergencies but for permanent needs as well.*

"The building and loan association is a creature of the laws of our several States separate and apart from every other type of financial agency. Its beneficent purposes have given it universal recognition. In any proposed set-up for a rediscount or reserve institution, the functions and services of the building and loan associations should be preserved and no different financial types should be included so as to embarrass the standing and capacity of

these savings and home financing organizations which have so successfully served the people of the United States and for whose plans no substitute or superior has ever been conceived.

"Part II—Any proposal for junior or second mortgage home financing by societies to be known under the general title of building and loan associations is abhorrent to those principles which have caused our associations to achieve the highest record of safety in the realms of American finance over a period of one hundred years. The acceptance of it would be nothing short of a betrayal of the interests of the millions of people who have entrusted their savings to our type of institution and the addition of such second mortgage practices would lose to the present system of building and loan associations that confidence and trust which have brought to them nearly nine billions of dollars of the savings of the people of this Nation.

"In a nation composed so largely of wage earners and persons of moderate means, it is apparent that home ownership must be achieved through financial institutions lending sufficient sums on the security of the home and on the faith and ability of the borrower to pay small amounts out of his earnings as received to cover interest charges, taxes, insurance, and a portion of the principal.

"The building and loan association provides this means of home financing without excessive costs and charges and offers a time-tested plan of small, periodic payments spread over a sufficiently long period of time to obviate renewals or the calling of substantial sums of money.

"No straight mortgage or other plan of short or long maturity could have accomplished such successful results in home ownership."

In closing I wish to state that the balance of the report has my enthusiastic approval as I consider it one of the most constructive studies of home financing principles and problems that has ever been made and published and I am going to make it my personal responsibility to give it wide circulation among building and loan associations in the United States when it has been published in its final form.

#### DISSENTING STATEMENT OF MR. HARRY S. KISSELL

(Member—Committee on Finance.)

December 23, 1931.

**Down Payment.** The committee recommends that no home buyer undertake home purchase until he shall have accumulated a down payment of 25 per cent. With this I cannot concur.

We have made no statistical survey on the matter, but the general experience of our own membership is that of the homes they have

sold, about 75 per cent have been sold on less than a 25 per cent down payment. The recommendation of the committee, therefore, is too restrictive and proposes to put up additional bars against home ownership, which the successful experience of the past has proved unnecessary. Were we to lay down the rule that one-fourth should be accumulated before a home is purchased we would be condemning the great majority of our people to die in rented houses.

**Appraisal Bureaus.** The committee recommends the creation of central appraisal bureaus to advise home buyers. The committee does not disclose whether such bureaus should be commercial enterprises, or philanthropic ones. Our own investigations in the past convince me that the creation of such bureaus on a commercial basis would be costly and difficult, and would pile more charges on the already overburdened home buyer. Moreover, there is in existence already an appraisal service in the 562 cities where the National Association of Real Estate Boards has local member boards, which for a nominal sum will do exactly what the committee has in mind. This service is maintained without any overhead charges and is widely used.

**Foreclosures.** The report greatly minimizes the foreclosure situation. A Division on Statistics was appointed to gather facts on this, and kindred matters. This committee was given the facilities of the United States Department of Commerce and offered the cooperation of the National Association of Real Estate Boards and other organizations in gathering facts. No summary of the facts assembled showing the situation throughout the country, is presented. The situation for "one type of lending agency" is cited specifically and an attempt made to show that the condition is not serious. The report should properly contain a clear and fair picture of this whole matter in order that the facts may be known.

**Junior Financing.** With respect to junior financing, the report merely passes the problem back to local communities and urges that additional experiments be tried. The committee thus washes its hands of one of the most stubborn and critical problems in the home financing field.

**General.** In general it may be said that the report, by suggesting new refinements and restrictions by law to protect the mortgagee and larger equity payments by the home buyer, lays



down principles and conditions which, if generally adopted, would tend to restrict home buying greatly in the future, and not to encourage it. The members of the committee seem to have considered the entire home financing problem, not from the point of view of the home buyer, but from the point of view of the investor who is anxious about his security. While such a report may have its value, it is not germane to the purpose of the President's Conference on Home Building and Home Ownership which is to assist and encourage.

## APPENDIX I

### HOME FINANCING IN WEST COAST CITIES<sup>1</sup> SUMMARY—PACIFIC COAST MORTGAGE SURVEY

The data in this report were obtained from questionnaires sent through local offices of the United States Department of Commerce to banks, mortgage bankers, building and loan associations, second mortgage companies, builders and realtors in Los Angeles, San Diego, and San Francisco, California; Portland, Oregon; and Seattle, Washington; supplemented by personal interviews in each of these cities.

	<i>Present supply of loanable funds</i>	<i>% Usual</i>	<i>% Loaned Maximum</i>
<b>FIRST MORTGAGE FUNDS</b>			
Building and Loan Associations...	Shortage	60%-70%	80%
Mortgage Bankers.....	Surplus	50%	60%
Banks.....	Sufficient	40%	50%
<b>INTEREST</b>			
5½% to 8.4%			
<b>COMMISSION</b>			
0% to 3%			
<b>TERMS OF LOANS</b>			
1 year to 15 years			
<b>SECOND MORTGAGE FUNDS</b>			
Practically none, due to heavy losses			
<b>HOME PURCHASES</b>			
Down payment accepted—0% to 10% and up			
Down payment recommended—25% minimum			
Percentage of income allotment recommended for principal and interest—25% maximum			
Percentage of sales requiring secondary financing—70%			
Percentage of sales with all cash above 1st mortgage—20%			
Percentage of sales with all cash—10%			

<sup>1</sup> The data in this paper were compiled by Mr. Hiram S. Cody, member of the Committee on Finance, who supplemented questionnaire data by personal interviews in each of the cities named. The paper was submitted as an appendix to the report of the Committee on Finance.

DISTRICTS	City		1930 Population		
	San Diego	Los Angeles	San Francisco	Portland	Seattle
	San Diego	Los Angeles	San Francisco	Portland	Seattle
	6	11	2	6	3
57 Mortgage Bankers.....	9	22	6	11	9
30 B. & L. Assns.....	3	13	6	4	4
61 Builders.....	4	27	5	2	23
227 Realtors.....	44	94	29	30	30
4 Second Mtg. Agencies.....	1	1	2	—	—
407 TOTAL.....	67	168	50	53	69

1. **Adequacy of Funds.** (A) In your city as a whole, are adequate funds available to meet all reasonable demands for loans on single family dwellings?

	Total		San Diego		Los Angeles		San Francisco		Portland		Seattle	
	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
22 Banks.....	22	—	6	—	8	—	2	—	3	—	3	—
57 Mtg. Bankers...	49	8	6	3	21	1	6	—	7	4	9	—
25 B. & L. Assns...	10	15	2	1	2	9	3	1	1	3	2	1
56 Builders.....	38	18	3	1	17	9	3	—	2	—	13	8
199 Realtors.....	116	83	9	11	49	42	19	9	21	9	18	12
359 TOTAL.....	235	124	26	16	97	61	33	10	34	16	45	21

(B) Are your funds now adequate to meet all reasonable demands for loans on single family dwellings?

25 Banks.....	24	1	6	—	8	1	2	—	5	—	3	—
57 Mtg. Bankers...	45	12	5	4	22	1	4	1	6	5	8	1
30 B. & L. Assns....	5	25	1	2	2	11	1	5	—	4	1	3
112 TOTAL.....	74	38	12	6	32	13	7	6	11	9	12	4

(C) Have your funds been adequate during the past fifteen years for home loans?

17 Banks.....	13	4	4	—	3	3	2	—	4	—	—	1
49 Mtg. Bankers....	45	4	5	2	20	—	3	—	8	2	9	—
23 B. & L. Assns....	17	6	1	—	6	4	3	2	4	—	3	—
89 TOTAL.....	75	14	10	2	29	7	8	2	16	2	12	1

2. **Sources of Funds.** Please indicate the sources of your funds.

## (a) 77 BUILDERS

		San	Los	San		
	Total	Diego	Angeles	Francisco	Portland	Seattle
Mortgage Bankers....	47	3	19	2	2	21
Banks.....	14	1	3	4	1	5
Private Investors.....	12	1	5	—	1	5
B. & L. Assns.....	3	2	1	—	—	—
Own funds.....	1	—	1	—	—	—
TOTAL.....	77	7	29	6	4	31

## (b) 57 MORTGAGE BANKERS

(Indicating the order of their importance)

		San	Los	San		
	Order	Diego	Angeles	Francisco	Portland	Seattle
Insurance Companies..	1	2	2	2	1	1
Private Investors.....	2	3	1	3	3	2
B. & L. Assns.....	3	1	3	4	2	5
Banks.....	4	5	4	1	5	3
Other funds.....	5	4	5	5	4	4

3. Safeguarding Home Ownership. (A) What is the minimum percentage of the purchase price required as the down payment?

Per Cent	Now			1924
	Total	Builders	Realtors	Realtors
0.....	7	—	7	1
1.....	6	—	6	—
2.....	2	—	2	—
5.....	40	3	37	10
10.....	118	32	86	48
15.....	11	1	10	16
20.....	20	10	10	35
25.....	11	4	7	37
Miscellaneous.....	21	3	18	25
TOTAL.....	236	53	183	172
WEIGHTED AV.....	10.372	13.000	9.575	16.292

(B) What minimum initial cash investment *should* the home buyer or home builder have as the basis of a sound transaction?

	<i>Average</i>
111 First Mortgage Lenders.....	31%
58 Builders.....	20%
199 Realtors.....	21%
368 TOTAL	
<i>Average of all estimates</i>	<i>23.85% of purchase price.</i>

(C) What maximum monthly payment of principal and interest, in relation to his assured monthly salary or income, *should* the home buyer or home builder contract for?

	<i>Average</i>
91 First Mortgage Lenders.....	23.5%
50 Builders.....	25.8%
193 Realtors.....	23.4%
<hr/>	
334 TOTAL	
<i>Average of all estimates</i>	<i>23.79% of assured monthly income.</i>

(D) What is the approximate percentage of your sales?

(a) Requiring secondary financing:

	<i>Average</i>
36 Builders.....	75.6%
166 Realtors.....	63.0%

(b) Made for all cash above the first mortgage:

39 Builders.....	17.2%
163 Realtors.....	19.0%

(c) Made for all cash:

31 Builders.....	13.0%
144 Realtors.....	9.0%

(E) What, in your experience, are the principal causes of defaults, numbered in the order of their importance?

1. Unemployment<sup>2</sup>
2. Too heavy investment
3. Installment purchases
4. Excessive principal payments
5. Business losses
6. Stock market losses
7. Depreciation in building
8. Domestic difficulties
9. Increase in taxes or special assessments
10. Illness<sup>2</sup> or death
11. Neighborhood changes
12. Bank failures

#### ADDITIONAL CAUSES REPORTED

- (a) Decline in market values
- (b) Lack of amortization
- (c) Excessive loan
- (d) Building and Loan suspension prevents refinancing

<sup>2</sup> There is evidence that unemployment and illness usually receive special consideration at the hands of lenders.

- (e) Lack of second mortgage funds
- (f) Overfinancing with second mortgage
- (g) Inflated purchase price owing to instalment purchase
- (h) Too small original equity (less than 25%)
- (i) "Keeping up with the Joneses"
- (j) Business transfer to other locality
- (k) Absence of budget system
- (l) Decline in earning power

(F) In your experience, are defaults more common on:

- (a) First mortgage home loans up to 66% than on those up to 50%?  
99 First Mortgage Lenders—Yes 91 No 8
- (b) First mortgage home loans up to 75% than on those up to 66%?  
95 First Mortgage Lenders—Yes 94 No 1
- (c) "Straight" or "flat" loans than on amortized loans?  
90 First Mortgage Lenders—Yes 45 No 45

#### 4. Description of Loans. (A) Amount.

(a) LOAN RATIO TO LENDER'S APPRAISAL

Per Cent	<i>First Mortgage Lenders</i>		<i>Builders</i>	<i>Realtors</i>
	Usual	Maximum	Maximum	Maximum
30.....	—	—	—	5
35.....	—	—	—	4
40.....	20	1	7	38
45.....	10	—	1	3
50.....	54	43	35	91
55.....	2	3	1	3
60.....	16	23	12	46
65.....	4	6	—	3
70.....	1	3	—	—
75.....	1	1	—	1
80.....	—	1	—	—
TOTAL....	108	81	56	194

(B) Term.

Years	<i>First Mortgage Lenders</i>		<i>Builders</i>
	Straight Loans	Amortized Loans	Both Types
1.....	6	—	2
3.....	68	—	31
5.....	7	31	10
10.....	—	37	12
7-12.....	—	15	1
15.....	—	5	11
16 years 8 months.	—	1	—
TOTAL.....	81	89	67

## (C) Interest.

<i>Per Cent</i>	<i>First Mortgage Lenders</i>	<i>Builders</i>
5.....	3	—
5½.....	13	—
6.....	35	19
6½.....	23	7
7.....	60	32
7.2 (B. & L.).....	2	—
7.8 (B. & L.).....	4	—
8.....	16	7
8.4 (B. & L.).....	18	1
8 to 10 (B. & L.)..	3	—
PAYABLE:		
Semi-annually.....	31	
Quarterly.....	40	
Monthly.....	33	

Before remitting to the investor, do you deduct a portion of the interest to help cover your cost of servicing the loan?

Yes—30      No—73

If so, what is your interest differential?

½%—19      1%—8

## (D) Commission.

<i>Per Cent</i>	<i>First Mortgage Lenders</i>		<i>Builders</i>	
	<i>Completed Buildings</i>	<i>Construction Loans</i>	<i>Completed Buildings</i>	<i>Construction Loans</i>
	<i>Original Loan</i>	<i>Original Loan</i>	<i>Original Loan</i>	<i>Original Loan</i>
0.....	27	12	7	4
½.....	—	1	—	—
1.....	15	11	7	8
2.....	31	18	9	10
2½.....	5	2	—	—
3.....	39	41	27	31
3½.....	—	5	—	—
4.....	—	2	1	—
5.....	—	2	2	3
5 to 10.....	—	—	1	1
TOTAL....	117	94	54	57

## RENEWALS

Per Cent	First Mortgage Lenders	
	Completed Buildings	Construction Loans
0.....	26	13
½.....	—	1
1.....	27	16
1½.....	1	2
2.....	14	27
2½.....	2	2
3.....	10	13
TOTAL.....	80	74

## (E) Construction Loans.

1. Do you make construction loans to
  - (a) Individual home builders?
 

Yes—86	No—25
--------	-------
  - (b) Those building for sale?
 

Yes—54	No—52
--------	-------
  - (c) Did you in 1924?
 

Yes—56	No—34
--------	-------
2. Do you require a bond to guarantee completion?
 

Yes—42	No—46
--------	-------
3. If so, at what additional cost to the borrower?
 

1%—3	1¼%—1	1½%—14	2%—1
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## (F) Amortization.

- (a) 2% to 3% semi-annually
- (b) B. & L. plan, monthly
 

\$12.30 per thousand per month, 8.4% interest.
\$11.00 per thousand per month, 7.8% interest.

## 5. Supply of Buildings.

## (A) LOW PRICED HOMES.

	For Sale	For Rent
San Diego.....	Surplus	Normal
Los Angeles.....	Normal	Shortage
San Francisco.....	Normal	Normal
Portland.....	Surplus	Surplus
Seattle.....	Normal	Normal

## (B) MEDIUM PRICED HOMES.

	For Sale	For Rent
San Diego.....	Surplus	Normal
Los Angeles.....	Normal	Normal
San Francisco.....	Normal	Normal
Portland.....	Normal	Normal
Seattle.....	Heavy Surplus	Normal



## (c) EXPENSIVE HOMES.

	<i>For Sale</i>	<i>For Rent</i>	
San Diego . . . . .	Marked Surplus	Surplus 10	Normal 10
Los Angeles . . . . .	Heavy Surplus	Surplus	
San Francisco . . . . .	Surplus	Normal	
Portland . . . . .	Normal	Normal	
Seattle . . . . .	Normal	Normal	

## (d) APARTMENTS FOR RENT.

	<i>Low Priced</i>	<i>Medium Priced</i>	<i>Expensive</i>
San Diego . . . . .	Surplus	Surplus	Surplus
Los Angeles . . . . .	Surplus	Surplus	Marked Surplus
San Francisco . . . . .	Normal	Surplus	Heavy Surplus
Portland . . . . .	Heavy Surplus	Normal	Normal
Seattle . . . . .	Heavy Surplus	Heavy Surplus	Heavy Surplus

\* 6. Foreclosures. (On reports from 40 cities scattered throughout the United States.)<sup>3</sup>

1928—23,601
1929—29,799
1930—37,314
1931—31,606 <sup>4</sup>

## 7. Remedies Suggested. What steps should be taken to improve home financing facilities?

	<i>Realtors</i>		<i>Commercial Builders</i>	
Lower interest . . . . .	49		15	
Higher percentage loaned . . . . .	33		11	
Higher appraisals . . . . .	33			
Longer term . . . . .	27		8	
Lower commissions . . . . .	27		16	
Federal mortgage bank . . . . .	Yes 24 <sup>5</sup>	No 3 <sup>5</sup>	Yes 4	No 4
More amortization loans . . . . .	19			
Provide funds to discount contracts and for second mortgages . . . . .	14		6 (Seattle)	
Lower title and other charges . . . . .	11		9	
Lower taxes and assessments . . . . .	9			
Secure willingness to renew sound loans . . . . .	8			
Have banks lend to non-depositors . . . . .	6			
Lower principal payments . . . . .	5			

<sup>3</sup> These 40 cities in 1930 had a total population of 12,175,324.<sup>4</sup> Figures for 1931 were reported by some cities for the first six months, some for nine months and some for ten months.<sup>5</sup> Out of 227 replies from realtors.

	<i>Realtors</i>	<i>Commercial Builders</i>
Include taxes and insurance in monthly payments.....	5 (Seattle)	
Copy Veterans' Welfare Board plan.....	4	
Longer periods without payment on principal.....	3	
Better construction.....	1	3

## OTHER SUGGESTIONS

- (a) Have the banks "loosen up."
- (b) Stricter inspections and building ordinances.
- (c) Beware of easy financing.
- (d) Organize appraisal company to advise lenders.
- (e) Help *good* older districts.
- (f) Insist on sound down payment.

## APPENDIX II

# SUMMARY OF DATA FROM LENDING AGENCIES<sup>1</sup>

### I. LIFE INSURANCE COMPANIES

Questionnaires were sent to the presidents of four hundred life insurance companies. Approximately one hundred companies responded to these questionnaires, and eighty-four companies returned questionnaires with the information requested.

Following is a summary analysis of the replies received to six subdivisions of our first three questions: <sup>2</sup>

1. The percentage of home mortgages reported in process of foreclosure compared with the total outstanding mortgages on homes was . . . . . 0.790%
2. The percentage of home properties reported as owned by companies as a result of foreclosure proceedings compared with the total amount of outstanding mortgages on homes was . . . . . 0.738%
3. The percentage of city mortgages other than homes reported in process of foreclosure compared with the amount of mortgages outstanding on city properties other than homes was . . . . . 0.683%
4. The percentage of city properties other than homes reported owned by companies due to foreclosures compared with the total amount of outstanding mortgages on city properties other than homes was . . . . . 0.662%
5. The percentage of all outstanding city mortgages reported in process of foreclosure compared with the total amount of outstanding city mortgages was . . . . . 0.805%
6. The percentage of all city properties reported owned by companies due to foreclosure compared with the total amount of outstanding mortgages on all city properties was . . . . . 0.662%

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<sup>1</sup> These data were compiled under the direction of Mr. Arthur J. Mertzke, Research Assistant to the Committee on Finance, as an appendix to the committee's report.

<sup>2</sup> Since all questionnaires were not completely filled out, the total number of replies on which each of the above summaries was computed differs. Each percentage figure (which it is to be noted is less than 1%) is computed on the basis of total figures taken from all replies that were made to the particular subdivision of the question asked.

**Question 4. Table 1. Net Return on City Mortgages**

Year	Net Return on Home Mortgages		Net Return on All City Mortgages	
	Average Rate	No. of Replies	Average Rate	No. of Replies
1926	5.738%	20	6.335%	43
1927	5.705%	24	5.877%	48
1928	5.725%	27	6.077%	47
1929	5.734%	29	5.956%	48
1930	5.792%	34	5.956%	53

**Question 5. Terms and Interest Payment on Straight or Non-curtable Loans, Now and in 1924.**

*I. Now*

- (a) 16 companies replied, term 5 years, interest payable semi-annually.
- (b) 16 companies replied, term 3 to 5 years, interest payable semi-annually.
- (c) 13 companies replied, term 3 years, interest payable semi-annually.
- (d) 9 companies replied that they make no straight loans.
- (e) 12 companies reported miscellaneous other terms.

*II. In 1924*

- (a) 15 companies replied, term 5 years, interest payable semi-annually.
- (b) 17 companies replied, term 3 to 5 years, interest payable semi-annually.
- (c) 5 companies replied, term 3 years, interest payable semi-annually.
- (d) 4 companies reported that they made no straight loans.
- (e) 13 companies reported miscellaneous other terms.

**Question 6. Terms and Interest Payment on Amortized Loans, Now and in 1924.**

*I. Now*

- (a) 9 companies replied, term 5 years, amortized 5% annually, interest payable semi-annually.
- (b) 7 companies replied, term 5-7-10 years, amortized 5% annually, interest payable semi-annually.
- (c) 5 companies replied, term 3 to 5 years, amortized 5% annually, interest payable semi-annually.
- (d) 13 companies replied that they make no amortized loans.
- (e) 16 companies reported miscellaneous other terms.

II. *In 1924*

- (a) 9 companies replied, term 5 years, amortized 5% annually, interest payable semi-annually.
- (b) 5 companies replied, term 5-7-10 years, amortized 5% annually, interest payable semi-annually.
- (c) 3 companies replied, term 3 to 5 years, amortized 5% annually, interest payable semi-annually.
- (d) 8 companies reported that they made no amortized loans.
- (e) 7 companies reported miscellaneous other terms.

**Question 7. Deferred Principal Payments on Amortized Loans.**

To the seventh question, "Do you make amortized loans with the first payment of principal due several years or more after issue of the mortgage?", 73 companies replied as follows:

- (a) Yes..... 24
- (b) No..... 49

**Question 8. Commercial Loans to Builders.**

To the eighth question, "Will you state whether you make loans to commercial builders on completed but unsold homes and whether you did so in 1924?", the replies were as follows:

I. *Now*

- (a) Yes..... 9
- (b) No..... 68

II. *In 1924*

- (a) Yes..... 17
- (b) No..... 45

**Question 9. Predominant Causes of Defaults.**

To the ninth question, "Will you give three predominant causes of defaults experienced by your company leading to foreclosures on homes?", replies were as follows:

- (a) 19 replies were: Financial condition of borrower, reduced income.
- (b) 16 replies were: Have had no defaults.
- (c) 15 replies were: Depreciated value of property.
- (d) 11 replies were: Unemployment.
- (e) 9 replies were: Too large a project.
- (f) 9 replies were: Business depression.
- (g) 5 replies were: Excessive loans.

Table II. Number of Companies Making Mortgage Loans on Homes in Each State

Alabama.....	17	Montana.....	4
Arizona.....	5	Nebraska.....	15
Arkansas.....	10	Nevada.....	1
California.....	12	New Hampshire.....	1
Colorado.....	10	New Jersey.....	12
Connecticut.....	9	New Mexico.....	3
Delaware.....	6	New York.....	16
District of Columbia....	8	North Carolina.....	12
Florida.....	13	North Dakota.....	8
Georgia.....	18	Ohio.....	16
Idaho.....	7	Oklahoma.....	23
Illinois.....	26	Oregon.....	10
Indiana.....	14	Pennsylvania.....	17
Iowa.....	18	Rhode Island.....	3
Kansas.....	18	South Carolina.....	11
Kentucky.....	10	South Dakota.....	8
Louisiana.....	12	Tennessee.....	16
Maine.....	3	Texas.....	33
Maryland.....	10	Utah.....	8
Massachusetts.....	10	Vermont.....	2
Michigan.....	22	Virginia.....	10
Minnesota.....	19	Washington.....	11
Mississippi.....	12	West Virginia.....	14
Missouri.....	18	Wisconsin.....	7
		Wyoming.....	3

**Question 10.** Arrangements for Compensating Loan Correspondents.

To the tenth question, "What arrangement do you have for compensating your loan correspondents? Please indicate commission rates and what, if any, part of the mortgage interest is retained by them.", there were sixty-four replies:

- 26 replies—No commission charged.
- 13 replies—Correspondent retained  $\frac{1}{2}$  of 1% interest.
- 15 replies—Commission paid to correspondent by borrower—varies from 1% to 5%.
- 7 replies—Mortgages purchased from banks, etc., for commission ranging from 1% to 3%.
- 3 replies—No commission charge on loan—commission on life insurance suffices.

## II. BANKS

Questionnaires were sent to savings banks and to all other banks who are members of the Savings Bank Division of the American Bankers Association. Replies were received from 884 banks. The following is a *national summary* of these replies.

**Question 1.** Will you supply the information called for below covering your practices in making "straight" mortgage loans on homes now and in 1924?

Table III. Straight Mortgage Loans

(Charges, and Ratio to Market Value)

	Now	1924
<i>Usual</i> percentage of market value lent . . .	47.69%	52.14%
<i>Maximum</i> percentage of market value lent.	53.92%	55.98%
Loan periods . . . . .	2.89 yrs.	3.10 yrs.
Interest rate . . . . .	6.34%	6.45%
	595 s/a	605 s/a
Interest payable (annually, semi-annually, etc.) . . . . .	117¼	95¼
	35 an.	70 an.
	29 mo.	22 mo.
Commission rate . . . . .	2.01%	2.11%
Renewal rate . . . . .	1.68%	1.76%

**Question 2.** If you make amortized loans on homes will you supply the information called for below in regard to such loans?

Table IV. Amortized Loans

(Charges, and Ratio to Market Value)

(Average of all replies)

	Now	1924
<i>Usual</i> percentage of market value lent . . .	50.23%	54.16%
<i>Maximum</i> percentage of market value lent.	54.84%	57.99%
Interest rate . . . . .	6.41%	6.42%
Commission rate . . . . .	2.42%	2.44%

**Question 3.** Will you also state the periods of your amortized loans and the rates of amortization, indicating how interest is pay-

able in each case? (For example, 5 years, 10% annually, interest s/a; 10 years, 1% monthly, including interest.)

Following is a summary of 335 replies:

**Table V. Amortized Loans**  
Amortization and Interest Periods

Term	Amortization and Interest Payments	No. of Cases	Term	Amortization and Interest Payments	No. of Cases
1 yr.	1% and int. monthly..	3	8 yrs.	6% annl., int. s/a.....	1
1 yr.	1% and int. s/a.....	2	8 yrs.	5% mo. pay.....	1
1 yr.	Others.....	19	8 yrs.	3% s/a, 139 mo., \$10 per mo.....	1
2 yrs.	1% per mo. incl. int...	1	111 mos.	\$13 per mo., int. mo...	1
3 yrs.	Int. s/a.....	3	10 yrs.	1% per mo. incl. int...	3
3 yrs.	10% annl., int. s/a.....	3	10 yrs.	Others.....	17
3 yrs.	5% s/a and int. s/a....	2	11 yrs.	1% and int.....	1
3 yrs.	6-7% int. mo.....	2	11 yrs.	7%.....	1
3 yrs.	10% annl., int. quart...	2	11½ yrs.	6% annl., int. mo.....	1
3 yrs.	Others.....	36	12 yrs.	1% per mo. incl. int...	1
40 mos.	1% int. mo.....	1	12 yrs.	5% annl. reduc. or 1% mo. incl. int.....	1
4½ yrs.	.....	1	12 yrs.	Others.....	2
5 yrs.	10% annl., int. s/a....	12	15 yrs.	5% annl., int. s/a.....	1
5 yrs.	5% annl., int. s/a.....	6	15 yrs.	6% s/a, int. 6% annl..	1
5 yrs.	20% annl.....	4	20 yrs.	5% annl., int. s/a.....	1
5 yrs.	5% annl., int. s/a.....	3	20 yrs.	4% amort. s/a incl. int	1
5 yrs.	10% s/a.....	3	20 yrs.	Others.....	27
5 yrs.	1% mo. incl. int.....	2		Miscellaneous with no term of loan specified.....	118
5 yrs.	2% annl., int. s/a.....	2		TOTAL.....	335
5 yrs.	5% s/a, int. s/a.....	2			
5 yrs.	Others.....	46			

**Question 4.** What are the total charges to the home buyer from all sources on a \$3,000 *home buying* or *refinancing* loan, exclusive of interest and commission, but covering appraisal, survey, title examination, drawing and recording mortgage, insurance against liens or other possible claims, etc.?

Average of all replies: New loan..... \$33.72  
Renewal..... \$21.05

**Question 5.** If you make *construction* loans to individual home builders, will you indicate below total charges to the home buyer from all sources on a \$3,000 loan, *exclusive* of interest, and *including* only charges which are additional to those made for the permanent financing, such as additional commission, fees for performance bond, inspection of job, disbursing funds, etc.?

Average of all replies..... \$47.86



**Question 6.** Will you state whether you make loans to commercial builders on unsold homes and whether you did so in 1924?

*Now*

No.....	729
Yes.....	119

*1924*

No.....	617
Yes.....	205

### III. BUILDING AND LOAN ASSOCIATIONS

Questionnaires were sent to approximately 5,500 building and loan associations which were on the mailing list of the United States Building and Loan League. Replies were received from 1,242 associations. The following is a *national summary* of these replies.

**Question 1.** Will you please supply the information called for below concerning your practices in lending on homes, *now*, in 1928 and in 1924? The following figures are averages of all replies received:

**Table VI. Home Loan Practices**

	<i>Now</i>	<i>1928</i>	<i>1924</i>
<i>Usual</i> percentage of market value loaned.	57.36%	62.94%	64.15%
<i>Maximum</i> percentage of market value loaned.....	64.34%	69.03%	69.78%
Usual loan period.....	10.15 yr.	10.11 yr.	10.06 yr.
Interest rate.....	6.88%	6.91%	6.98%
Payment per \$1,000 per month.....	\$12.26	\$12.48	\$12.58

**Question 2.** If a premium or similar charge is made will you indicate the rate and how it is payable? (For example, if the premium is 3% of the face of the loan deducted at the beginning of the term, it may be stated as "3% gross." A premium payable in instalments might be stated "25c per \$200 share per month.")

Table VII. Rate of Premium or Similar Charge

	No.	No. of Changes Since 1928		No. of Changes 1924-1928	
		Increase	Decrease	Increase	Decrease
Less than 1% per year.....	20	1	2		
1% per year.....	79		1	1	3
Between 1 and 2% per year.	23	1		1	1
2% per year.....	60	1	2	4	2
Between 2 and 3% per year.	13	1	1		2
3% per year.....	71	7	1	3	4
Between 3 and 4% per year.	6	1			1
4% per year.....	16	7	1		
5% per year.....	32	2	2	2	
6% per year.....	14	2	1		1
7% per year.....	1				
Between 7 and 8% per year.	1				
8% per year.....	2	1			
Between 8 and 9% per year.	1				
9% per year.....					
10% per year.....	6				
Between 12 and 15% per year.....	1				
15% and over per year....	1				
TOTAL.....	347	24	11	11	14

**Question 3.** What are the total charges to a home owner from all sources, exclusive of interest and premium, on a \$3,000 *home buying or refinancing* loan, but covering appraisal, survey, title examination, drawing and recording mortgage, etc.?

Average of all replies..... \$42.68

**Question 4.** What are the total charges to an individual home builder on a \$3,000 *construction* loan exclusive of interest, and *including* only charges which are additional to those made for permanent financing, such as additional premium, fees for performance bond, inspection of job, disbursing funds, etc.?

Average of all replies ..... \$45.41

**Question 5.** Does your institution render services to home builders and home buyers, in addition to the loan of money, such as giving advice as to the soundness of the undertaking, advice on plans and specifications, the selection of a contractor, etc.? If so, please list below the services rendered.

No services rendered.....	376
Yes—full service.....	370
Yes, if requested.....	147
Service in regard to soundness of undertaking.....	81
Plans and specifications.....	64
Advice in general.....	63

**Question 6.** What percentage of your delinquencies are on loans, which, when made, represented

(a) 50% or less of original market value?.....	23%
(b) 50% to 66 2/3% of original market value?.....	43%
(c) More than 66 2/3% of original market value?.....	34%
<b>TOTAL.....</b>	<b>100%</b>

**Question 7.** What percentage of your defaults over the past six years have been on loans representing

(a) 50% or less of original market value?.....	19.2%
(b) 50% to 66 2/3% of original market value?.....	44.4%
(c) More than 66 2/3% of original market value?.....	36.4%
<b>TOTAL.....</b>	<b>100.0%</b>

**Question 8.** Number, in order of their importance (1, 2, 3, 4, etc.), the following personal causes of foreclosure by your association. The following is a composite of all replies received:

1. Borrower was unable to pay because of unemployment.
2. Financial circumstances of borrower did not warrant such an expensive home.
3. Borrower was unable to pay because of special assessments and increases in taxation.
4. Borrower was a speculative builder or holder who failed to find buyer.
5. Domestic troubles of borrower.
6. Borrower was dishonest.

**Question 9.** Number, in order of their importance (1, 2, 3, 4, etc.), the following difficulties contributing to default. The following is a composite of all replies received:

1. General decline in home property values.
2. Loan was too large a percentage of value.
3. Poor construction of building.
4. House out of keeping with neighborhood.
5. Intrusion in neighborhood of incompatible elements or other change in character of the neighborhood.
6. Loan was made on property in a subdivision not yet developed.
7. Zoning law was inadequate.

**Question 10.** Do you regard the causes listed in question 8 of more importance than those listed in question 9?

Yes.....	842
No.....	145
Equal.....	48

**Question 11.** List any other causes of, or contributing factors to, default.

Unemployment.....	112
Instalment buying.....	72
Depreciation and obsolescence.....	60
Lower income.....	58
Depression.....	55
Death.....	48
Sickness.....	42
Poor business methods of borrower.....	32
Assessments and taxes.....	31

**Question 12.** What would be your suggestions as to how the number of foreclosures may be greatly reduced in case of a future depression?

Loan smaller percentage.....	217
Greater care regarding moral risk.....	165
More careful appraisals.....	111
Suspension of payments on principal.....	62
Restrict loans to 50%.....	59
Amortize all loans.....	48
Loan on residences only.....	45
Refinancing.....	43

**Question 13.** Do you favor the adoption by your state of the Uniform Mortgage Act prepared by the National Conference of Commissioners on Uniform State Laws? If not, do you favor any changes in the mortgage foreclosure law of your state?

Not acquainted with act.....	205
In favor of act.....	294
Not in favor of act.....	206
Satisfied with present law.....	124
No changes desired.....	50
Redemption period should be shorter.....	82
Foreclosure period should be shorter.....	72

**Question 14.** What laws affecting your interests as a mortgagee should in your opinion be revised?

No changes desired . . . . .	199
Redemption should be shorter . . . . .	138
Foreclosure time should be shorter . . . . .	59
Revise mechanics' lien law . . . . .	37
Reduce foreclosure costs . . . . .	35
Satisfied with present law . . . . .	34
Simplify foreclosures . . . . .	28

## APPENDIX III

### SPECIAL TYPES OF SECOND MORTGAGE COMPANIES<sup>1</sup>

#### NOTES ON FIELD TRIP REGARDING SECOND MORTGAGE INSTITUTIONS<sup>2</sup>

##### I. Providence Mortgage Corporation, 1518 Turks Head Building, Providence, Rhode Island

*W. W. Dempster, Secretary-Treasurer.* The Providence Mortgage Corporation was incorporated in May, 1924, to take second mortgages on real estate. The initial capitalization was \$300,000. During the following year this was increased to \$600,000.

All of the initial stock of the corporation was underwritten by seven brokers and the entire initial \$300,000 issue was sold at \$105 per share (par \$100). The sale of the entire issue at \$5 above par provided an initial surplus of \$15,000, out of which the promoter of the idea, a Springfield, Massachusetts, man, was paid as well as the attorney who drew up the papers and advised those incorporating the institution on all legal points involved in the entire plan, and in addition provided a 3 per cent commission for the brokers who sold the stock. This procedure enabled the corporation to start business with its total capital of \$300,000 intact and available for loans.

Within the first year after the corporation was formed the demand for loans was such that they exhausted the available funds in the corporation's account, and it borrowed a total of \$300,000 from local banks at interest rates ranging from 4 per cent to 4½ per cent. When it was found that the corporation could use more than \$300,000 capital, the capitalization was increased to \$600,000 by doubling the volume of stock issued. At the present

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<sup>1</sup> This chapter comprises reports on field trips by Mr. Arthur J. Mertzke, Research Assistant to the Committee on Finance, submitted as an appendix to the committee's report.

<sup>2</sup> Cities visited were: Providence, Rhode Island; Utica, New York; Niagara Falls, New York; Rochester, New York; and Philadelphia, Pennsylvania.

time the corporation has a capital and surplus of approximately \$700,000, of which \$600,000 came from paid-in stock and approximately \$100,000 more has been accumulated as a surplus.

After the capital stock had been increased to \$600,000, the volume of business increased still further and again the corporation borrowed \$300,000 from local banks, but this amount has been amortized at the present time to a balance of \$60,000 due to banks.

Both *Mr. Dempster* and *Mr. Wilson G. Wing*, the president of the Providence Institution for Savings, and a director of the Providence Mortgage Corporation, stated that the principal purpose behind the organization of this institution was philanthropic. Aside from dividends on stock which the corporation has paid from the beginning, no one connected with the institution has ever realized one dollar of profit from it and never expects to.

Stock is all common and therefore the corporation is not compelled to pay dividends, and in case the earnings during any year should prove to be small, the directors are under no obligation to pay a dividend. Dividends paid so far have been at the rate of 6 per cent a year for the first three years and after that dividends of  $\frac{1}{2}$  of 1 per cent were declared semi-annually, making a total of 7 per cent per annum. On account of the possibility that losses this year may be heavier than have been experienced in the past, Mr. Wing believes that no dividends should be declared the latter part of the year;  $3\frac{3}{4}$  per cent has been paid this year.

**Lending Policy.** While the charter of the corporation does not restrict its operations exclusively to homes, the policy followed has, however, been to lend on homes with few exceptions. The terms on a loan are as follows:

Commission.....	5%
Amortization.....	2% per month.
Interest.....	8% paid semi-annually in advance and reduced semi-annually as the loan is amortized.

The corporation has no fixed rule governing the percentage of the value of the property on which it will lend. It will not make a loan, however, unless the owner's equity is at least 25 per cent. The Providence Mortgage Corporation will then lend *up to 75 per cent* of the value of the property based on its own appraisal of the

property and provided also that the confidential report on the moral risk of the borrower is satisfactory. The corporation has refused many loans on properties in which it was fully satisfied with the value of the property and the percentage of the loan requested, but declined to make the loan because of an unsatisfactory credit report on the moral risk of the borrower.

Mr. Wing stated that the corporation had gotten into difficulty on the second mortgage loans which it made on other than individual homes, on some of which it will probably suffer losses. The corporation makes no construction loans nor will it make a loan to a builder until the house is sold to an owner-occupier and then they do business with the owner.

The corporation never buys mortgages and never sells or discounts any of its own mortgages. The loans secured from banks were made on the notes signed by officers of the corporation purely on the credit of the corporation and no mortgages were put up as collateral.

When a borrower applies for a loan, the Providence Mortgage Corporation immediately gets in touch with the agency making the first mortgage on the property to get the facts with reference to the first mortgage loan. After the corporation has placed a second mortgage loan it notifies the first mortgage lender of the amount and terms of the second mortgage by sending duplicate copies of this notice form to the first mortgage lender, one of which is acknowledged and returned to the files of the Providence Mortgage Corporation as evidence of the fact that the first mortgage lending institution has notice with reference to the amount, terms and payments on the second mortgage. Monthly amortization payments on all second mortgages begin after the first month. Up to the present time, the corporation has made approximately 2,385 second mortgage loans, 742 being now in force, ranging chiefly from \$1,500 to \$2,500. Since the corporation started business in 1924, it has foreclosed a total of 71 properties. Most of these have been sold, and at the present time the corporation owns 18 properties, which are profitably rented.

The Providence Mortgage Corporation has been making second mortgage loans regularly at the rate of from one to seven a week during the past few months. At one time the corporation purchased approximately \$225,000 worth of mortgages from another



second mortgage company which was being liquidated. As a general policy, however, the corporation does not buy existing second mortgages, but in the case where second mortgage refinancing is necessary, it issues a new mortgage on its own terms and lets the borrower pay off the existing second mortgage held by another lender.

In reply to the question as to the principles which must be observed in operating an institution of this kind on a sound basis, Mr. Wing listed the following:

1. Lend only on homes occupied by owners.
2. Make a careful and thorough inspection of the moral risk.
3. Take care that the first mortgagee is thoroughly responsible and preferably a financial institution like a bank or building and loan institution.
4. Require payment of interest semi-annually in advance, giving an opportunity to anticipate lenders' financial difficulties.
5. Require some amortization on first mortgages such as is required by all first mortgage lending institutions in Providence of  $2\frac{1}{2}$  per cent a year, at least.
6. Insist upon a thorough interior as well as exterior inspection in all appraisals for loans.
7. In many cases withhold all or part of the money borrowed for new improvements until these have actually been built.
8. If the loan is wanted for purposes other than the owning or improving of a home, look very carefully into the purposes for which the loan is desired.

The executive committee of the corporation passes upon all applications for loans, and no loan is granted without a unanimous vote. Each application is judged on the nature of the appraisal, the owner's equity, the terms and amount of the first mortgage, and equally upon the report concerning the moral risk of the borrower.

Mr. Wing feels that sound second mortgage financing is of sufficient importance to all first mortgage lenders so that in the interest of avoiding junior financing which will jeopardize their own loans they can well afford to devote some time and effort at nominal remuneration to the work of such an institution as the Providence Mortgage Corporation. While the directors and the executive board receive a small nominal fee for their services, their contribution is essentially charitable when measured in terms of direct financial return, but public spiritedness of this type is well worth while not only as a service to the community but also to those directly interested in first mortgage financing.

Mr. Wing suggested that it would be desirable if the Committee on Finance would carefully consider some recommendation with reference to the exemption from Federal taxation of the reserve for losses set up by an institution of this kind. He feels that the present exemption from taxation of a reserve not in excess of 1 per cent of outstanding mortgages is too low and that consequently this feature in the Federal income tax tends to restrict the carrying of an adequate reserve for losses. Mr. Wing believes that a 1 per cent reserve is entirely too small and that this fact should be recognized in the income tax regulation governing these reserves. He feels that while, despite this rule, many companies will naturally follow the policy of the Providence Mortgage Corporation in carrying a reserve in excess of 1 per cent, there may be a tendency on the part of some to limit their reserves to the amount exempted from Federal taxation as the result of a tendency to use this figure as a standard.

The Providence Mortgage Corporation owed its inception to the efforts of Mr. Hall of Springfield, who had sold the idea for a similar institution in both Springfield and Worcester, Massachusetts. The man who sponsored the idea in Providence was Mr. Henry D. Sharp, to whose initiative Mr. Wing credits the establishment of the institution. Mr. Sharp called together as a steering committee representatives of most of the financial institutions lending on homes, and one or two other large business interests. In working out the plan, many of the features in Mr. Hall's plan were eliminated or modified with the result that the Providence Mortgage Corporation is a much stronger institution than the original proposal called for. The Providence Mortgage Corporation may therefore be characterized as a high grade second mortgage institution sponsored and directed by the principal home financing institutions in Providence for the purpose of eliminating excessively burdensome financing charges and practices which previously had involved high discounts and commissions, annual renewals of loans, high interest charges, etc.

## II. Utica Home Mortgage Company, Inc., 1160 First National Bank Building, Utica, New York

*D. H. Colgrove, Attorney.* The Utica Home Mortgage Company was incorporated in July, 1919, chiefly through the initiative

of a group of builders and building supply people. The County Judge was made president of the company at that time and the same man still occupies this position. D. H. Colgrove was chosen as attorney and acts at present in the capacity of manager for the company.

The institution was incorporated with a capitalization of \$100,000, which was all sold and fully paid within a year. While the company was organized primarily to take second mortgages on homes, it has made two exceptions, one of which is a \$5,000 second mortgage on a business property, and the other a \$10,000 second mortgage on an apartment building.

The terms on which the company makes second mortgage loans are:

- 10% discount of face value of the mortgage.
- 6% interest, adjusted monthly or semi-annually on balance due on loan.
- 2% of the original amount of the mortgage monthly amortization for a period of three years.

It will be noted that 2 per cent a month for amortization for a period of three years pays off only 72 per cent of the loan during the three years which the mortgage runs. When these loans fall due at the end of the three years, the mortgagor is expected either to pay the balance in full or to transfer the balance of the loan to another lender.

As an example of the manner in which the plan works out, take the case of a house purchased at \$6,000. The owner is required to pay in cash at least 20 per cent of the purchase price or \$1,200. He can then secure from a savings bank or other lending institution or private party a first mortgage in ordinary times for as much as \$3,500, leaving a balance of \$1,300 to be covered by a second mortgage loan. In order that the borrower will get \$1,300 net out of his second mortgage, therefore, the contract price of the property would be increased prior to the closing of the deal by an amount equal to the discount on a second mortgage, which when discounted, would leave a balance of \$1,300. This second mortgage would then run for three years as explained above with interest at 6 per cent on the unpaid balance of the loan adjusted semi-annually, plus 2 per cent per month amortization.

If second mortgages are written for a term of four years as is sometimes done, the discount is raised to  $13\frac{1}{3}$  per cent, and if the

term of the second mortgage is five years the discount is  $16\frac{2}{3}$  per cent.

The company sets aside  $\frac{1}{2}$  of 1 per cent of all mortgages to take care of losses.

During the first few years of the life of the company it paid a 7 per cent dividend. For later years, this was reduced to 5 per cent a year, and at the present time will probably not be more than 2 per cent.

The company at the present time has 80 outstanding mortgage loans. The total number of loans which the institution has made since it was formed is 355. These loans average approximately \$1,000 each. At the present time the company owns 6 houses, and these are rented.

The banks have offered to loan to the company, without collateral security, an amount equal to 50 per cent of the company's capital. The company's surplus on September 1, 1931, was \$7,124. The company is not permitted to buy or sell mortgages. It makes no charge for appraising properties, drawing papers, etc. All the accounting work for the company is done by an outside accounting firm. Before making any loans the company makes a very careful check on the moral risk of the borrower. Many of the borrowers are personal acquaintances of the members of the board of directors, or records can be secured on them from the Chamber of Commerce. All properties are inspected once a year. The company will take only purchase-money mortgages although in a few instances they have taken material men's mortgages, charging them the same discount as other lenders and requiring the material or lumber men to guarantee the mortgage. Interest is paid monthly.

In Mr. Colgrove's opinion, this is an ideal type of second mortgage institution for lumber and other building material men to foster in other communities as they did in Utica for the benefit it will be to them in facilitating the building and sale of homes.

In 1931 new loans amounting to \$11,000 were made by the company up to November 1.

### III. Manufacturers and Employees Mortgage Corporation, Gluck Building, Niagara Falls, New York

*Mr. R. L. MacDonald, Manager.* The Manufacturers and Employees Mortgage Corporation was incorporated in September,

1919. In essence, the corporation represents a philanthropic attempt on the part of a group of manufacturers to assist their employees in acquiring home ownership through an institution designed to take care of second mortgage financing of employees.

The corporation was originally organized with a capitalization of \$200,000. Four years later this was increased to \$400,000.

The capital stock of the corporation was purchased by a group of manufacturers who were interested in assisting their employees in acquiring home ownership. At the time the corporation was first formed there was a shortage of houses, and loans were made to anyone desiring to build a house in Niagara Falls. As the housing shortage disappeared the policy was changed so as to lend primarily to employees of stockholders in the Manufacturers and Employees Mortgage Corporation. Since November 1, 1930, the corporation has made no new loans.

Receipts for interest and principal on loans are being set aside to carry twenty properties which the corporation now owns. These are mostly rented and yield 3 to 4 per cent return to the corporation.

Delinquencies of the first mortgage payments and of taxes have caused more trouble than arrears of payments on the second mortgages. Actions at foreclosure for a combination of these reasons averaged  $1\frac{1}{4}$  per year from 1919 to 1928 and any properties that the second mortgagee bid in were immediately resold. In September, 1928, an action at foreclosure brought by the first mortgagee, caused the second mortgage corporation to bid in the property and the second mortgage corporation has not been able to resell the property and is now the owner. Since that date 20 other properties have been added to the ownership list.

The stock of the corporation, each share of which has a par value of \$100, was initially sold at a premium of \$25 per share. As a result, the total capital realized on the sale of the initial shares was \$250,000.

The corporation was formed as a result of the work of a committee of the Chamber of Commerce which brought together a group of manufacturers to consider devising a plan to make junior home financing more readily available. All of the initial group signed a stock subscription agreement before the corporation was

formed and a few more came in later. The corporation makes construction loans on homes only.

**Financing Plan.** The plan for financing a new home requires the prospective builder of a home to have a cash equity equal to from 20 to 25 per cent of the value of the land and building when completed. The Manufacturers and Employees Mortgage Corporation will then furnish, in two mortgages, all the balance needed to complete the house—a first mortgage preferably placed by the owner with a local savings bank or loan association and a second mortgage with the Manufacturers and Employees Mortgage Corporation. In some cases the second mortgage corporation takes both the first mortgage and the second mortgage and later disposes of the first mortgage, the commission for such service being  $2\frac{1}{2}$  per cent of the amount of the first mortgage loan. All applications for loans have to be approved by the executive committee of the mortgage corporation.

The term of the second mortgage loan varies from three to ten years depending upon the borrower's ability to pay. The average second mortgage is written for a term of seven years. As a rule the corporation requires a payment of \$11 per \$1,000 of loan per month. An appraisal fee of \$5 is payable in cash at the time of making application for a second mortgage loan and the interest rate in New York State for both first and second mortgage loans is 6 per cent per annum.

The corporation does not buy or sell mortgages but does carry a few municipal bonds which it can use as collateral security for loans.

First mortgages must cover at least 50 per cent of the value of the property and preferably 60 per cent. The corporation will then lend an additional amount up to 75 or 80 per cent of the value of the property.

During the peak of real estate values, the corporation's appraisals ran from 15 to 20 per cent under prevailing market prices.

**Illustration.** Suppose a borrower desires to build a house which, including the lot, will cost him \$6,600, and assume that he is able to pay \$1,900 in cash, the balance to be covered by a first and second mortgage. The first mortgage of \$3,700 would run for a term of twenty years, involving monthly charges of \$33.50.

This charge would pay 6 per cent interest on the mortgage and would include amortization.

In addition the project would require a second mortgage for \$1,000, written for a term of five years, on which the monthly principal and interest charges (interest 6 per cent) would be \$20. This would mean total monthly charges on both mortgages amounting to \$53.50.

#### IV. Rochester Lumber Company, Rochester, New York

*Mr. A. F. Stahl, Treasurer.* The Rochester Lumber Company and associates have at present \$750,000 in second mortgages behind \$3,000,000 of first mortgages. According to Mr. Stahl, practically all of these second mortgages are sound and are being amortized regularly.

Their plan as outlined by Mr. Stahl is as follows :

A 20 per cent initial payment is required. A first mortgage is arranged by the company, with one of the savings banks and the balance is taken by the company as a second mortgage. This mortgage is written for five years and, at the rate of payment,  $66\frac{2}{3}$  per cent of the amount is paid at the end of that time. At that time the borrower will either pay the amount due or enter into some new agreement whereby the balance will be refinanced.

Interest is charged at 6 per cent per annum and is paid quarterly with the amortization payments.

If the borrower does not have the required initial payment, but does have 10 per cent of the price of the property, the company will buy or build for him and lease to him for one year at an amount great enough to pay interest, taxes, and increase the equity to the required 20 per cent. At the end of that time the property is deeded to him and the financing is done as previously described.

Savings banks are preferred as holders of first mortgages because, in Mr. Stahl's opinion, they are more conservative in their appraisals and take a greater personal interest in the mortgagor than do the insurance companies. Also, the brokerage fees charged by savings banks are usually  $1\frac{1}{4}$  per cent while the insurance companies generally charge  $3\frac{3}{4}$  per cent.

Mr. Stahl says his loss due to foreclosure, if spread over the past twenty years, would be approximately 1 per cent and for the period of 1929, 1930 and 1931, about 5 per cent.

## V. The Philadelphia Plan of Second Mortgage Financing by Building and Loan Associations

A typical instance of second mortgage home financing under the Philadelphia Plan would involve:

(a) A minimum cash payment by the purchaser amounting to 20 per cent of the value of the property as appraised by a committee of three directors of the building and loan association;

(b) securing a three to five year straight first mortgage from a bank, insurance company, or private lender for 50 per cent;

(c) securing a second mortgage for 30 per cent from a building and loan association.

Under the second mortgage contract, the purchaser is then required to purchase one \$200 share of stock for each \$200 of the amount loaned to him. He pays for these shares by monthly instalments, the usual requirement being \$1 per month per share. In addition to this he pays 6 per cent interest on the original amount of the mortgage to the date of maturity. By means of the \$1 per share monthly payments plus the earnings of the association which belong to the borrower as a member of the mutual organization, a sum equal to the par value of his share, is accumulated during a period of eleven to eleven and a half years. At the end of that time, the borrower assigns his shares to the association, and the association in turn cancels the debt which it holds against him.

In addition to the monthly payments and interest on the loan, there are several other items which enter into the cost of the loan. These are:

1. *Premium.* The premium is an annual charge amounting in a majority of cases to 2 per cent of the loan, which in effect increases the rate of interest from 6 to 8 per cent.

2. *Entrance Fee.* An entrance fee amounting in most instances to 25 cents per share is charged to new members.

3. *Fee for Recording Mortgage.* A fee for recording all instruments of writing is \$1 for each five hundred words or fraction thereof.

4. *Sheriff's Sale Certificate.* This certificate is evidence that the issuing company guarantees to inform the association in whose name it is taken out, of any legal action for the purpose of acquiring title to the mortgaged property. The fee for this certificate is usually \$5 for a term of five years or less, and \$10 for a term of five to ten years.

5. *Solicitor's or Conveyancer's Fee.* This fee on a loan ranging from \$1,000 to \$1,500 would be about \$25.



6. *Commission.* A commission is sometimes charged by the person who "gets the loan" for the prospective borrower. Since the legality of this charge is questionable, it is difficult to secure reliable data regarding this charge. The State Department of Banking objects to commissions being charged by an officer or director of an association and requests his removal if the practice is continued.

7. *Fines.* Philadelphia building and loan men claim that a fine is an incentive to promptness in meeting payments. A fine in Pennsylvania cannot legally exceed 2 per cent of the amount of the dues unpaid.

8. *Appraisal Fee.* The Pennsylvania law requires that "each application for a loan shall be referred to a committee of not less than three directors. The committee shall in each case conscientiously appraise the property offered as security, and state in its report what is considered the fair market value thereof, and how much in their opinion may be loaned on it." The usual charge for an appraisal varies between \$3 and \$6.

9. *Title Insurance.* The schedule of charges made by the Real Estate Title Insurance and Trust Company of Philadelphia for title insurance is as follows: Examination of title, \$25 for one title; premium,  $\frac{1}{2}$  of 1 per cent to insure a conveyance, with a minimum of \$10 for a policy of \$2,000 or less; a policy for a mortgage only (no conveyance being made), the premium is reduced by  $\frac{1}{4}$  of 1 per cent, with a minimum premium of \$5.

*The composite of these charges added to the interest and premium charge results in total charges to the borrower amounting to approximately 8 to 11 per cent of the loan. (Not including fines or title insurance.)*

**Extent of Philadelphia Plan.** While there are a few building and loan associations in Philadelphia which make first mortgages exclusively, the great majority have engaged to some extent in second mortgage financing, many of them on a split loan or two mortgage basis, in which the first is a straight mortgage and the second a share mortgage.<sup>3</sup>

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<sup>3</sup> It means that for every \$200 (par value of stock) borrowed from the association, the mortgagor must subscribe to a share of stock on which he must make monthly payments at the rate of \$1 a share. In other words, if a mortgagor borrows \$2,000 on the split mortgage plan, he pays \$5 a month dues, \$10 a month interest on the loan, and if a premium is charged by the association, he pays \$1.25 premium a month. His total charges would then amount to \$5 dues, \$10 interest and \$1.25 premium, making his total monthly carrying charges \$16.25, which he must pay to the building and loan association.

"The majority of second mortgages, however, are not split mortgages. In most of the associations where they grant a \$2,000 second mortgage, the borrower is required to take out ten shares of stock, on which he pays \$10 a month dues, besides the other charges of \$10 a month interest and \$1.25 premium, which makes the total carrying charges \$21.25. The idea of the split mortgage is to make the carrying charges of the loan easier for the borrower."—From letter by Mr. Henry R. Knowles.

Probably 20 per cent of all associations in Philadelphia are engaged exclusively in the second mortgage business. The great number of building and loan associations has made it impossible to secure original data regarding them except through the Pennsylvania State Department of Banking, through which we have obtained consolidated statements of receipts and disbursements as well as assets and liabilities for all associations in the City of Philadelphia for the years 1924 to 1930, inclusive. In the year 1925, the number of building and loan associations in Philadelphia reached a high water mark of 3,437. During the year 1930, 322 Philadelphia associations were absorbed by merger proceedings. The business and property of 5 Philadelphia associations was taken in possession by the Secretary of Banking. Possession of one of these associations was later surrendered and the association later reorganized. During the same year, 140 Philadelphia associations went into voluntary liquidation.

According to the Deputy Commissioner of Banking, about 95 per cent of the building and loan associations in Philadelphia are financially sound at the present time. The remaining 5 per cent, some of which eventually may be liquidated or merged, are under close observation of the Department of Banking. In all cases they are required to segregate their free shares and place these funds on deposit in some bank, to be used as a reserve fund. They are not allowed to loan this money. In addition these associations are not allowed to mature any stock or to allow any withdrawals.

In 1924, real estate held by Philadelphia associations amounted to \$240,000. In 1928, building and loan associations were plaintiffs in foreclosures involving mortgages amounting to \$20,000,000. By 1929, the value of real estate held by Philadelphia associations amounted to \$42,000,000, and by the end of 1930 this had increased to over \$51,000,000.

**Weaknesses in the Philadelphia Plan.** In spite of the fact that the great majority of Philadelphia building and loan associations are at present financially sound according to the State Department of Banking, the weaknesses in the Philadelphia Plan may be grouped under two headings:

- (a) Weaknesses in the laws regulating building and loan associations in Philadelphia; and
- (b) abuses due to ignorance, incompetence, or dishonesty.

Table I. Receipts of All Building and Loan Associations in Philadelphia, 1924-1930, Inclusive

RECEIPTS	1924	1925	1926	1927	1928	1929	1930
Cash balance beginning of business year.....	5,361,118.20	6,790,916.38	9,381,318.51	10,095,498.73	13,462,935.30	18,212,761.12	16,299,106.71
Dues.....	115,683,863.27	127,671,711.39	136,424,470.63	140,761,248.20	139,550,957.19	127,706,420.90	105,140,625.58
Interest (include interest on bank account)	30,883,646.27	35,541,409.76	40,573,128.59	44,633,842.20	46,914,336.29	46,277,798.26	42,442,957.40
Premiums.....	4,688,693.43	5,829,950.04	7,174,977.68	7,942,992.45	7,937,572.56	7,232,993.32	6,156,628.35
Fines.....	653,013.50	776,843.70	961,485.60	1,136,282.56	1,267,234.70	1,340,114.23	1,271,982.51
Admission fees.....	595,424.43	521,340.21	495,021.41	428,511.45	366,079.17	281,451.30	181,272.68
Withdrawal fees.....	18,092.74	43,014.20	130,738.19	24,912.63	17,755.50	21,184.92	127,835.25
Money borrowed.....	79,297,686.41	82,125,030.06	88,012,742.98	90,107,301.23	86,990,607.36	75,812,100.52	58,959,273.33
Mortgage loans repaid.	74,941,780.15	87,899,993.87	94,086,459.90	99,323,946.15	113,571,028.97	10,756,606.52	105,797,387.72
Straight mortgages repaid.....	1,351,310.86	1,630,549.89	1,990,365.11	2,074,740.29	2,635,565.10	2,989,245.56	2,961,369.87
Stock loans repaid.....	14,899,462.41	17,821,151.99	20,679,140.32	24,686,917.44	29,996,378.27	31,042,838.29	34,976,115.74
Loans to other B. & L. associations repaid.....	2,423,591.98	2,616,925.00	2,966,202.87	2,688,722.59	3,007,896.89	3,774,418.25	3,624,239.87
U. S. war bonds sold.....	93,285.40	148,651.45	11,554.80	14,445.80	89,641.81		
Sales of real estate.....	184,488.61	291,279.31	534,561.86	2,232,878.82	5,671,813.52	7,941,643.47	8,617,976.05
Rents.....	22,410.06	14,189.77	42,338.43	226,955.99	1,074,639.83	3,019,542.96	4,982,547.20
Fire insurance, taxes, etc., rec'd from stockholders.....	345,629.97	376,414.71	449,495.34	455,189.00	824,851.37	1,054,047.53	1,640,516.71
Satisfaction and committee fees.....	33,893.10(?)	33,028.85	41,857.55	31,139.48	28,202.86	25,542.44	19,556.50
Full-paid stock.....	7,298,459.76(?)	8,652,293.76	7,078,764.90	5,780,995.44	5,018,294.00	2,972,659.85	2,167,770.32
Miscellaneous.....	1,266,087.55	1,658,091.02	2,323,052.81	4,091,842.45	3,491,900.39	4,668,666.51	8,266,495.43
TOTAL.....	340,041,938.10	380,442,785.36	413,357,677.48	436,738,362.90	461,917,691.08	345,130,035.95	403,633,657.22

Table II. Disbursements of All Building and Loan Associations in Philadelphia, 1924-1930, Inclusive

DISBURSEMENTS	1924	1925	1926	1927	1928	1929	1930
General expenses (books, stationery, rent, legal, etc.).....	873,955.22	833,858.63	876,652.73	967,024.71	1,116,207.06	1,161,153.52	1,222,603.40
Salaries of officers.....	1,869,976.08	2,146,975.00	2,395,033.78	2,587,255.15	2,694,947.64	2,598,866.59	2,439,055.46
Commissions, directors fees, etc.....	73,313.95	100,216.30	109,554.55	146,026.21	157,167.48	151,609.35	143,299.76
Interest on borrowed money.....	4,479,549.79	4,516,111.55	4,527,047.66	4,347,991.28	3,876,401.30	3,524,724.79	3,438,304.96
Borrowed money repaid.....	72,759,835.52	83,273,051.90	88,382,965.90	95,709,330.51	92,497,567.98	73,795,741.94	58,435,397.57
Mortgage loans on stock shares.....	153,064,979.21	161,890,107.82	169,757,201.83	154,094,665.71	133,248,711.84	106,034,868.20	63,180,454.64
Straight mortgage loans	1,302,169.00	2,097,907.50	4,081,638.85	4,777,865.02	7,317,298.53	9,728,404.12	6,448,600.48
Stock loans.....	21,839,623.21	25,776,585.09	31,974,676.69	34,039,330.87	36,705,864.46	39,750,318.98	34,296,047.37
Loans to other B. & L. associations.....	2,726,136.37	2,724,305.00	2,888,250.58	3,531,462.64	4,394,146.39	5,349,361.06	2,991,222.10
U. S. war bonds bought.....	15,700.28	9,206.77	16.00	88,530.16	174,630.83	174,630.83	
Real estate bought.....	130,688.32	272,268.70	1,776,797.34	8,657,618.46	24,115,589.82	36,475,675.79	35,784,228.79
Expense on real estate owned by associations.....	20,267.90	18,110.67	68,062.40	506,490.32	2,351,543.94	4,966,156.49	7,598,875.06
Fire insurance, taxes, etc., paid for shareholders.....	341,459.56	371,148.41	440,632.45	535,228.62	1,125,669.09	1,511,277.77	2,484,473.24
Satisfaction and committee fees.....	28,881.36	27,446.63	32,043.32	30,747.22	27,528.81	39,424.60	21,149.94
Withdrawals, instalment stock dues.....	27,626,074.50	34,024,652.43	38,822,711.99	42,790,611.63	54,329,546.36	70,204,897.90	94,155,780.08





The difficulties in which a number of Philadelphia building and loan associations find themselves may, in most cases, be traced to one or more of the following causes:

1. *Legal requirements in the past made chartering of new associations too easy.* For the past five or six years, the State Banking Department, before granting a charter to a new association, interviews the officers and directors of the proposed association and makes them show the necessity of a new association in the community where the proposed association is to be located. The Banking Department also passes upon the ability of officers to serve in their respective posts and endeavors to judge the character of all the officers and directors before granting the charter requested.

2. *Overexpansion resulting from the chartering of an excessive number of building and loan associations.* At the present time, however, charters are not granted in any community where, in the opinion of the Department of Banking, a sufficient number of building and loan associations are already located.

3. *Associations were often manipulated to finance properties which could not be financed in other ways.* An act of the State legislature passed in 1929 prohibits building and loan associations from granting equal lien mortgages, that is, borrowing from a number of building and loan associations to get sufficient money to grant large-scale loans.

4. *Many associations exceeded their borrowing capacity which is limited by law to 25 per cent of the paid-up stock of associations.* The State Banking Department strenuously objects to this practice and prohibits building and loan associations from borrowing beyond 25 per cent of the paid-up stock of an association.

5. *Issuing full paid stock: (a) As a subterfuge for borrowing, and (b) illegal issue of stock as a basis for additional borrowing from banks.* While there is no law to prevent an association from issuing an excessive amount of full paid stock, the State Banking Department strenuously objects to an association issuing full paid stock as a subterfuge for borrowing money.

6. *Use of excessive appraisals and overloaning.* This practice has been corrected to a certain extent by an act of the State legislature passed in 1929, which prohibits a building and loan association from granting a mortgage upon a property where the total encumbrances exceed 80 per cent of the present market value.

7. *Inflation of real estate values and overbuilding.*

8. *Loaning on speculative income property.* The State Banking Department is making an effort to prevent this practice.

9. *Syndicating large loans among a number of associations.* This practice is now prevented under a law passed by the State legislature in 1931.

10. *Incompetent or dishonest management.* If an examination by the State Banking Department reveals incompetent or dishonest management, this condition must be corrected or the association is taken over by the State Department of Banking.

In commenting upon the above weaknesses of the Philadelphia

Plan, Mr. Henry R. Knowles, Deputy Secretary of Banking of the Commonwealth of Pennsylvania, says:

"While it must be admitted that the Philadelphia Plan has been abused in the past, and that losses have resulted to the stockholders of building and loan associations, the Department of Banking has taken a very decisive action in the past several years to correct the existing evils.

"The Department of Banking is slowly weeding out all associations which are in the hands of incompetent directors. No new charters are granted, except after a most careful and rigid investigation, and it is very unlikely that the mistakes of the past will ever be repeated in the future.

"With careful supervision and frequent examinations, the Philadelphia Plan can be made to function safely and to the best interests of the community in which the associations are located."

**Conclusion.** While there are many responsible building and loan men and others who agree with the Deputy Examiner of the State Department of Banking that "the Philadelphia Plan is fundamentally sound in principle and a godsend to the worker," those who may consider the adoption of this principle should take decisive steps to prevent the abuses listed above, both as a means of safeguarding the public and insuring the stability of the second mortgage institution. These abuses are reported to have resulted in the failure or insolvency of 5 per cent of the associations in Philadelphia.

**Foreclosures.** During the past seven years the list of Philadelphia properties to be sold at sheriff's sale has grown longer at each sale. The following figures will clearly show the increase in the number of properties offered for sale:

Table V.

<i>Year</i>	<i>Properties offered at Sheriff's Sales</i>
1919.....	958
1920.....	737
1921.....	1,156
1922.....	1,300
1923.....	1,271
1924.....	1,677
1925.....	2,406
1926.....	4,659
1927.....	6,543
1928.....	9,093
1929.....	11,919
1930.....	14,841



Dr. William D. Gordon, Secretary of Banking, stated that:

"An analysis of the sheriff's sales in Philadelphia reveals that building and loan associations were plaintiffs and were compelled to purchase real estate upon their own writs in the amount of approximately \$20,000,000 in 1928, \$24,000,000 in 1929, and \$25,000,000 in 1930, or a total of \$69,000,000 worth of real estate during the three years.

"A more alarming picture of the serious struggles encountered by building and loan associations will be shown when it is stated that, in foreclosures for the three years just mentioned, many building and loan liens were divested without any protecting bids from the associations, entailing losses to the associations in the amount of \$2,434,000 in 1928, \$6,435,000 in 1929, and \$13,183,000 in 1930, yet the better managed associations have survived."

## APPENDIX IV

### FORECLOSURE LAWS<sup>1</sup>

#### SUMMARY OF FORECLOSURE PROVISIONS— STATE AND UNIFORM LAWS

**Diversity of Foreclosure Laws.** The foreclosure laws in the United States present a great diversity of provisions. In general, foreclosure is either by court action or by the exercise of a power of sale contained in the mortgage or deed of trust.

**Foreclosure by Court Proceedings.** In many states foreclosure is conducted either by a suit in equity or by a civil action of an equitable nature. Some states expressly forbid the use of any other method. The mortgagee becomes entangled in a complicated and costly procedure, usually followed by an inactive period of redemption.

**Foreclosure by Exercise of Power of Sale.** In a smaller number of states, foreclosure is by an unregulated power of sale without redemption. A mortgagor may be closed out completely after notice has been published in a newspaper for a few days.

In a few states, such as Michigan, Minnesota, North Dakota, South Dakota and Wyoming, foreclosure by power of sale is regulated by statute and a period of redemption is allowed.

**Foreclosure Provisions of Uniform Mortgage Act.** The Uniform Mortgage Act has adopted the theory of foreclosure found in these few states, with provision for court action either as an alternative remedy or following an injunction restraining a foreclosure by power of sale. The act sets forth what the notice of sale shall contain, and regulates the publication of notice and mailing to interested parties. It requires that the notice of sale shall be published three times, once in each of three successive weeks, in a newspaper, the first publication to be not less than forty-two days prior to the date of sale. It also provides:

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<sup>1</sup> This chapter constitutes a summary of a study of the foreclosure laws of the various states and the foreclosure provisions of the Uniform Mortgage Act, submitted by Mr. Bernard B. Bailey, of the staff of the legal department of the New York Title and Mortgage Company, as an appendix to the report of the Committee on Finance.

"The notice of sale shall be given by mail as herein provided to each person known by the person foreclosing to be the original mortgagor or a subsequent grantee of the mortgaged premises or to have an estate or interest in or lien upon the premises subject or subsequent to the mortgage. Such notice shall be mailed, by registered and unregistered mail, directed to each such person at his last known address, not less than five weeks before the date of sale, or at such subsequent time before the sale as the name or address of any such person is learned. Failure to mail the notice shall not invalidate the foreclosure, but any person entitled to the notice may recover all damages suffered by him from such failure. No action shall be commenced to recover such damages after two years from the date of the sale."

The uniform act gives to the mortgagor and subsequent lien holders the right to redeem. The period of redemption is not fixed by the act because of the diversity of redemption provisions in the different states. The drafting committee has suggested a period of one year. Redemption by the mortgagor has the effect of annulling the sale, leaving the premises "subject to all liens which would have existed if no sale had been made, except the lien of the foreclosed mortgage, which is discharged by the sale."

**Redemption.** Various arguments have been made for and against the right of redemption. Some believe that redemption is necessary as a means of protecting the borrower, while others either object to redemption on principle, or feel that a long period is burdensome to the lender.

**Views of Life Insurance Companies.** Some of the life insurance companies have expressed views on the foreclosure laws of the various states. A questionnaire was sent out by the President's Conference on Home Building and Home Ownership. Eighty-four companies returned the questionnaire, but some of them did not reply to all of the questions. (Since the report was prepared, seven other companies have returned the questionnaire but their answers have not been incorporated in the report.)

*Objections to Foreclosure Law.* Twenty-one companies reported that they are satisfied with the foreclosure laws, or made no complaints. These companies either make loans on homes in a small number of states, or the volume of their loans is relatively small, or they have had only a few foreclosures on small loans. Thirty-three companies complained of delay and expense arising principally from foreclosure by court action and periods of redemption. Most of the complaints were made against the laws of Illinois, Kansas and Michigan. No objections were made to

the laws of 23 states, 14 being those in which foreclosure is by power of sale and/or no period of redemption is allowed, and 9 being those in which loans are made only by a few companies.

*Effect of Foreclosure Laws on Lending Policies.* Seventeen companies stated that foreclosure laws have no effect on their lending policies, but it appears that these companies either operate in a comparatively few states or have had a limited experience with foreclosure on homes. Five companies stated that such laws have had no effect in the past but will have in the future, and seventeen companies stated that foreclosure laws do have effect on their loans. It is significant that the companies that are influenced or will be influenced by the foreclosure laws are those that have had a wider and more recent experience with foreclosures in unfavorable states.

*High and Low Cost of Foreclosure.* Some of the life insurance companies furnished specific examples showing high and low costs of foreclosure throughout the country in the case of loans on homes ranging from \$3,000 to \$5,000. The examples given are limited to 23 states. The highest cost (\$667.12) was reported to be in the State of New York, where mortgages are foreclosed usually by court action. The lowest "high cost" (\$95) was reported to be in the State of Missouri, where foreclosure is by the exercise of a power of sale.

*Uniform Mortgage Act.* Forty-two companies did not state their views on the Uniform Mortgage Act, some of them not being familiar with it. Eight companies expressed opposition either to the act as a whole, or to some parts of it, particularly the redemption provisions. Thirty-four companies either favored the act or, if not familiar with it, approved of the movement for uniformity. In general, they believe that the act would provide a short and simple procedure, reduce expense and make it easier to handle a large volume of loans in the various states.

*Miscellaneous Laws.* Of the miscellaneous laws found to be objectionable, 8 companies complained of the statute of limitations, principally in Texas, and 7 companies objected to escheat laws, particularly in Kentucky and Oklahoma. The usury laws of Texas as interpreted recently in the *Shropshire* case were objected to by five different companies. Other laws mentioned by a few companies were the mechanics' lien laws of Oregon, the hail insurance tax in some states, and the homestead law in Texas.

**Conclusion.** To be well balanced, a foreclosure law should respond to the needs of both lender and borrower. If the procedure is retarded to such an extent that it becomes oppressive to the lender, it may divert capital into other territory; if accelerated without adequate protection to the borrower, it may suppress the desire for a loan. A long period of redemption may enlarge the borrower's opportunity to meet his obligation, but it may diminish his opportunity to finance his property. "The law of diminishing returns operates upon mortgages as well as in other lines of business."<sup>2</sup>

The foreclosure provisions of the Uniform Mortgage Act assist the lender and protect the borrower. It appears that the length of notice is adequate and that the method of notice is reliable. Ordinarily notice by mail would actually reach the borrower, those holding inferior liens, and other interested parties. The act assists the lender by making it possible to avoid the delay and expense of court action. The redemption provisions of the act might be unattractive to many lenders. Aside from redemption, the foreclosure provisions of the Uniform Act probably give more protection to the borrower and cause less delay and expense to the lender than any law now in operation.

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<sup>2</sup> Report of the Committee on Uniform Mortgage Act, August, 1921, page 10.

APPENDIX V

MORTGAGE FORECLOSURE AND LOAN COSTS<sup>1</sup>

I. FORECLOSURE COSTS

Table I. Summary

Item	Md.	D. of C.	Va.	Philadel- phia, Pa.	New York		N. J.
					Rochester	N.Y.City	
Advertising.	\$35 to \$60	\$25 to \$50	\$7.50 to \$8	\$30 to \$35	\$35 to \$50	\$100 to \$150	\$60
Inspection...	....	....	....	....	....	\$5	....
Tax search..	....	....	....	....	....	\$35 to \$40	\$10 to \$15
Court costs <sup>1</sup> .	....	....	....	....	....	....	....
Referee.....	....	....	....	....	\$125	\$125 to \$200	....
Auctioneer..	\$10	\$15	\$5	....	....	\$55 to \$100	....
Attorneys <sup>2</sup> ..	\$50	....	....	\$50 to 2-5%	1% \$25 min.	\$100 to \$500	....
Trustee.....	5%	5%	5%	....	....	....	....
Sheriff.....	....	....	....	Fee - \$50 Deed-\$5.25	....	....	1%

<sup>1</sup> Court Costs

1. New York City: (a) Serving summons, \$3 to \$5 for each service; (b) Filing of lis pendens, \$1.50 to \$3.50; (c) Taxing costs and entering judgment, \$2 to \$6; (d) Guardian ad litem—rare, about \$25; (e) Recording costs, \$5 to \$10.

2. Rochester, New York: (a) Serving summons, \$1 to \$1.50 for each service; (b) Filing of lis pendens, \$1; (c) Taxing costs and entering judgment, \$1.50; (d) Guardian ad litem—rare, about \$25; (e) Recording costs, \$2.50; (f) Issuing summons (notice before trial), \$25.

3. Philadelphia, Pennsylvania: (a) Entering bond, \$2.50 (Two persons, \$2.75; (b) Averment of default, \$0.50; (c) Order of fieri facias, \$0.75.

4. Maryland: (a) Bond of trustees, \$4 for bond up to \$3,000; \$3 per \$1,000 for bond in excess of \$3,000; (b) Report of auditor, \$9.

5. Virginia: (a) Recording costs, \$1.50.

<sup>2</sup> Attorneys' Fees

1. New York City: According to an officer of the Bowery Savings

<sup>1</sup> These data were compiled by Mr. Robert A. McCormick, Accountant, Research Assistant to the Committee on Finance, as an appendix to the committee's report.

## II. COSTS OF SECURING MORTGAGE LOANS

Table II. Summary

Item	Md.	D. of C.	Va.	Phila- delphia, Pa.	New York	
					Rochester	N. Y. City
Interest.....	6%	6 to 8%	6%	6%	5½ to 6%	6%
Appraisal.....	\$5	\$5	\$5	\$3 to \$6	\$3 to \$6	1/10 of 1%
Title exam- ination	\$15 <sup>1</sup> to \$35	\$30 to \$45	.....	\$25	\$25 <sup>1</sup> up	\$50 up
State tax.....	.....	.....	.....	.....	½ of 1%	½ of 1%
Tax search.....	Note 2	\$1	Note 2	Note 2	Note 2	Note 2
Conveyancing...	.....	\$5 <sup>4</sup>	\$10 <sup>3</sup>	\$15	.....	\$7.50 to \$35
Recording.....	\$3.50	\$3	\$5	\$6.50	\$1.50	\$5 to \$10
Attorneys.....	.....	.....	.....	.....	\$25 to \$75	\$100 to \$500
Bond and mort- gage.	.....	.....	.....	.....	\$7.50 to \$10	.....
Brokerage.....	.....	1 to 5%	4 and 5%	5%	1½%	1 to 3½%

<sup>1</sup> Includes conveyancing.

<sup>2</sup> Included in title examination.

<sup>3</sup> Includes title examination.

<sup>4</sup> Recording of deed of trust.

Bank, attorneys' fees are ordinarily charged at the rate of \$15 to \$20 per hour for the amount of work done, exclusive of clerical, stenographic services, etc.

2. Rochester, New York: An attorney who was interviewed stated that attorneys' fees are usually 1% of the amount involved, with a minimum charge of \$25.

3. Philadelphia, Pennsylvania: (a) An official of the State Banking Department states that attorneys' fees average \$50; (b) The secretary of a building and loan association states that the charge for attorneys ranges from 2% to 5% of the face of the mortgage.

## CHAPTER II

# TEXT OF PRESIDENT HOOVER'S STATEMENT ON THE PROPOSED ESTABLISHMENT OF HOME LOAN DISCOUNT BANKS

(NOVEMBER 13, 1931)

I shall propose to Congress the establishment of a system of Home Loan Discount Banks for four purposes:

1. For the present emergency purpose of relieving the financial strains upon sound Building and Loan Associations, Savings Banks, Deposit Banks and Farm Loan Banks that have been giving credit through the medium of small mortgage loans upon urban, village, and farm properties used for homes. Thereby to relieve pressures upon home and farm owners.

2. To put the various types of institutions loaning on mortgage in a position to assist in the revival of home construction in many parts of the country and with its resultant increase in employment.

3. To safeguard against the repetition of such experiences in the future.

4. For the long-view purpose of strengthening such institutions in the promotion of home ownership particularly through the financial strength thus made available to Building and Loan Associations.

The immediate credit situation has for the time being, in many parts of the country, restricted severely the activities of building and loan associations, deposit banks including country banks, and savings departments, savings banks and farm loan companies in such a fashion that they are not only not able to extend credit through new mortgages to home and farm owners, but are only too often unable to renew mortgages or give consideration to those in difficulty, with resultant great hardships to borrowers and a definite depreciation of real estate values in the areas where such pressures exist.

A considerable part of our unemployment is due to stagnation in residential construction. It is true there has been some overbuilding in certain localities in the boom years. But even in these localities the inevitable need is obscured by the tendency of the population to huddle temporarily due to unemployment. The



real need steadily accumulates with increasing population and will become evident and insistent as we come out of the depression. The high importance of residential construction as a matter of employment is indicated by the fact that more than 200,000 individual homes are erected annually in normal times which, with initial furnishing, contribute more than two billion dollars to our construction and other industries. This construction has greatly diminished. Its revival would provide for employment in the most vital way. As a people we need at all times the encouragement of home ownership, and a large part of such action is possible only through an opportunity to obtain long term loans payable in instalments. It is urgently important, therefore, that we provide some method for bringing into continuing and steady action the great facilities of such of these great national and local loaning concerns as have been under pressure and should provide against such difficulties in the future.

The farm mortgage situation presents many difficulties to which this plan would give aid.

I have consulted with representatives of the various groups granting credit on mortgage loans for homes and farms, as well as with government officials and other economic agencies, and as a practical solution from the various needs and the various ideas advanced I propose the following general principles for the creation of an institution for such purpose:

(a) That there be established twelve Home Loan Discount Banks (if necessary), one in each Federal Reserve District under the direction of a Federal Home Loan Board.

(b) The capital of these discount banks to be initially of minimum of five to thirty million dollars as may be determined by the Federal Board upon the basis of the aggregate of such mortgage loans and probable needs of the particular district.

(c) The proposed discount banks to make no initial or direct mortgages but to loan only upon the obligations of the loaning institutions, secured by the mortgage loans as collateral so as to assure and expand the functioning of such institutions.

(d) Building and Loan Associations, Savings Banks, Deposit Banks, Farm Loan Banks, etc., may become members of the system after they have satisfied the conditions of qualifications and eligibility that may be fixed by the Federal Board.

(e) The mortgage loans eligible for collateral not to exceed

\$15,000 each and to be limited to urban, village, and farm property used for home purposes.

(f) The maximum amount to be advanced against the mortgage collateral not to exceed more than 50 per cent of the unpaid balance on unamortized or short term mortgage loans, and not more than 60 per cent of the unpaid balance of amortized long term mortgages, and no advance to be made on mortgages in default. Such loans to be made on the basis that there are sound appraisals of the property upon which such mortgages have been made. In other words, given sound appraisals, there will be advanced in the case of short term or unamortized loans 25 per cent of the appraisal, and in case of amortized long term loans, 30 per cent of the appraised value of the property.

(g) The discount banks as their needs require from time to time to issue bonds or short term notes to investors to an amount not to exceed in the aggregate twelve times the capital of the issuing bank. The bonds of these discount banks would be thus secured by the obligations of the borrowing institutions, the mortgages deposited as collateral against such obligations, and the capital of the discount banks. These bonds to be acceptable for security for government and postal deposits. The result would be a bond of high grade as to quality and security.

(h) If the aggregate initial capital of the discount banks should in the beginning be fixed at \$150,000,000 it would be possible for the twelve banks to finance approximately something over \$1,800,000,000 of advance to the borrowing institutions which could be further expanded by increase in their capital.

(i) It is proposed to find the initial capital stock for the discount banks in much the same way, in so far as is applicable, as the capital was found for the Federal Reserve Banks—that is, that an organization committee in each district should first offer the capital to the institutions which would participate in the service of the bank. And as was provided in respect to the Federal Reserve Banks, if the initial capital is not wholly thus provided, it should be subscribed by the Federal Government; and further, somewhat as was provided in the case of the Federal Land Banks, other institutions using the facilities of the discount banks should be required to purchase from time to time from the Government some proportionate amount of its holdings of stock if there be any. In this manner any Government capital

will gradually pass over to private ownership as was the case in the Federal Land Banks.

The above details of the proposal are put forward as suggestions in order to give clarity to the central idea rather than as inflexible conclusions. The whole plan would necessarily be subject to the action of Congress and many parts of it will no doubt need development.

There is no element of inflation in the plan but simply a better organization of credit for these purposes.

This proposed institution does not in any way displace the National Credit Association which occupies an entirely different field of action.

## CHAPTER III

### TAXATION AND HOUSING

#### I. THE SUBJECT AND ITS LITERATURE

The purpose of the present report, briefly stated, is to "ascertain in what ways our housing problems are created or complicated by current methods of taxation," and to examine the measures which have been tried or proposed both to correct the housing difficulties which result from taxation and to facilitate improved housing through taxation or tax exemption.

"The major function of the committees," according to the procedure recommended, "is to assemble and evaluate the work which has been and is being done in the United States in the field in which it is concerned."

So far as was possible in the limited time at its command, the committee has followed this order of procedure. Certain illustrative facts are cited in the body of its report. Larger compilations or analyses of fact are contained in immediately succeeding chapters of this volume. Although the committee collected a list of references to the literature bearing more directly upon the subject assigned to it, in general, it must be reported that there is found no adequate body of literature bearing directly upon the effect of taxation upon housing and home ownership in the United States, and no considerable body of relevant evidence or experience the meaning of which can be formulated with anything approaching scientific certainty. Some of the most important facts, such as the general escape or undervaluation of personal property for purposes of the property tax, are matters of common knowledge, as difficult to describe comprehensively or measure accurately as they are certain. Further research of an extended nature is necessary before many of the conclusions reached by this committee can be verified or contradicted with confidence. In general, conclusions respecting taxation are characterized and frequently controlled by considerations of judgment or policy and cannot be settled by a brief reference either to experience or accepted principles of economic or political science.

## II. THE PROPERTY TAX

**1. Burden of the Property Tax.** This is now the heaviest tax imposed in the United States. Some idea of its burden may be gathered from the following statistics, applicable to American cities of over 30,000 population, in which the problems of housing and home ownership are most acute.

In these cities in 1928 the general property tax yielded 64 per cent of the total revenue receipts. Real property constituted 83 per cent of the basis on which the property tax was laid, and thus produced 53 per cent of the total revenue receipts. Special assessments and special charges which fall principally upon real estate produced an additional 8 per cent of the total. Taxes, as usually considered, yielded 69.5 per cent of the revenue of these cities, and the general property tax supplied 92 per cent of the taxes collected. Data collected by the committee indicate that approximately 65 per cent of the assessed value of real estate in cities represents buildings or building values, from which it follows that buildings bear approximately 34 per cent of the total revenue burden, and land 19 per cent. Of the taxes imposed by these cities, buildings bear about 47 per cent of the total and land about 25 per cent.

**2. The Property Tax Is now Unduly Concentrated upon Real Estate.** This concentration of the property tax upon real estate conforms neither to the law nor to sound economic principles. It is a matter of common knowledge that a far larger proportion of personalty than realty escapes taxation, either by outright exemption or evasion of the requirements of the tax law. In a few jurisdictions selected classes of personal property are carefully assessed. But in hundreds of important communities no real effort to tax tangible personal property is made; in thousands of districts only half-hearted effort is made and the major proportion of tangible personal property escapes; while exemption or evasion of intangible personal property is the rule rather than the exception. At this point the committee expresses no opinion about the wisdom of attempting to tax personal property either tangible or intangible, but simply records the fact that a much larger proportion of personalty than of realty escapes the prop-

erty tax, throwing the burden thus avoided largely upon real estate.

**3. Tax Rates upon Real Estate.** The burden imposed by the property tax upon real estate is nearly everywhere heavy and in many communities destructive. In 1910 the average rate of the general property taxes imposed by cities having more than 30,000 inhabitants was 18.9 mills on the assessed valuation. This average rate rose to 20.2 mills in 1918, and to 27 mills in 1928. In addition, state taxes (averaging 2 mills) were collected in the majority, county taxes (averaging 5.9 mills) in a large number, and special taxes (averaging 1.2 mills) in a very small number of these cities. While no weighted general average covering state, county, city and special levies can be accurately computed, it is highly probable that this general average exceeds 30 mills for the year 1931. Approximately half of the taxpayers are above the average, that is, pay more than 30 mills at the present time. It is among those taxpayers that the hardship is greatest. In general, property is still assessed at less than full value. But in millions of cases today the assessed value equals or exceeds the actual market value. Such properties are paying to the state and local governments an annual average rate which frequently exceeds 3 per cent upon their full capital value.

A useful measure of the burden of the property tax is found in the proportion of rental income (before taxes) taken by the tax. The results of studies of urban property taxes in nine states are thus summarized by Whitney Coombs in his *Taxes on Farm Property* (page 32): Arkansas (1923-25), 17.1 per cent; Colorado (1926), 27.1 per cent; Indiana (1922-23), 30.6 per cent; Iowa (1927), 31.3 per cent; North Carolina (1927), 29.5 per cent; Pennsylvania (1924-25), 20.9 per cent; South Dakota (1922-26), 29.9 per cent; Virginia (1926), 16.0 per cent; Washington (1924-26), 31.7 per cent.

An interesting study of the taxation of urban real estate was made by the North Carolina Tax Commission and embodied in its report for 1928. The following quotation from that report shows the ratio of taxes to rent for 859 properties, classified by use, region, and value.

Classification of property	Number of cases	Percentage of net rent (before taxes) taken in taxes	Percentage earned on fair value After expenses and taxes	
			Before Depreciation	After Depreciation
Business .....	275	28.6	5.0	3.9
Residential .....	584	34.5	5.5	3.2
Total .....	859	29.5	5.1	3.8
Tidewater .....	106	38.5	5.2	3.3
Coastal Plain .....	329	31.5	5.6	3.8
Piedmont .....	330	26.9	5.0	3.9
Mountain .....	94	32.2	4.5	3.3
Value Classes				
\$ 0- 4,000 .....	416	47.7	5.2	2.2
4,001-10,000 .....	164	39.4	5.4	2.9
10,000-50,000 .....	187	30.3	5.4	3.9
Over 50,000 .....	92	27.4	5.0	3.9

**4. The Inequalities and Uncertainties of Assessment Increase the Tax Burden on Real Estate and Small Homes in Particular.** The irregularities and inequalities of the assessment of real estate under the property tax are too well known to require extended comment. The results of Prof. H. D. Simpson's studies in the State of Illinois for the year 1927 show how glaring these inequalities may become. Using normal sales as a measure of fair value he found for ten Illinois counties outside of Chicago that assessments on the basis of 2,049 transfers averaged 34.1 per cent of the fair value. With the average level at 34.1 per cent, only 10 per cent of the properties were assessed within the range of 30 to 35 per cent, and only 19 per cent within the range 30 to 40 per cent, the remaining properties ranging from 2 per cent to 100 per cent, with an average deviation from the average of 51.6 per cent. In the City of Chicago, a study of 6,017 transfers indicated that the assessments of 1927 averaged 39.8 per cent when it left the hands of the Board of Assessors, and 35.9 per cent after revision by the Board of Review. Out of this sample, 15.5 per cent of the properties were assessed between 1 and 20 per cent, while nearly 10 per cent were assessed from 60 to 100 per cent. The average deviation from uniformity of the 1927 assessment was 36.5 per cent. This combination of under-assessment and over-assessment results in partial exemption to some and partial confiscation to others. In the City of Chicago it caused a misplacement in the taxes paid of about \$30,000,000, while in the State of Illinois the similar misplacement was estimated at \$64,000,000.

A study for the State of New York made by C. B. Pond<sup>2</sup> indi-

<sup>2</sup> Pond, C. B.: "Full Value Real Estate Assessment as a Prerequisite to State Aid in New York," Albany, Special Report of the State Tax Commission, No. 3, 1931, p. 29.

cates that, to correct inequalities arising from defective assessments, taxes would have to be changed up and down in an amount exceeding \$150,000,000 a year. Mr. Pond estimates that for the nation as a whole somewhere between 10 and 20 per cent of taxes on real property are "unjustly assigned," to correct which positive and negative changes in taxes of from 20 to 40 per cent would have to be made.

A number of studies have been made of the relationship between assessed and true values for various classes of real estate. In some tax districts there is a tendency to assess residential properties on higher basis than business properties, but in other districts there is an equal discrepancy in favor of residential real estate. Thus, the North Carolina Tax Commission, in a study of 1,062 properties for the year 1927, found that the business properties were assessed at a level of 57.6 per cent while residential properties were assessed at a level of 63.1 per cent. On the other hand, Professor Simpson's studies for the year 1927 in Chicago show that residential real estate was assessed at a lower level than vacant land or commercial and office buildings. In general there is no evidence of a marked bias either in favor of or against residential real estate.

Where real properties are classified by value, however, there seems to be some tendency to assess the less valuable parcels on a higher basis than the more valuable parcels. Thus, the North Carolina study quoted above shows an even regression from a level of 66.5 per cent for property valued at less than \$4,000 to a level of 56.7 per cent for properties valued at more than \$50,000. This and other studies in various parts of the United States show a more or less uniform regression or regular relationship between higher value and lower assessment. Other studies show little or no regular relationship between size and the rate of assessment except in the case of properties in the classes of lowest value which are assessed markedly above the general average.

**5. The Property Tax Restricts Home Ownership.** The concentration of the heavy property tax upon real estate discourages and materially restricts home ownership. The reasons for this conclusion are convincing:

(a) In the cases of homes occupied by the owner, the incidence of the property tax is upon the owner. Subject to certain qualifi-



cations noted in the next section, he pays the tax not only in appearance but in reality.

(b) As pointed out under (4) above, the small home is likely to be assessed on a higher basis than other real estate.

(c) Under existing conditions the maxim that "it is cheaper to rent than to own" is in large measure true in city communities. Its truth arises largely from the fact that building activity is recurrently subject to speculative booms in which buildings are constructed without careful reference to taxes or other costs, with the result that the taxes are not wholly shifted to the renter or tenant. This fact operates to discourage investment in homes. The increase of the multiple dwelling and the relative decline of the one family house in large cities is in appreciable part due to apprehension on the part of home owners or potential home owners about the uncertainties and growing burden of the property tax.

The head of a family who has invested his savings of four or five thousand dollars in a mortgaged home is not only bothered with the danger of an unfair assessment, but he is likely to see the value of his property materially reduced by a sharp advance in the tax rate. Compared with the renter, he is tied down by his investment. The renter is in a far more flexible condition. He may shift his residence from place to place, from an old to a newer type of residence, and take quick advantage of any decline in rents.

**6. Incidence of Taxes on Residential Real Estate.** At this point, the practical subject of the effect of taxes upon housing and home ownership becomes involved with the intricate question of the shifting and incidence of taxes upon residential real estate. The subject is discussed at some length by Prof. H. D. Simpson in Appendix II. The conclusions of the committee may be briefly summarized as follows:

(a) As a cause of hardship, the necessity of payment is more important than the ultimate incidence. Whether he is making or losing money, whether his property is free or encumbered, the owner of the property must ordinarily pay the property tax within the period prescribed by law or suffer the heavy penalties, direct and indirect, of delinquency. What may be called the "obligation of payment" is frequently more important than the abstruse question of who ultimately bears the tax.

(b) The more important conclusions and recommendations

reached by the committee are independent of considerations of incidence and shifting. They are tenable whatever theory of incidence be adopted.

(c) Owners occupying their own homes, as stated above, pay and bear the taxes on these homes: There is no one else to whom the burden may be shifted. This consideration is subject to the following qualification:

To the extent that the property tax upon any parcel of real estate is exclusive, i. e., exceeds the average tax burden upon other investments, this excess is capitalized and deducted from the amount which a purchaser of that parcel would otherwise pay for it. A new purchaser of the property will buy it tax free or exempt from any exclusive element in the tax burden known to exist at the time of purchase. In this sense and degree the occupying owner does not bear the tax which he pays.

It will be noted, however, that the purchasing owner escapes only that part of the tax which is exclusive; that he bears both what may be called the average tax burden upon investments generally and any unforeseen increase in the property tax rate; and that ordinarily he is the sole victim of what has been called above "the obligation of payment." He must meet the tax bill as he must meet payments on a mortgage, although the latter are fixed and the former is likely to increase just when his ability to pay is lowest.

(d) Coming to residential real estate rented or leased to others than the owner, the shifting of the tax will depend largely upon conditions in the building industry. If the supply of and demand for residential buildings are controlled by careful calculation of the costs of producing and carrying such real estate, the taxes known to be inevitable, according to one widely accepted theory, will operate to reduce the supply of building accommodation, rentals will rise accordingly and, in general, the tenant will pay the tax.

If, on the contrary, the building of homes is controlled by speculative booms in which taxes and related costs are largely ignored, over-building is likely to become recurrent or chronic, the supply of homes will not be affected by the tax burden, and the tax on homes will be borne in general by the owners and not by the tenants. In the opinion of the committee, this condition of over-

building exists in many if not most American cities at the present time. There are some reasons to believe that it may even exist as a chronic condition in the majority of large American cities. It is not necessary to decide here whether it is chronic or not. It exists and is likely to persist to a sufficient extent to require serious modification of the widely accepted theory that taxes on rented homes are always and fully paid by the tenant.

(e) In the opinion of the committee, the excessive taxation of residential real estate contributes to poor housing. This conclusion follows partly because of, and partly despite the factors of incidence and shifting discussed above.

The relationship between high taxes and poor housing is obvious in the case of occupying owners and renters to the extent that they pay the property tax upon the homes which they occupy. To that extent, the tax upon houses increases the cost of housing and in accordance with familiar economic laws reduces the quantity and/or quality of housing enjoyed.

To the extent that the tax on houses is not borne by the occupier (whether owner or tenant) it does not affect adversely the quality and/or quantity of housing enjoyed. The occupier buys housing at something less than normal price. However, as pointed out above, he does this largely as the result of speculative over-building, and this in turn is probably responsible in the long run for more damage to home owners and home users than any possible benefit which they receive from the reduction of rents through over-building.

The problem at this point ramifies into collateral questions too diverse and complicated to be adequately discussed in this report. This much, however, may be said: After careful examination of the subject the committee finds no reason to contravert the popular belief that if a permanent reduction in the property tax on homes could be effected, it would result eventually in lower prices for housing accommodation—in more and better housing.

This statement assumes, of course, that in reducing the property tax no new or substitute tax of equivalent burden is imposed on homes.

**7. Delinquency and Tax Sales.** Striking evidence of the oppressive and growing burden of the property tax is found in Appendix III, entitled "Increasing Tax Delinquency," by the

Forest Taxation Inquiry, Fred R. Fairchild, Director. In Michigan, for example, statistical coefficients of delinquency based upon area, assessed value and taxes are given for selected years from 1900 to 1928, inclusive. "The figures" show a large amount of delinquency at the beginning of the century, a rather steady decrease for the next ten years, a fluctuating but slightly increasing amount for the next ten years, and a sharp and steady increase since 1920, the amount by every measure having risen above the 1900 level by 1925.

In Michigan and probably elsewhere the growth of delinquency is apparently not due to the present business depression but has been going on since 1920 at the latest; it applies to city lots and the wealthier counties as well as to wild or cut-over lands, and is apparently due to the increase of the property tax more than any other one cause.

In the face of this growing volume of delinquency there is, in many districts, a practical breakdown of the machinery of enforced collection and tax sale.

Tax titles are in many states untrustworthy, no bidders or buyers appear at the tax sales for many of the delinquent properties, the unpaid taxes and interest on these properties accumulate, and in the end the Government is apt to effect some compromise with the owners by which a large portion of the back taxes and interest is wiped out. Many holders of property actually count upon the probability of some such compromise. They refuse to pay the current taxes as they fall due, confident that in the end they will be able to get their property back through a compromise settlement in which a large portion of the taxes will be avoided. This attitude is particularly prevalent where property taxes are augmented by large, special assessments. When such accumulated claims come to exceed the value of the property, it is obvious that the Government has little chance of collecting the full amount of its claim, and the burden upon those who do pay is correspondingly increased.

The non-payment of property taxes has become a serious problem in the United States. The causes of the evil involve but are not confined to taxation. The treatment and remedy deserve further study by this and other committees of the President's Conference, particularly the committees dealing with city planning and zoning, subdivision layout, and utilities for houses. There is

pressing need not only for greater efficiency in the collection of property taxes but for improvement in the procedure of tax sale and redemption.

**8. The Property Tax: Defects and Remedies.** In concluding this survey of the property tax as it affects residential real estate it is important to note that the defects of the tax characterize not only its details but the tax as a whole. Familiar conditions of American history and politics have made the property tax the only important flexible element in the revenue system of our counties and municipalities. Real estate in turn has come to represent almost the entire taxable aggregate subject to flexible rates in a few states, and the preponderant part of the aggregate in the remaining states. Technological changes, the increasing complexity of modern life, growing humanitarianism, and increased standards of municipal living, intensified by the civic carelessness engendered by a prolonged period of undue optimism, have combined greatly to increase aggregate expenditures for governmental purposes; and the greater part of these increases has inevitably, under the present tax system, fallen on real estate. In brief, the present situation is characterized by excessive public spending, excessive reliance by local governments on the property tax, and by excessive concentration of the property tax on real estate.

If this diagnosis of the situation is approximately correct, certain general conclusions of fundamental importance follow:

First of all, the evils are avoidable. A few authorities on taxation hold that both the dependence of the local governments upon the property tax and the concentration of the property tax on real estate have resulted from inevitable economic conditions or tendencies and that it is useless to oppose them. In the opinion of the committee, not only the facts and the logic of the situation but the great weight of authority are all against this conclusion.

Secondly, there is no simple solution of the problem. Until the American public rouses itself to work fundamental and far-reaching changes both in the fiscal habits and the structure of our state and local governments, the problem will remain substantially unsolved. Nothing could be more ill advised than a superficial optimism on this point.

Third, in the opinion of the committee, sound policy, tactical expediency, and in many states constitutional law, all require that

home owners should seek redress of their grievances through general measures designed not only to benefit themselves but to relieve real estate in general. Special exemptions to home owners, or even to buildings and improvements as distinguished from land, are inadvisable. The results of special experiments with such exemptions are discussed elsewhere in this report. These results have been negative and inconclusive. General experience, however, creates a strong presumption against special favors or exemptions. The existing discrimination against real estate applies to practically all forms of real estate. If a remedy or corrective is to be applied, the relief should be granted to all classes of real estate. Farms in particular—regarded not only as homes but as business units—deserve relief fully as much as homes, and the same conclusion applies to certain other classes of real estate, the uses of which are as salutary as good housing or home ownership. In principle, the individual should pay for his housing as he pays for his bread, his clothes, or any other necessity of life, without special help or assistance from the state. In general, special exemptions expose the legislative bodies controlling them to demoralizing influences and arouse class conflicts. Decisions are apt to be reached not on the basis of merit alone but on a basis of merit plus volume of votes.

The committee realizes that unhappily large fields of exemption, subsidy, or other favorable treatment have grown up in this country; and that in many cases there is less ground, in considerations of social policy, for extending this treatment to its present beneficiaries than to home owners and home ownership. It may be conceded that home ownership is more in need of public encouragement than many of the fields which, by accident, tradition, or otherwise, are now receiving the encouragement of exemptions or special privileges. But the committee, while aware of all this, is convinced that the line of relief lies in the direction not of increasing the areas of exemption and subsidy but of rigidly reducing these areas where such policies are no longer justified. The committee believes that home owners will reap more lasting benefits not by seeking exemptions or subsidies for themselves but by helping to reduce the areas where unwise public policies of this character still persist.

The discussion of remedial measures, to which the remainder of

this report is largely devoted, treats the proposed remedies roughly in the order of their practical availability. A few of them are both sound and easy of accomplishment, but they only touch the fringes of the problem. The committee advises against a sole reliance upon the easy sounding or so-called "practical remedies." To illustrate: Among the important improvements possible, none perhaps is more "practicable" than the more thorough assessment and taxation of tangible personal property. But in most communities such a "reform" if achieved would do more harm than good unless accompanied by thorough-going improvement in the personnel and machinery of assessment. Again, the adoption of the income tax represents a major improvement entirely practicable of achievement in many states in the near future. But the introduction of an income tax would probably do more harm than good, in most states, unless accompanied by the introduction of such checks upon public expenditures as would prevent the income tax from being an additional rather than a supplementary or substitute tax. The income tax as an opportunity or excuse for further public spending would be worse than useless. The present conditions of acute distress and aroused public opinion should be utilized as a unique opportunity to introduce fundamental improvements.

### III. REMEDIAL MEASURES

**1. Better Administration of Present Tax Laws.** Such information as the committee has been able to compile concerning the burden of taxation which rests on property subject to levy by local governments indicates not only that local taxes have reached an almost unprecedented height when compared either with capital values or with income, but that the burden is falling with unequal severity on the several classes of properties subject to local taxation under existing tax laws, and on individual properties within the several classes. The application of more skillful and aggressive administrative methods to the compilation of tax rolls will permit municipalities to ameliorate the effects of an inequitable distribution of tax burdens among classes of property, and among individual properties, by shifting the unfairly excessive burdens to those properties which are at present undertaxed. In effect, therefore, some measure of tax relief is possible for over-

burdened properties by the utilization of the hitherto unused and, for all practical purposes, new sources of revenue available to municipalities under existing laws. The suggestions of the committee are concerned with two phases of the problem: (1) The correction of the unconscious bias against small properties of all types, including small homes, which it believes to exist in many cities; and (2) the prevention of the almost universal escape of certain types of tangible personalty which experience in a limited number of taxing jurisdictions has proven it is practicable to assess.

(a) *Correct the Bias of Assessment Against Small Homes.* A number of tests of the accuracy of real estate assessments have been made in various parts of the country, by the comparison of large numbers of carefully selected sales prices with the assessed values for the same properties. The results may be summarized as follows: In cities which maintain well-designed and well-administered systems of real estate valuation, the average ratio of assessed values to sales prices which prevails for the entire sample, is also found to be adhered to with reasonable accuracy when the sample is broken up into, and analyzed by, classes of properties based on size; in some cities which maintain assessment systems in which matters of partisan or factional expediency are given undue weight, large properties may tend to be assessed at a higher ratio than the smaller properties owned by the rank and file of the voters; in cities which are operating both without adequate assessment methods and without conscious bias, small properties tend to be overassessed in comparison with large. A considerable percentage of the number of American cities belong in the third group. This is equivalent to saying that, in a considerable number of American cities, small homes are probably assessed at a higher percentage of sales price than larger properties are.

This assertion is not sufficient to indicate the full extent of the probable shift of an undue share of the local tax burden to small homes. Sales prices for small homes include a much larger percentage of loading for costs of financing, costs of selling, and costs of instalment buying, than is the case in large revenue producing office buildings, for example. Furthermore, the bare costs of construction per unit tend to be higher in the small-scale operations under which many of the small homes are built, than under the methods employed in connection with larger buildings.



These tendencies stand clearly revealed by studies recently made in the City of Washington. When the land values assigned to the lots on a careful unit basis were deducted from sales prices for small homes and for large fireproof buildings, the building prices arrived at by difference revealed substantially higher values per cubic foot of contents for the smaller low grade buildings than for the larger high grade structures. This bias is being corrected in some cities by computing the values of small building at reproduction cost new, with proper allowances for structural deterioration and economic obsolescence. In Chicago, for example, where that method was used for the reappraisal of 1928, the ratio of assessed values to sale prices was smaller in the size groups containing small homes than in those containing the larger resident and business properties. This method of assessment avoids the necessity for including in the taxable value of small homes certain extraneous and evanescent elements which, under the existing methods of producing and selling small homes, enter into the market prices. The committee believes that the adoption of this method of valuation for buildings in general is not only equitable and legal, but also socially desirable.

(b) *Improve the Assessment of Tangible Personal Property.* The general property tax laws vary widely from state to state in their provisions. At one extreme, tangible and intangible personalty alike have practically disappeared from the tax base for local purposes, real estate alone being left to bear the burden; at the other, practically every conceivable type of personalty is required by law to be listed. The committee is under no illusions as to the practicability of a general property tax law of the latter type, and includes among its suggestions for tax relief under another head a proposal for the special taxation of intangibles. Neither does it believe that all types of tangible personalty can be fairly assessed, or that the taxes assessed against all types can be uniformly collected. Nevertheless, in the large mass of tangible personalty, now legally taxable, which escapes taxation almost completely in many jurisdictions, there are large and important classes which aggressive and capable assessors here and there have succeeded in placing on the tax rolls. Except in the small number of states which specifically exempt such classes, those properties are both legally and practically within the reach of the

taxing authorities for the purpose of reducing the burdens on real estate.

Among the classes of tangible personalty which it is difficult to assess is that large class vaguely grouped under the headings of household and personal effects. Even when some rough and ready method of assessment is employed, the inescapable lag between the date as of which the property is valued, and the date when the tax is due and payable, interposes obstacles in the way of uniform collection. This is notably true in the growing number of metropolitan areas, where tenants, as opposed to home owners, flit from suburb to suburb, or from suburb to center, at short intervals. Such analyses of tax delinquencies as have been made in that field indicate a high percentage of unenforceable delinquency among the tenant group; an almost negligible percentage among those home owners who have paid their real estate taxes. In other words, while the tax on household effects is almost as rigid and inescapable as the real estate tax itself for the man who owns his own home, it is by no means equally rigid for others. The remedies of distress and sale, in some states, or of application to the courts for a judgment in others, have proven so difficult and costly in use as to make uniform collection of the tax against all persons who do not own real estate quite impracticable. Therefore, for the reason that the tax on household effects falls with disproportionate weight on the small home owner, and for the further reason, that the cost of administering it adequately is large compared to the probable yield, the committee advocates an exemption for household effects sufficient to eliminate the necessity for taxing such property in the homes of persons of moderate income.

There are difficulties in the way of enforcing the existing laws in many states relative to certain other types of tangible personalty, types which, because of their nature, are readily movable from one state to another. Examples of the properties in this class are freight and passenger steamers, grain and other food-stuffs in storage, and similar articles which are part of the easily divertible stream of consumer's goods flowing to market. Policies in that field must be dictated by the practical considerations which prevail locally, and may range from nominal assessments at one extreme, to moderately high valuations at the other.

This leaves certain large classes of tangible personalty which can be valued with varying degrees of accuracy, and against which taxes can be levied with reasonable hope of collection. The stocks in trade of merchants; the goods in process of manufacture by, or in the hands of manufacturers; and the household and personal effects, in excess of the exemption recommended above, which are in possession of the well-to-do, are among the outstanding examples in the group. For the stocks of merchants and manufacturers, an assessment at an average value of the stocks on hand at stipulated intervals throughout the year, rather than at the value as of a fixed taxing date, is to be recommended. Manifestly, the amount by which the tax base can be increased through the inclusion of taxable personalty will influence the tax rates; and a substantial decrease in tax rates, in turn, will make it easier to add taxable personalty to the base. Intelligent administration, in other words, should make better administration possible in the future.

In this field of personal property, the committee has not moved with entire assurance. Some of its members from states where the tax on personalty has practically disappeared feel that the foregoing recommendations deserve support only as emergency measures in other states. Others felt that the types of tangible personalty stressed above possessed tax paying capacity at least as great as that of the buildings in which they were housed—that no sharp line could be drawn, for example, between the ornamental detail embodied in the building itself, and the elaborate furnishings used to embellish the interior. This unanswerable argument, and the urgency of the present situation as regards the tax burden on real estate, combined to forge the program outlined as the least that will help to meet the situation, and the most that is practicable of accomplishment. The committee is a unit in feeling that the administration of a personal property tax is one that requires ability and integrity of the highest order on the part of the officials responsible for it.

In many districts, the tangible personal property of business concerns is now escaping taxation in whole or in large part. The committee recommends that the assessment of such personal property should be brought up to the level at which buildings and other improvements are assessed. In such cases, however, the change should be brought about in a deliberate and orderly

way. An unwise attempt to expand the property tax base unduly will only aggravate the existing situation by making unbalanced budgets, due to a high percentage of delinquency in collections, inevitable.

(c) *Taxation of Personal Property Not Essential in a Few States.* In a few states, practically all classes of tangible personal property are now lawfully exempt from taxation, and the wealth and income of the state are so great as to hold out hope that, if effective checks upon public expenditure can be introduced, it will be possible to raise the necessary revenue and bring the tax on real estate within the bounds of reason, under a tax system consisting essentially of a tax on real property, an income tax and other familiar taxes on corporations, business, inheritance and miscellaneous sources now in effect or readily available. In such states, the committee sees no necessity for the taxation of personal property, particularly if the majority of the owners of real estate are in favor of exempting personal property.

(d) *Improvement in the Machinery and Personnel of Assessment Essential.* The recommendations of the committee regarding the taxation of personal property rest upon the assumption that a material reduction of the tax rate applicable both to real and personal property can be effected. It is both undesirable and impractical to tax personal property at the high rate now applied to real estate in many communities. To reduce the tax rate materially it will be necessary both to check public expenditures effectively and to increase materially the volume of real and personal property assessed for taxation.

To effect the latter, in turn, a marked improvement in the machinery and personnel of assessment must be brought about in most communities. In the opinion of the committee, assessors should be appointed on the basis of merit and not elected; assessment districts should be large enough to engage the whole time of the assessor, who should devote his entire time to the work of assessment, retain office while efficient, be promoted on the basis of efficiency, and receive a compensation sufficient to secure and hold a first class man. Local assessors should be subject to the control and direction of state authorities, and for purposes of economy there should be a group of expert state assessors available for particularly difficult assessment work in any part of the state.

**2. Taxation of Intangible Personal Property.** The committee recommends that stocks, bonds and similar intangibles be taxed at the domicile of the owner at a low special rate. We believe that the effective assessment and collection of such a tax, in the manner described below, would be entirely practicable. We are equally convinced of the expediency and equity of such a tax.

It is frequently urged that such intangible property represents for the most part mere claims or evidences of title to tangible property taxed at situs. This contention is largely but not wholly true. Some of the tangible property and most of the intangible property "represented" by securities is not taxed at situs. Corporate shares in particular, represent in large part the earning power, good will, or other intangible assets of corporations not ordinarily taxed to such corporations under the property tax. In addition, the tax jurisdiction where the owner of the securities or other intangibles resides, as distinct from the jurisdiction in which the corporate property is situated, has a valid claim to a partial tax upon such property. Moreover, as a class, security holders have more than average ability to pay.

A light tax at the domicile of the owner is thus justified and would, in its actual effect, cause little double taxation. With real estate carrying the burden which it now bears, and tangible personal property taxed as the committee proposes, there could be no justification for the complete exemption of securities and other intangibles, in the hands of individual investors. Failure to tax such intangibles would cause greater inequalities than any element of double taxation involved in a light tax. This is particularly true of the owners of bonds and preferred stocks, who in a very real sense (though not completely) escape the burden of taxes imposed upon the corporations whose securities they hold.

The committee recommends that where practicable such intangible property be taxed on the basis of its income, at a rate not to exceed 6 per cent, the tax to be assessed and collected as an adjunct of the personal income tax. A tax of this kind is effectively assessed and collected in Massachusetts. It has the great merit of avoiding the necessity of valuing the intangible property concerned. Where local opinion or conditions make such a tax impracticable, the committee recommends that a special property tax rate at a low flat rate be applied.

**3. Personal Income Tax.** The committee recommends the introduction of a progressive personal income tax in most of the states in which such a tax is not now in force, provided that it be accompanied by effective measures to check public expenditures and administered by assessors appointed on the basis of merit and subject to state direction and control.

Experience with the income tax in Massachusetts, New York and other states has shown that it is practicable and fairly productive.<sup>3</sup> In 1929, for instance, the individual income tax produced \$28,194,565 or 9.77 per cent of the "total revenue from direct taxation" in Massachusetts, and \$84,508,173 or 7.83 per cent of the "total tax bill" in the State of New York.

To effect a material reduction in the burden of existing taxes, however, the state income tax must be made much more productive than at present. To accomplish this it will be necessary to make personal exemptions lower and the rates on moderate incomes higher than in most of the state income taxes now in force. In this country, state income taxes must be adjusted to the Federal income tax. If the combined rates on the various income groups were brought to the levels necessary to bring material relief to real estate, they would still be very far below those imposed on similar groups in other countries. This is especially true as regards England and France and in respect to the lower income groups. It is both unnecessary and undesirable to raise American income taxes to the levels to which in Europe they have been pushed by financial necessity. But if the public "means business" in its effort to reduce substantially the excessive tax burden on real estate, the personal exemptions must be kept low and the tax rates on moderate incomes must be made higher than in most American income taxes. The committee assumes, in this recommendation, that under state and Federal income taxes combined, the rates on large incomes will be raised approximately to the point of diminishing returns.

In this connection, the committee calls attention to the serious weakness of the Federal income tax and some of the state income taxes resulting from the personal exemptions. Under the Federal

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<sup>3</sup> "In 1927, taxes based on net income in 14 states provided less than 6 per cent of the total state and local revenue. However, data presented in this report indicate that the proportion of total state and local revenue derived from state income taxes is increasing." *National Industrial Conference Board*, "State Income Taxes," Vol. 2, pp. 1-3.

law, the exemption to the head of a family with three dependents, amount to \$4,700, and under the New York law, to \$5,200. This dividing line between exemption and taxation is, in the opinion of the committee, too high. If all heads of families in the United States be ranked in the order of their annual income, 75 per cent or more would probably fall below \$4,700. The median family income at present is almost certainly below \$2,500. Families above this line, that is, in the upper half are, comparatively speaking, rich. In the opinion of the committee, all heads of families above the median line should pay an income tax where such a tax is imposed. We recommend also that the exemption be expressed in terms of the tax, as in the Wisconsin income tax. Thus, if the lowest rate be 1 per cent and it is desired to limit the personal exemption (including the exemption for dependents) to \$2,500, the maximum exemption would be \$25.

Finally, the committee recommends that no offsets in respect of property be authorized. Property taxes should be allowed as deductions in computing net or taxable income, but should not be offset dollar for dollar against the income tax. The reasons for this recommendation are based largely upon careful studies of the effect of an offset upon a typical group of 5,086 individual taxpayers in Dane County, Wisconsin, and 13,104 corporations in that state, made by Prof. Herbert D. Simpson of the committee. With respect to the yield of the income tax, with and without an offset, Professor Simpson found as follows:

1. The effect of incorporating a property tax offset in the income tax is to reduce the yield of the income tax 51 per cent.

2. The adoption of an income tax without an offset would, in the situation of the above sample, make it possible to reduce the property tax rates by 15.2 per cent; that is, to bring a property tax rate of 20 mills down to approximately 17 mills.

3. The adoption of an income tax with a property tax offset would make it possible to reduce property tax rates only 7.4 per cent, or from 20 mills to 18½ mills.

4. With regard to the distribution of burden, the study of the 5,086 taxpayers indicates that 54 per cent would be most benefited by the introduction of a straight income tax, 33 per cent by a straight property tax with no income tax at all, and 13 per cent by an income tax accompanied by an offset provision. The study of the corporations indicates that 48½ per cent would be most bene-

fited by a straight income tax, 25½ per cent by a straight property tax, and 26 per cent by an income tax with property tax offset.

5. With regard to the amount of offset appropriated under a property tax offset provision, the study of the individual taxpayers indicates that the average offset enjoyed by those whose net income was below \$2,000 was thirty cents; those with a net income between \$2,000 and \$5,000 received an average offset of \$5; between \$5,000 and \$10,000 an average offset of \$44; between \$10,000 and \$20,000 an average offset of \$147; and over \$20,000 an average offset of \$585; the average offset for the entire group being \$8.

A study of 3,872 manufacturing corporations indicates that corporations whose taxable income was below \$5,000 received an average offset of \$29; those with a taxable income from \$5,000 to \$10,000 an average offset of \$246; between \$10,000 and \$20,000 an average offset of \$749; between \$25,000 and \$50,000 an average offset of \$1,725; between \$50,000 and \$100,000 an average offset of \$3,298; between \$100,000 and \$500,000 an average offset of \$8,340; between \$500,000 and \$1,000,000 an average offset of \$16,957; over \$1,000,000 an average offset of \$100,677; the average offset for the group being \$739.

In general, an income tax is designed not so much to reduce the burden of the property tax, as to reduce the burden of the property tax upon those less able to pay. This object is best achieved by a straight income tax without offsets. An individual who, despite the heavy property taxes which he may be paying, nevertheless has a large net income, is still "able to pay." Moreover, as a property taxpayer, he benefits materially by the general reduction in the rate of the property tax caused by the income tax. It is misleading to treat the income tax as a direct "substitute" for the property tax. It is designed, in general, to correct overdependence upon the property tax by supplementing the latter with a tax based upon ability to pay.

Fiscally speaking, perhaps the worst feature of the offset is its effect in reducing the importance or productiveness of the income tax as a whole. It is not worth while to go to the trouble and expense of devising and administering an income tax unless it is to play an important part in the financial system of the state in which it is introduced.

Finally, it may be noted that a majority of the states (Wis-



consin, Missouri, North Dakota, New Mexico and Georgia), which have used the offset, have subsequently repealed it, while the Washington law authorizing an offset has been declared unconstitutional.

**4. Other Revenues.** The committee makes no positive recommendation or finding concerning a large number of other taxes which could be employed, if necessary, for the purpose of reducing the excessive burden on real estate. With the qualifications noted below, it gives preference to the program already outlined: The reduction of public expenditures; reorganization of the machinery of assessment for the dual purpose of reducing inequalities and effectively taxing personal property; and a personal income tax designed to introduce into the system of state and local taxation a major tax adjusted to ability to pay. This program in the average state is sound and practicable. It is sufficient to reduce materially the burden on real estate. It is unnecessary in the average state to go farther. The committee recognizes, however, that in a few states it may be possible to relieve real estate by changes less sweeping than those recommended in the committee program. On the other hand, it is equally recognized that in a few states the preferred program may prove unsuitable. In such states, other taxes than those recommended by the committee will be necessary.

(a) *Income Tax on Corporations.* The committee regards the adoption of a corporation income tax not only as beneficial but inevitable in those states which make use of the personal income tax. Nevertheless, the committee believes that a corporation income tax should not be adopted in the average state unless careful adjustments are first made in its fiscal system. Such adjustments will require careful planning and technical advice, as well as time for development.

The adjustment of taxes on incorporated and unincorporated businesses is a nice problem. In most American states the taxation of business corporations is markedly unequal. Some classes of corporations, either by law, practice, or both, escape adequate taxation on large categories of important assets; many of them, perhaps the majority, pay no property taxes on intangible assets, while others are effectively taxed on intangibles and/or capitalized earning power. To correct this situation, franchise, capital stock and a variety of other taxes are imposed, some of which correct the

inequality while others intensify it. In short, such taxes as have generally been engrafted on the existing structure have not uniformly accomplished the equitable taxation of corporations. If, then, corporation income taxes are summarily added, grave injustices may result which will be made even more acute because of the existing business depression. On the other hand, in states having a personal income tax, the tax ordinarily applies to the earnings of partnerships and sole proprietors regardless of whether they are withdrawn from the business or not. The failure of the personal tax to reach corporate income subjects partnerships and sole proprietors to unfair competition, which injustice, combined with other factors, almost inevitably results in the application of the income tax to corporations. Provided that the necessary adjustments are made in the fiscal system, the advantages of taxation on the basis of net income apply to business corporations as well as to individuals. If, too, the adoption of the corporate income tax effects a reduction in the property tax rate, it transfers the burden so shifted from taxpayers less able to taxpayers more able to pay.

The recommendations of the income tax, personal and corporate, by the committee, are made with the full understanding of the weaknesses and defects of the state income tax. These defects are real and grave but, in the opinion of the committee, they are markedly less serious than the evils and defects of the property tax. After all is said, the income tax embodies this great practical advantage: The taxpayer is not called upon to pay taxes unless he has earned or received the income with which to pay the tax. In a rough way the income tax, in practice as well as theory, is adjusted to ability to pay. We repeat, however, that the introduction of the income tax is justified only when it replaces an equal volume of more harmful taxation.

(b) *Fees and Other Charges.* The great expansion of the range and character of governmental services that has occurred during the past half century has involved many readjustments of the relationship between the government and the citizen. In the case of many of these newer services, the element of special benefit to individuals frequently predominates over the general or common social benefit. Owing to the natural and inevitable lag in the adjustment of the financial system, some of these services are being paid for out of general funds, whereas their character is such as to justify meeting their cost, wholly or in part, by the use

of fees, prices or other special charges representing the payment by the citizen for a service primarily of specific rather than of general benefit and advantage.

The degree of this maladjustment between the nature of the service and the manner in which it is to be financed, varies so greatly as to preclude the possibility of any general characterization or recommendation by the committee. It is recommended, however, that this subject be given careful consideration by the states and the larger local units, and that appropriate steps be taken to relieve general taxpayers of the burden of financing services which can be equitably paid for by the development of a system of fees, prices or other special charges. Appropriate "changes in law and administration" would often be required to assure the use of such special revenues to defray the costs of these special services and to avoid a recurrence of the gross abuses of the old fee system.

**5. The Utilization of New or Additional Revenues to Promote Equalization of Tax Burdens.** The elimination of bias in the assessments of real property and the more effective assessment of personal property, recommended by the committee, should result in some increases of local revenue which could be devoted to a reduction of local tax rates. The imposition of additional taxes such as the income tax and the tax on intangible personalty is beset with the grave danger that the new funds will be used for additional expenditures, leaving the present tax burden on real estate intact. Such new or additional taxes should be adopted only where and when adequate safeguards against this danger can be introduced. Methods of controlling and checking public expenditures are discussed in Section V below. In addition, however, a proper method of utilizing or distributing new taxes must be devised inasmuch as these new taxes in the opinion of the committee should be assessed and collected by the state government.

No single formula or procedure for distributing the new revenue applicable to all states can be devised. Three possible methods of procedure may be utilized:

1. The state may retain the new revenue and make possible a reduction of local expenditures by assuming both the administrative and the financial responsibility for certain services now devolving upon the local units. The choice of services eligible for

transfer to state jurisdiction must be governed by consideration of the probable relative efficiency and economy of central as against local administration. The custody of prisoners under sentence, institutional care of defectives and delinquents, courts, some aspects of education costs and the maintenance of highways, may be suggested as services or functions eligible for assumption by the state. The prevailing practice of making local units responsible for these and similar services often results in costly duplication of expenditure for equipment and overhead.

2. The state may assume financial responsibility for certain services, while leaving in appropriate local jurisdictions the actual administrative responsibility, under an arrangement for state reimbursement of the cost. This proposal avoids the extreme administrative centralization involved in a complete transfer of functions from local to state control. The following safeguards and qualifications are necessary to a satisfactory operation of this arrangement:

First, adequate local units must be selected or provided, in order to assure a basis for economical local operation of the service. This may be the county, the large municipality, or a regional district. Small townships or other small municipalities are seldom adequate in size or resources to be recognized in the capacity of local agents.

Second, an appropriate state agency should have supervision of the local administrative units, with authority to prescribe the standards for the operation of the service. For example, if highway maintenance were to be paid for by the state but actually performed by local administrative units, the state highway commission should classify the roads and set suitable maintenance standards for each class. The engineering staff of the local unit would supervise maintenance within the standard allowance established, and the state would pay the bill from the funds appropriated for this purpose.

3. The state may distribute the new revenues in whole or part to the local units as grants in aid. This alternative is now in general use, but the distribution plans of the several states vary greatly. There is no uniformity of purpose or of method. Although this device is given recognition here, it is necessary to direct attention to certain obvious drawbacks in it, from the standpoint of its use for purposes of local tax reduction:

First, the grant system necessarily recognizes all of the existing governmental units of the class aided, whether counties, municipalities or school districts. While the distribution may be so conditioned as not to give money to some particular units, the tendency is to aid the weaker ones, and thus to perpetuate their existence. The high cost of operating small weak units is now generally recognized. A subsidy therefore may tend to prevent the elimination of weak units through consolidation or local reorganization.

Second, any fixed formula for determining the local shares of a grant is likely to fall far short of an apportionment according to need, and so to give rise to gross inequalities of local taxation. Numerous instances are available of the inequitable operation of systems of grants under fixed or statutory formulae. Such results are almost unavoidable.

Third, an equitable distribution can only be achieved if the apportionment is made by a state administrative authority having discretion over the amounts. If this discretion is based upon the results of a careful survey of the service to be aided or supported, this device becomes similar to the second alternative, except that no freedom would exist to select or to establish suitable local agencies.

In view of these considerations, the system of grants must be regarded, despite its present extensive use, as a less satisfactory method of applying new revenues to secure tax reduction than other methods which involve or which will permit greater freedom and flexibility in the correction of the serious administrative defects of the local governmental structure.

**6. The Partial or Complete Exemption of Improvements.** Partial or complete exemption of all improvements, or of specified types of improvements, have been granted from time to time, the purpose being to bring about certain shifts in the distribution of the property tax burden which were deemed socially desirable. The committee has already expressed in another section of this report its general conclusion that special exemptions to home owners, or even to buildings and improvements as distinguished from land, are inadvisable. Because of the keen interest in many quarters in the effects of the experiments which have been made or are in progress, the committee has, nevertheless, felt impelled to present material on a selected group of these experiments which it considers typical.

(a) *The Limited Exemption of New Dwellings from Property Taxes in New York City.* In common with a number of other cities, New York City suffered from an acute shortage of housing following the end of the World War—a shortage attributable in part to the temporary cessation of nonessential building operations while the war was in progress; in part also to the uncertainties introduced into the building field by the marked upward shift in the price levels of labor and materials, and the lack of rents in adjusting themselves to those levels. The situation can best be illustrated by a concrete case. Prior to the war, one standard type of single-family house had cost about \$5,000 to erect. Shortly after the end of the war, bids on identically the same plans and specifications ranged between \$9,000 and \$10,000. Conservative bankers who had become accustomed to lending one-half or two-thirds of the pre-war costs of construction, were hesitant about advancing a similar percentage of post-war costs. As a result, only two classes of builders found it possible to operate: Those with independent capital of their own sufficient to make up the difference; and those who were willing to pay the ruinous rates demanded for the added sums needed in the form of junior financing. The situation led to a deadlock, in which the volume of new residential construction was hardly sufficient to keep pace with increasing population.

In this emergency, the legislature of the state added a new section to the tax law, which permitted any city in the state to exempt from taxes all new one- and two-family residences, and multi-family dwellings, begun within a stipulated period, such exemption to expire in 1932, and to be limited in the case of multi-family dwellings, to a maximum amount per apartment.<sup>4</sup> New York City was the only municipality in the state which made use of this act.

While it is probable that the measure was a factor in breaking the deadlock in building, it is difficult to measure the exact extent of its influence in this direction. Certainly, the savings in taxes for a period of years gave the new buildings an advantage over existing buildings, which increased the safety of investments in the second mortgages on them. If this be conceded, however, it follows that little, if any, of the advantage of tax exemption was

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<sup>4</sup> Chap. 949, N. Y. Laws of 1920; as amended by Chap. 281, Laws of 1922, and Chap. 337, Laws of 1923.

passed on to the purchaser or to the tenant. Furthermore, the rapid adjustment of general conditions to the new price levels proved sufficient to break the building deadlock in other parts of the New York metropolitan district without resort to this form of tax exemption.

Certain weaknesses inherent in this type of exemption deserve comment. Because the special favors were conferred on all new dwellings regardless of the character of the buildings themselves, the building movement stimulated by the law concentrated largely in those sections of the city where building regulations were most lax. As a result, a considerable percentage of the new housing was of very low quality. In other words, the grant of special favors without the exaction of an adequate *quid pro quo*, had unfortunate by-products. Considered as an emergency measure designed to meet a critical situation, the law under consideration probably served a useful purpose, although this is debatable in view of the paucity of evidence. In the absence of a critical shortage of housing, nothing can be said for such an exemption.

(b) *The Limited Exemption of Housing Provided by Certain Types of Limited Dividend Companies in New York City.* In a more recent law providing for the exemption of new housing the *quid pro quo* is written directly into the act.<sup>5</sup> Any city in the state is authorized to extend exemption to new housing provided by such limited dividend companies as agree to erect their buildings on plans approved by the state, and to limit their rentals to the maximum amounts per room stipulated. In short, this law is designed not only to enforce definite standards of construction in every detail, in return for the tax exemption, but also, to insure that the tax exemption is passed on to the tenants in the form of reduced rentals.

Altogether, the measure constitutes a bold frontal attack on the entire complex of problems involved in the provision of adequate housing in congested urban centers. In this attack, tax exemption is only one of the implements made available. The companies which subject themselves to the provisions of the law also have power to resort to condemnation for the purpose of consolidating the plots necessary for their purpose.

Up to the present, New York City alone has taken action to

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<sup>5</sup> Chap. 283, N. Y. Laws of 1926, as amended in 1927, 1928, 1930, and 1931.

grant exemptions under the act. Seven projects have been completed; more are under way. Applications for others are held in abeyance, pending the outcome of an attack on the constitutionality of the law. None of the companies has yet seen its way clear to invoke the powers of condemnation, because of obvious defects in the general law and procedure of condemnation.

Although the experience under the law in New York City is too new to warrant the committee in altering its opinion as to the advisability of exemptions in general, it feels that the progress of the experiment deserves close attention.

(c) *The Pittsburgh Graded Tax Plan.* The Pittsburgh graded tax plan has been in full operation only since 1925. Over a ten year period, beginning in 1915, the rates on buildings were gradually decreased until in 1925 the millage on buildings had been reduced to one-half of that on land. This is the limit prescribed by the law. This period is too short to demonstrate the fullest possibilities one way or the other. The results of thus taxing buildings in Pittsburgh will be different from those in other cities because of the fact that practically all revenue for city purposes is derived from the levies on real estate, including buildings. In other words, personal property is not taxed for city purposes. Moreover, it must be remembered that for school and county purposes the graded tax does not apply.

It is difficult to ascertain to what extent the lower rates on buildings have stimulated construction in Pittsburgh. There has been since the full operation of the law a greatly increased building program, though it is checked somewhat now. The same thing, however, can be said of many other cities. It would be unwarranted to attribute the increase in new buildings to the workings of the tax system. Especially is this true when we observe that there was at the same time pronounced building activity in the suburban districts and neighboring towns and boroughs where the lower rates do not apply.

In the opinion of the committee, the results hoped for by the proponents of the plan have not been achieved due to the fact that the ratio between assessed building values and land values has been so strikingly changed. Thus in 1914, building values were 60 per cent of assessed land values, in 1929 they had increased to 97 per cent, and at the present time the total value of buildings probably exceeds that of land. Obviously, if an equitable



assessment had been in existence when the plan was put into operation, the rates in the intervening years would have been quite different, and possibly the effects of the experiment would have been more pronounced.

The committee is not prepared to recommend the general adoption of the graded tax plan. It believes that the plan is calculated to bring some relief to the small home owner, but that it is also likely to increase the burden on others who, under present economic conditions, neither deserve nor are specially able to bear such increase.

(d) *The Exemption of Improvements in Western Canada.* The most extensive experiments with the exemption of buildings and improvements have been made in the provinces and cities of western Canada. As early as 1891, British Columbia authorized its municipalities to assess improvements at a lower rate than land for purposes of municipal taxation. Within a few years the movement to exempt improvements spread to other western provinces. It reached a peak about 1913, when it was checked by a severe business depression, and tax delinquency grew to such proportions that it seemed probable that the experiment with exemptions of improvements would have to be abandoned.

"In the City of Edmonton arrears outstanding increased from \$2,360,000 in 1914 to \$6,775,760 in 1918, and the tax rate rose from 17.5 mills to 30 mills per dollar of assessed valuation. Calgary showed an increase in tax arrears from \$527,544 in 1913 to \$4,539,718 in 1918, probably caused in part by the decrease in population from more than ninety thousand in 1914 to seventy thousand in 1918. Vancouver arrears grew to more than five million dollars as population and assessed values decreased. In Victoria the assessed value had fallen by 1918 to 50 per cent of the 1914 value and arrears increased from about two hundred and fifty thousand dollars to nearly three and one-half millions of dollars. In Victoria tax arrears in 1918 amounted to nearly three times the tax levy for that year. The difficulties were general throughout British Columbia. Mr. R. Baird, Inspector of Municipalities, reported that in 1917 the municipalities of the province collected a revenue of \$10,700,000, out of which they had to set aside more than \$9,000,000 to meet 'uncontrollable' expenditures such as sinking funds and bond interest, which left about a million and a half for ordinary expenses. The situation in Winnipeg was never as serious as in the far-western cities. Winnipeg has taxed buildings and improvements at 66  $\frac{2}{3}$  per cent of their full value throughout the period. Even so, the depression left Winnipeg with relatively high tax arrears, and there was agitation for a still broader tax base."

The fiscal difficulties caused by depression led to a general re-

duction of the exemptions theretofore granted. However, the experiment has never been abandoned, and it appears that the people of western Canada still believe in partial exemption. In all the districts where partial exemption has been tried "improvements are still given at least a  $33\frac{1}{3}$  per cent differential in western Canada."

The above quotations are taken from a careful and impartial account of the Canadian experiments by Prof. Mabel Newcomer and Dr. Ruth G. Hutchinson of Vassar College (see Appendix VI, following). Their conclusions about the entire movement are well expressed in the closing paragraph of their report:

"It is significant that under the more static economic conditions prevailing in the eastern provinces, exemption of improvements from taxation has never gained any real foothold. Nevertheless the experiment being carried on in western Canada has successfully passed through an extremely critical period. Tax arrears are being steadily reduced. The result has been achieved by a compromise, and the improvements once wholly or almost wholly exempt are now assessed at a higher percentage of their full value. Also the real estate tax has been more generally supported by business and income taxes. It is apparent, however, that if the amount of the exemption is flexible and if, further, too much dependence is not placed on the one tax, a limited exemption of improvements is feasible and possibly useful in achieving certain social ends."

Concerning the social effects of this Canadian legislation the evidence is conflicting. It is probable, in the opinion of the committee, that it has had no important social effects, particularly upon housing and home ownership. From the fiscal standpoint, in the opinion of the committee, its most important lesson is contained in Prof. R. M. Haig's findings applicable to the cities of Saskatchewan.

" . . . Such data as are available tend to show that land values form the least stable portion of the tax bases, and that those cities which have depended upon land most heavily are those which have had the greatest difficulty in collecting taxes. Taking, for example, the cities of Saskatchewan, it is found that the order in which they stand with regard to success in making collections promptly is almost exactly the reverse of the order in which they stand in regard to their dependence upon land as a source of revenue."<sup>6</sup>

Beyond the conclusion quoted from Professor Haig above, in the opinion of the committee, the Canadian experiments convey no

<sup>6</sup> R. M. Haig, "Limited Single Tax," *National Tax Association Proceedings*, November, 1917, p. 377.

lesson of importance for city communities in the well-developed states of this country. In the provinces of western Canada, the exemption of improvements came largely as part of a speculative movement in real estate, and when that speculative movement broke the exemptions proved embarrassing. But the fiscal difficulties which followed were probably due more to speculative reverses than to the exemption of improvements. Certainly, many cities in the United States which have never experimented with the exemption of improvements are now in similar fiscal difficulties as the result of the collapse of land booms. The proposal to exempt improvements in American cities must still be decided on grounds of general experience and abstract analysis. The experiments which have been made with exemption furnish no convincing reason either for or against the proposal.

**7. Special Assessments for Local Improvements.** The plan of levying special assessments on properties deemed benefited by a public improvement in order to obtain the funds for meeting the cost of that improvement, like the other plans already discussed in this section, reduces the general tax burden on property by shifting a part of that burden to specific types of property. The plan of benefit assessment seems to have been employed not only in England, where the legal basis for the present American procedure was laid, but also in Japan and in India, as the only means of financing needed public works the magnitude of which exceeded the limited financial capacity of the organized central and local governments. Cooperative associations of property owners were therefore formed who agreed to bear the cost in more or less accurate proportion to the amounts of land which the several parties to the agreement owned within the area affected by the improvement. Except for the more highly involved procedure necessary for its organization, the modern special assessment district still bears a close resemblance in many parts of the country to its ancient prototypes. In this fact, both its strength and its weakness have their source.

If true to the traditional form of the district, its finances are entirely divorced from those of the municipality as a whole—a condition which prevails in those sections of the country where narrow tax and debt limits, coupled with the needs for a great volume of improvements generated by a real or hoped for increase in population, make adherence to that form inescapable—

the orderly planning of improvements and of the means of financing them became impossible. Not one but many types of improvements are essential to fit a piece of land for urban utilization; not one but many pieces of land must be equipped with the particular types of improvements which each piece needs, in order to fit it for that one of the many varieties of urban uses for which it is best adapted. The proper coordination of these improvements in one comprehensive physical plan becomes impossible with the detached type of district; the costs of financing, because of the risks, are increased through discounts on bond prices and high interest rates. When these high costs for a succession of uncoordinated improvements are all piled on one area, they frequently become confiscatory.

If, on the other hand, the finances of the district are coordinated with those of the municipality as a whole, a new set of dangers must be faced. The immediate costs of financing, it is true, are reduced; and certain obstacles to comprehensive planning are removed. If, however, the city fails to take advantage of the opportunity for the sound physical planning of its improvements; or if, under the stimulus of speculative optimism, the plan formulated is too elaborate for its needs, the result may be that the general taxpayers will be called on to foot the bill. That is the situation today in city after city, and in state after state. Owners of land are in default for the special assessments levied against their holdings; the city finds the vacant lands affected by the liens unsalable for the amount of the liens, or for any amount; the pledge of full faith and credit which is the price the city paid for its power of coordinated financial and physical planning comes into play; and the general taxpayer is called on to support and retire bonds issued for public improvements which are of no benefit to him whatsoever, and which, so far as one can judge from present indices, may never be of any benefit to anyone.

That special assessments have proven a highly useful means of financing public improvements over large areas of the country, and during long periods, there is little reason to doubt. The question remains whether the faults which both the coordinated and the independent types of districts have evinced of late can be corrected. Facts gleaned from the experience of a number of cities convince the committee that an affirmative answer to that question can safely be made. The proposals for safeguarding the

use of special assessments which it deems desirable, together with the reasons for the proposals, are briefly summarized in the paragraphs which follow.

The manifest advantages of coordinated financial and physical planning make it desirable that the special assessment district be considered simply an administrative unit of the city itself, and that the securities issued for financing the work be supported by the full faith and credit of the city. Partly as a means of inducing careful planning, partly also in order to minimize the dangers of failure to plan or of grandiose plans, the special assessment debt should be subjected to a limit outside, and in addition to, the limit for general debt. Precedents for this suggestion may be found in the special limits outside the general limits which have been established in some states for certain types of self supporting municipal utilities.

Because the traditional bases of area or frontage are not, alone, reliable indices to the probable benefits which can be expected to flow to urban lands as a result of public improvements, their use should be abandoned; and assessments should be apportioned by methods patterned closely after those which are in use in many parts of the country for the valuation of land for general taxes. Existing full value, and the capacity for enhancement in value alike, are affected by the same variables—frontage, depth, shape, size, position with reference to cross or parallel streets and alleys, and topography. Several cities have demonstrated the desirability of apportioning benefits by this method.

The same principle, in somewhat modified form, is in use in several cities for apportioning levies for the costs of major improvements which are deemed to confer special benefits, in excess of the general benefits, on extensive areas. Under this plan the successive annual amounts required for the support and retirement of the debt incurred for a specific improvement are levied on the values at which the lands within the benefit area, exclusive of improvements, are carried on the rolls for general taxes. The use of this plan obviates the necessity for estimating in advance the enhancements attributable to the improvement in question—a task which is frequently beyond the powers of any human not gifted with powers of prophecy. As shifts in value occur during the life of the bonds, the relative burdens on the individual properties included in the area shift correspondingly.

Public hearings on special assessment projects have in many parts of the country become little more than a means of perfunctory compliance with constitutional requirements. Neither the property owner nor the city officials have in their possession all of the facts necessary for a reasoned opinion as to the desirability of proceeding with the project. The correction of this situation will provide added safeguards against the abuse of special assessments. Information should be compiled in advance of hearing on every factor which has a bearing on the probable benefits which will accrue, and on the capacity of the individual owners within the district to pay—information on existing land values and improvement values; on outstanding assessments for earlier improvements; on probable assessments for other future improvements which are also parts of the comprehensive plan; and on existing delinquencies for general taxes or special assessments. Only with such facts in his possession can anyone know whether the improvement should be made at once, whether it should be deferred to a later time, whether the physical plan should be modified, or whether the entire project should be abandoned.

Finally, the common practice of improving new subdivisions by the use of public funds should be, if not entirely abandoned, then at least severely restricted. The improvement of subdivisions by the owner, at his own expense, on city plans and specifications, and subject to city inspection, has in some cities been made a prerequisite to the recording of a subdivision plan. The plan has entirely eliminated the losses due to delinquencies in such areas, losses which have assumed disastrous proportions in many cities, and has at the same time preserved intact the full measure of the city's police power over land uses. If cities generally had adopted the policy ten years ago of refusing to extend public credit to private speculators, that step alone would have gone far to prevent much of the harm which has been done by loose, special assessment financing, and by the premature subdivision and improvement of suburban areas.

#### IV. THE REDUCTION OF PUBLIC EXPENDITURES

The foregoing sections of the report have emphasized a number of remedies which have been used, and are available, for ameliorating the plight of harassed owners of real estate. Varying widely from one another in method, those remedies have one character-

istic in common. They all aim at relieving certain taxpayers by shifting a part of their burdens to others. We come now to a more fundamental question: Can taxpayers as a whole be relieved by reducing the aggregate of public expenditures?

Most citizens have come to doubt that the costs of government can ever again be reduced. For more than a generation, they have seen that the trend of state and local expenditures, whether measured in aggregate or in amounts per capita, has been steadily upward, every decade having shown a steeper upswing than its predecessors. The same period, however, was characterized also by advancing wage scales, by increasing commodity costs, by growth in wealth and income, and by increased standards of living. Invention after invention imposed new demands on governments. Not public officials alone, but also the private citizens in their dual roles of workers and taxpayers, developed a state of mind in which the concept of never-ending progress and expansion was basic. As long as such conditions continued, there was slight probability that increases in aggregate expenditures for public purposes could be checked.

Whatever the long time historic trends in governmental spending may be, it is nevertheless possible to find in our own not too distant history examples which indicate that retardations and even reversals in trends are possible. While detailed studies are not available, some published material exists which indicates that the aggregate indebtedness both of states and of counties declined between 1870 and 1890; that aggregate state taxes declined, at least in the State of New York, during the same period; and that, in spite of the rapid increase in population in that period, aggregate local taxes in the same state increased but slightly during those two decades, in sharp contrast to the marked increases in the preceding and subsequent periods.<sup>7</sup>

Then, as now, a costly war followed by a period of post-war expansion led to depression; then, as now, general economic trends reversed themselves. If, therefore, state and local expenditures showed a tendency to adjust themselves to changed conditions in the earlier period, there is ample warrant for the belief that reduc-

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<sup>7</sup> Special Joint Committee on Taxation and Retrenchment (New York), *State Expenditures, Tax Burden and Wealth*, N. Y. Leg., Dec., 1926, No. 68; p. 93 ff; Studensky, *Public Borrowing, National Municipal League*, 1930; pp. 13 and 14. *Report of New York State Tax Commission*, 1929, p. 101.

tions in public spending are not beyond the bounds of possibility under existing circumstances.

This must not, however, be interpreted as meaning that the situation may be left to take care of itself. The reductions in governmental indebtedness which constitute the outstanding characteristic of the period following 1870 were the direct result of a changed attitude on the part of the people themselves, written into state constitution and statutes. In other words, what the people had learned by bitter experience concerning the shortcomings of their governmental procedure they applied to the correction of those shortcomings. Similar steps are prerequisites to progress in the face of the existing situation. Because the structure of our local government today is more complex, because the burdens imposed on government have become more numerous, and because the interrelations between local and superior governments have become more intricate, the remedies to be applied are not simple. Fortunately, a mass of information based on experience, and built up by patient study, is available for our guidance. Certain obstacles which stand in the way of accomplishment, and certain avenues through which accomplishment is possible, have been charted. They will be indicated in the pages which follow.

### **1. Obstacles Which Stand in the Way of Accomplishment.**

There are, however, certain obstacles which stand in the way of a general and sweeping reduction in aggregate expenditures, and which must be taken into account in any intelligent plan for the application of the remedy. Some of these arise out of the purposes for which expenditures are made, and are not immediately superable under any conditions. Others grow out of the fact that law, tradition and public opinion have imposed certain obligations on local governments for the care of those who are incapable of helping themselves. The costs of discharging those obligations vary with the business cycle, being greatest in the trough of a depression at the very time when the demand for the reduction of expenditures is the most insistent. Still others grow out of the rigidity of the structure and the procedures of local government itself, whether considered from the standpoint of a given local unit or from that of all of the overlapping units which discharge governmental functions within a given area. Granted the best of intentions and the highest ability on the part of local officials, these



obstacles alone make substantial reductions in aggregate expenditures difficult.

(a) *Some Items of Expenditures Not Susceptible of Immediate Reduction.* Examples of the first group of obstacles are so obvious as hardly to require statement. Because, however, a naive method of reducing governmental costs is widely advocated—that of slashing every item in the budget by a fixed percentage—illustrations will be cited to indicate the impracticability of that plan. If one could imagine a municipality in which the citizens enforced on their officials the immediate cessation of all governmental services, the entire municipal tax burden would not at once disappear. In the first place, interest and retirement charges on the outstanding debt would still have to be met. In other words, one substantial item which occurs with almost no exceptions in every municipal budget in the country is not susceptible of reduction except as the debt itself is reduced, either by repudiation or else by the payment of taxes levied for the purpose.

In the second place, the saving in taxes due to a complete abolition of current services would not represent a net gain to the taxpayers. Under conditions of urban life, expenditures for certain purposes, either by the individual citizens or by the organized group as a whole, become inescapable if discomfort, increased costs of doing business, and high morbidity and mortality rates are to be avoided. The removal of household wastes, the maintenance of avenues of transportation and communication, and the protection of property against fire are among the more obvious of the many municipal services in this group. To the extent that services of this type are administered with reasonable economy and efficiency by the public authorities, no saving in taxes for their support is possible which will not be more than offset by increased costs falling directly on the individual citizen. Any program for tax relief through the reduction of expenditures must therefore take these factors into account: That certain items in the budget cannot be reduced immediately by any means short of repudiation; that others can be reduced only within narrow limits, if at all, without creating conditions that will more than counterbalance the advantages to be gained by tax reduction.

(b) *Some Items of Expenditures Tend to Increase in Times of Depression.* We come now to the second group of obstacles cited above. The widespread demand for increased expenditures

for public works as a means of relieving unemployment has had its effect on all categories of governmental agencies. The increased debt already incurred, and still to be incurred, for that purpose must inevitably increase current taxes for the reasons already cited. In addition, the demands for increased services in the general fields of health and welfare—municipal lodging houses, employment bureaus, the hospitalization of the indigent sick, and other forms of direct aid for the amelioration of individual distress—make increases in the corresponding budgetary items almost unavoidable during periods such as the present.

Because, however, it is essential that aggregate tax burdens be reduced, the facts that certain items in budgets cannot be reduced, and that others must tend to increase at least during the immediate future, make it all the more necessary to survey the possibilities of reduction in other directions. The obstacles of the third group stand in the way of progress here. Some of them can be removed by municipal officials themselves; others only by the combined efforts of municipal officials and state legislatures. Both types will be removed, however, only if and when the citizens themselves understand the nature of those obstacles and insist on workable plans for their removal. The pages which follow endeavor to outline those plans in so far as they have been proved in practice, or accepted by competent students in the field as being practicable.

(c) *Municipal Powers Are Limited by State Law.* Contrary to the prevalent opinion, municipal officials are rarely vested with discretion to decide how much they shall provide for each of the various activities which they are nominally responsible for administering. Instances may be cited of state constitutions which embody provisions establishing the salary rates of certain municipal employees. In state after state, statutes exist which compel the levy of minimum mill rates for the support of specified municipal activities. Mandatory requirements for the use by cities of outmoded procedures survive in many state codes. General and special acts, and charter provisions which can frequently be repealed only with the consent of the state legislature, hamper and restrict local freedom of action in administrative reorganization and in the formulation of adequate personnel policies. In extreme cases, the picture is one of state supervision of municipal affairs in a most planless and inflexible form. This system has had

untoward effects. The difficulty of concrete accomplishment for the public weal under such conditions has made municipal office unattractive to large numbers of the very citizens who would have proved most capable of such accomplishment—a fact which cannot be overlooked in any diagnosis of the conditions which afflict not only our most flagrantly misgoverned cities but also those cities which are merely ineptly governed.

**2. Substantial Reductions by Cities Possible Despite Obstacles.** There are, however, notable exceptions which prove that substantial economies in municipal government are possible even under present conditions in a number of states. Where the citizens themselves have had the right to adopt simplified charters for their cities and have availed themselves of that right in order to centralize responsibility for municipal activities, the reduction of deficits accumulated during an earlier period of mismanagement has, in a number of instances, gone hand in hand with a reduction in the costs of current operation and maintenance, and with increased standards of service. The most notable examples of this possibility have occurred among the smaller cities, but instances are by no means lacking among the larger municipalities. It is to be noted, however, that once those cities had proved to the satisfaction of their citizens that they were capable of efficient administration, demand for more services again led to increasing costs. Because of the inevitable lag in the compilation of statistics, complete figures for the activities of those cities since the end of the period of worldwide expansion in 1929 are not available. Preliminary estimates for forthcoming budgets indicate, however, that some at least of those cities are proving capable not only of economies by the elimination of waste but also of further economies by prudent retrenchment during the depression.

(a) *Means Available for Reducing Expenditures by Local Action.* In many cities which have maintained their form of government intact for some time past, activities can be found which have outlived their usefulness. Provision is made for them in this year's budget because they were carried in that for last year. The responsibility for other activities is split apart and placed in separate departments, frequently under separate heads who are independent of the nominal head of the city government. The result is duplication of effort and expense, confusion where there should

be order, conflicting policies where there should be unified effort. Serious as these conditions are in their effects on costs of current operation, they are little short of disastrous when capital improvements are involved.

Subject to limitations imposed by statute or constitution, most cities in this country have power to correct situations such as these. Charter revision; administrative reorganization; the unification of related functions in single departments under competent heads; the installation of budget systems with work programs, allotments and centralized financial control; centralized purchasing; and long-term capital improvement programs coordinated with the current budgets and, where possible, with similar programs for overlapping or coterminous units—these are the means within reach of citizens everywhere which have proved their efficacy in the elimination of useless expenditures, and which can be applied within reasonable time to meet the present situation.

**3. Further Reductions Possible by Closer Coordination of Units.** But, even when all of these things shall have been done as completely as existing laws permit and as the citizens desire, large opportunities for the reduction of taxes will remain, in which state legislatures first, and state administrative agencies second, must cooperate. The anomalous inclusion in constitutions and statutes of provisions which should be left to city charters and ordinances, cited above, is only one of the matters which require action. The same diffusion and dispersion of functions which has been pointed out as existing between city departments exists also among overlapping units of government. States, counties, special districts, cities, towns, and villages maintain police forces, build highways, supervise building construction, administer safety codes in industrial fields, maintain charitable and penal institutions, and perform a wide range of other duties. Among these several related departments of the overlapping units, as well as among those of adjoining units of the same class, there is the same duplication of effort, the same conflict, and the same lack of unified plans which have already been pointed out as existing among departments in loosely organized cities. That these conditions are responsible for waste in the costs of operation and maintenance, and even greater wastes in the design and construction of improvements, hardly needs argument.

(a) *State Supervision over Local Finance.* If municipalities financed their operations exclusively from current taxation, and if all voters were also direct taxpayers, there would be little justification for state supervision over municipal finance. All of the parties directly concerned in the scale of municipal expenditure, both as taxpayer and as beneficiaries, would be fairly represented; and their own self-interest would insure effective control. Such conditions, however, never exist. When a city issues bonds, the interests of two important groups who have no representation at the polls are immediately involved—the bondholders, and the taxpayers of the future. When a municipal electorate is composed largely of voters who do not pay taxes directly, a distinct conflict in interest at once develops between the minority who pay directly for the support of government and the majority who share the burdens in a diffused and indirect manner. Under conditions of undue optimism as to future needs, or as the result of unwise political leadership, situations may arise which will lead inevitably to future injustice to groups who are not in position to defend themselves at the time when the foundation for the injustice is laid. For these reasons, state supervision over local finance has come into being in a number of states. The successes and failures of those states indicate rather clearly what can be done, the methods that can be employed, and the new fields in which extension is advisable.

In the supervision over the issuance of new bonds for general purposes, and in the enforcement of mandatory requirements for contributions to sinking funds, the states have met with the greatest measure of success. Because too many types of special bonds had been excluded from the provisions of the statutes, and because also the basic statutes were weakened in many states by unwise amendment, there have been conspicuous examples of failure. The failures themselves point clearly, on the other hand, to the necessity for extending the supervision over all types of securities issued by the municipalities. So much for the desirability of state supervision over municipal bonding policies as a means of protecting the interests of bondholders and future taxpayers.

Attempts to protect the interests of a minority of direct taxpayers against unwise policies supported by the majority take a variety of forms: The establishment of maximum limits for tax

rates, the review on appeal of the assessed valuations to which the rates are to be applied, and the review on appeal of the budgets adopted. Up to the present, limitations on tax rates—at least when they have been set at unduly low points—have frequently defeated their own purpose, because it has been difficult to install accounting budget and tax collection systems which would not permit resort to deficiency financing for current purposes. The review of assessments on appeal to a state agency is widely used, and its basic justice is of course manifest. The review of local budgets on appeal to the state has been less widely used. While the principle is sound, the technique for its application has not yet been highly developed. The task of reviewing the voluminous and intricate mass of material which supports an adequate municipal budget is no slight one; reliable standards by which to determine that this or that item is too high are practically nonexistent. Fortunately, intensive studies of the costs of specific municipal services under varying conditions are under way.<sup>8</sup> As this work progresses, the foundation for adequate review of local budgets by state officials will be laid.

As means toward the establishment of effective supervision and control over the phases of municipal finance in which such control is desirable, a number of states have been measurably successful in bringing about the installation of adequate accounting and budget systems, and in enforcing the requirements for independent audit. Because no supervision worthy of the name is possible without these instruments, it goes without saying that the work of the states along these lines should not only be continued but also expanded.

(b) *The Elimination of Superfluous Units.* A century ago, there were in some parts of the nation only two layers of government in the rural areas—the state and the county. A third layer—the city—was added in urban areas, but there was little room for overlapping in the simple functions assigned to the two or three layers. In other sections, there were uniformly three layers, but the intermediate layer—the county—was in effect a state administrative district manned by locally elected officials for the discharge of certain ministerial duties of the state. The subordinate entities

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<sup>8</sup> Of the work of The National Committee on Municipal Standards, and its various cooperating and subcommittees.

exercised their powers within definite boundaries. Throughout the greater part of the country, those boundaries survive today, firmly embedded in constitution, tax laws, debt limit laws, election laws, and home rule laws; in political exigencies generated by partisan struggles for the balance of power; in tradition and local pride.

Meanwhile the conditions to which they were adapted have passed away. New conditions to which they are not adapted have come about. Some of the old units have declined in population and in wealth; others have grown and spilled out over their own boundaries into adjoining areas. Problems of water supply, sanitation, transportation, the provision of open spaces, control over land utilization, have multiplied the functions not alone of the local political units but of groups of such units which have been welded into economic units. Ad hoc bodies have come into being to meet the situation, some temporary in their nature, some with all the characteristics of permanence. Ill-advised and poorly drafted state laws imposing limitations on local tax rates and on borrowing capacity have stimulated the creation of new units for the chief purpose of evading those laws. In many parts of the country, three layers of local government below the county have become commonplaces; five and six layers with the characteristics of permanence are not unknown; indefinite numbers of more temporary layers exist. Furthermore, added layers have also been interposed in some areas between the county and the state. When one considers that these layers have taxing and bonding powers within the same areas, that they are in most instances quite uncoordinated with one another, and that there is not always a clear-cut line between their functions, it is not surprising that aggregate local tax burdens within the areas of overlap should be out of proportion to the value of the services rendered.

There is little in the way of experience to which one can point in order to illustrate the precise means of correcting the situation. Undoubtedly, the tested principles of organization and administration which have been pointed out above as being available to existing units of local government will be applicable also in the reorganization of the overlapping units. Certain added factors will, however, have to be taken into account. Intensive studies carried on in some states, more general studies in others, have led

to the development of certain conclusions on which there is substantial agreement among those whose experience qualifies them to pass judgment. The committee ventures to state them tentatively as follows:

1. Superfluous units of local government should be disorganized.

2. As nearly as may be, political units corresponding with economic regions should be established. Where sheer size or other factors militate against the achievement of this end, regional units with definite responsibilities for functions which are clearly regional in their nature must be superimposed on the smaller units of which the region is composed.

3. Wherever possible, there should be only one, or at most two, layers of local government below the state in any area, the units composing those layers to be organized with clear-cut lines of authority and responsibility for their several functions, and coordinated where their taxing powers or service functions overlap.

4. Governmental functions should be reallocated between the state and the subordinate layer or layers of government in the light of modern conditions; and where the dispersion of functions is inescapable, there should be not only coordination between the overlapping units but also definite responsibility for supervision on the part of the superior unit.

The preceding analysis makes it clear that the effective check or control of public expenditure represents a task of great difficulty and magnitude. It cannot be accomplished by discussion or by sporadic organization. To achieve the desired end, it is probable that the taxpayers of each state will find it necessary to organize permanent associations, guided by leaders of broad views and assisted by experts who give their entire time to the work of reducing the costs and increasing the efficiency of particular divisions of government. A few taxpayers' associations of this type are now in operation in this country, with salutary results both for the general public and the taxpayers concerned.

The seemingly resistless advance of public expenditures in the past creates grave doubt in the minds of several members of the committee about the possibility of reducing public expenditures. In the opinion of these members, however, the difficulty or impossibility of reduction makes it the more necessary to exert every effort to check the growth of expenditures and improve the efficiency of government. If expenditures cannot be reduced, their rapid rate of increase can be reduced. Above all, in their opinion, it is possible and essential to secure from government more and better service for each tax dollar collected and spent.



## V. THE FEDERAL INCOME TAX, SPECIAL MORTGAGE TAXES AND OTHER SOURCES OF DOUBLE TAXATION AFFECTING HOMES

Many complaints are made concerning double or multiple taxation arising from taxes other than the property tax, which directly or indirectly affect real estate.

**1. Federal Income Tax.** The position of the committee regarding double or multiple taxation arising from the joint imposition of a property tax and an income tax has been suggested in the discussion of the property tax offset, Section III, 3, above. Double taxation of this kind does not call for correction. It is entirely proper that an individual should pay a reasonable tax on his property as such, imposed generally because of the benefits conferred by government, and in addition include the income from such property in his income subject to income tax. The latter tax is on his total net income; the rates are adjusted to ability to pay, and cannot properly be said to constitute an additional tax on property. A large income from real estate may be wiped out by losses and expenses connected with an entirely different department of the taxpayer's business.

The committee makes no recommendation with respect to the detailed treatment of income from real estate under the Federal income tax. In the past, this treatment has been open to grave question and objection. But the important grounds of objection were removed by the recognition in the Revenue Act of 1928 of deferred-payment sales of real estate on the instalment plan. There still remain some minor anomalies and inconsistencies affecting the home owner, but any grievance on their account is more than redressed by the permission granted to the home owner to deduct taxes on his home and interest paid on debts secured by his home, without the necessity of including an estimated rental as part of his income. In general, we find no substantial discrimination against home owners or real estate under the Federal income tax.

**2. Special Mortgage Taxes.** A few states impose special taxes in respect of mortgages, some of which are peculiarly objectionable because they are shifted directly to the mortgagor or debtor, who pays the property tax on the mortgaged property and

an additional tax on the mortgage itself. In the opinion of the committee these special taxes should be repealed and the mortgages taxed to the creditors or mortgagees as part of their intangible property as recommended in Section III, 2, above.

**3. Exemption for Limited Dividend Companies.** The committee does not recommend or endorse the exemption, under state or Federal income taxes, of the income of housing corporations of a semi-philanthropic nature, the dividends of which to shareholders are limited. Under existing methods of computing the income of real estate companies, it is practicable in general to defer recognition of earnings until such earnings have, in fact, accrued. The real estate company should then pay the income tax thereon. When these earnings are distributed to stockholders, in turn, we see no sufficient reason for their exemption in the hands of shareholders. Experiences with a similar exemption to investors in building and loan associations strengthen rather than weaken the position of the committee on this proposed exemption.

**4. Exemption of Buildings During Construction.** While the committee is opposed to special exemptions designed to stimulate building or home ownership, it heartily endorses the proposal to defer increased taxation upon new buildings and related improvements during the course of construction, at least for a limited period. The assessment of improvements during their construction is frequently difficult in practice and questionable in theory. Property is not taxable on its cost of construction, but upon its actual value. What is the value of an unfinished improvement? To defer new taxation for a reasonable period until the building is finished is not an exemption, but part of a wise procedure of assessment conducing to equal and efficient administration. To prevent abuses, it may be necessary to defer the increased tax for a period limited to two years after the building permit is issued.<sup>9,10</sup>

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<sup>9</sup> Mr. Nichols dissents from so much of the report as approves a tax on the income of real estate as one of the means of relieving the tax burden on real estate, and from so much of the report as approves a progressively graduated state income tax while a progressively graduated Federal income tax is also in force with respect to the same income.

<sup>10</sup> Mr. Fairchild writes that he was prevented by other pressing demands upon his time from taking any real part in the work of the committee and consequently feels that he is not entitled to credit or able to assume responsibility for this interesting report.

## APPENDIX I

### THE GENERAL PROPERTY TAX AS A REAL ESTATE TAX<sup>1</sup>

The majority of the problems of housing and home ownership for which taxation is responsible can be assigned to the effects of the general property tax. The purpose of this paper is to assemble facts pertinent to the effects of this tax upon real estate and home owners.

#### I. BURDEN UPON REAL ESTATE

**Importance of the General Property Tax.** The general property tax is now the heaviest tax imposed in the United States. Some idea of its burden may be gathered from the following statistics, applicable to American cities of over 30,000 population,<sup>2</sup> in which the problems of housing and home ownership are most acute. In 1928 the general property tax yielded 64 per cent of the total revenue receipts of these cities. Taxes, as usually considered, yielded 69.5 per cent of the total revenue, and the general property tax amounted to 92 per cent of the total taxes. The base for the general property tax was made up of 83 per cent of real property, 16 per cent of personal property, and 1 per cent of property that was not classified, which means that 53 per cent of the total revenue, or 72 per cent of the total taxes of these cities came from real property.

In 1910 the general property tax yielded 79 per cent of the total revenue of the cities then having a population of over 30,000, and real property represented 86 per cent of the general property tax base which placed 67 per cent of the total revenue burden upon real property. In 1918 the situation closely approximated that for 1928, with the general property tax yielding 67 per cent of the total revenue, and placing 52 per cent of the total revenue burden upon real property.

The 36 per cent of the revenue received by the above cities in

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<sup>1</sup> This paper was submitted by Mr. John E. Burton, Research Secretary to the Committee on Taxation, as an appendix to the committee's report.

<sup>2</sup> *Financial Statistics of Cities*, U. S. Bureau of the Census, 1928, 1918 and 1910.

1928 from other sources than the general property tax was so scattered among various sources that no one source yielded a large percentage of the total. Second to the yield of the general property tax were the earnings of public service enterprises, representing 9.6 per cent of the total revenue. Special assessments and special charges represented 8 per cent of the total revenue.

The *Financial Statistics of States* for the year 1928 show that taxes yielded 77.9 per cent of the revenue receipts of all the states, while the general property tax yielded 25 per cent of the taxes collected, or 19.7 per cent of the total revenue. Real property represented 77 per cent of the general property tax base, so that this form of property supplied approximately 15 per cent of the taxes levied, or 17 per cent of the total revenue received by the states.

In general, the burden of taxes levied for state purposes upon property in these cities is completely overshadowed by the burden of the taxes levied for local purposes. The average rate of the general property taxes levied against the assessments in these cities in 1928 amounted to 27 mills for the city governments, 2 mills for the state governments, 5.9 mills for the county governments, which in many cities is not included in the city levy, and 1.2 mills for certain miscellaneous governmental units, which in a few cities are not included in the city levy.

**Relative Amount of Land and Building Values in Property Tax Base.** In connection with a study of property taxes it is well to have some idea of the relative assessed values of land and buildings. It has been possible to collect data for this purpose from the tax commission reports of some twenty states. A summary of the findings is presented in Table I, which shows the percentage of the aggregate assessed value of buildings to the aggregate assessed value of all real estate. An effort has been made to segregate the data for cities and for that part of a state not within city limits. The total assessments for the cities include classes of real property that are reasonably uniform and homogeneous, while the different classes of real estate that are to be found outside of cities differ widely among the various states. This difference probably accounts in part for the large deviations shown in the figures for real estate outside of cities.

Table I. Percentage of Assessed Value of Buildings to the Total Assessed Value of Real Estate<sup>1</sup>

State	Year	Real estate outside of cities	Real estate in cities	Total
Arizona.....	1925	12.4	59.7	37.9
Colorado.....	1928	....	64.4	....
Idaho.....	1929	....	60.2	....
Kansas.....	1928	9.8	67.6	25.7
Kentucky.....	1928	....	68.0	....
Louisiana.....	1930	....	61.3	....
Maine.....	1930	....	....	62.6
Minnesota <sup>2</sup> .....	1928	17.3	65.1	38.4
Mississippi <sup>3</sup> .....	1928	22.8	63.2	42.3
Montana.....	1930	11.0	65.8	28.7
New Jersey.....	1929	....	....	59.2
New York <sup>4</sup> .....	1928	....	....	56.9
Ohio.....	1929	35.3	62.7	56.2
Rhode Island <sup>5</sup> .....	1928	....	....	68.4
South Carolina.....	1929	22.7	63.0	38.8
South Dakota.....	1929	6.5	65.7	15.0
Virginia.....	1928	....	58.2	....
Washington <sup>6</sup> .....	1928	24.3	50.7	42.4
Wisconsin.....	1927	26.0	67.0	48.8
Wyoming.....	1930	13.9	69.1	33.1

<sup>1</sup> Source: Tax Commission Reports of the respective states.

<sup>2</sup> Being the true and full value, and divided between platted and unplatted real estate.

<sup>3</sup> Real estate outside of cities being cultivatable lands.

<sup>4</sup> Distribution shown where found. \$3,567,298,204 undistributed.

<sup>5</sup> Being the tax assessed—shows proportion.

<sup>6</sup> Being only the improved land.

In general, it may be said that approximately 65 per cent of the value of real estate in cities is made up of building values. Applying this factor to the aggregate property tax burden indicates that buildings bear 34 per cent of the total revenue burden in cities of over 30,000 population, while land bears 19 per cent. With real property being levied upon for 72 per cent of the taxes levied by these cities, buildings carry something like 47 per cent of the tax burden imposed by city governments, leaving 25 per cent as the share of taxes borne by the land.

**Tax Rates.** Facts concerning the proportion of full value that is represented by the assessments are so scattered and fragmentary that it seems necessary to discard comparative real tax rates as a sound measure of relative tax burden among different forms of property, different classes of real estate, different localities, or

among different states.<sup>3</sup> However, before completely discarding the subject there are certain facts that are pertinent, even though not capable of generalization.

In 1910 the average rate of the general property taxes levied by the city governments of cities of over 30,000 population was 18.9 mills, in 1918 this rate had increased to an average of 20.2 mills, and in 1928 it had reached 27 mills on assessed valuation. In 1918 the state taxes imposed on property in these cities amounted to an average rate of 2.9 mills, which was reduced to 2 mills in 1928.

In Wisconsin the average general property full value tax rates had increased 44 per cent between 1913 and 1927 for the state as a whole, increasing from 14 mills to 20 mills. In the townships, the increase was from 11 mills to 16 mills, while in the cities and villages the average rate increased from 16.6 mills to 22 mills. In the City of Milwaukee the average rate increased 38 per cent, from 15.7 mills to 21.7 mills.<sup>4</sup>

In Oregon the rate of the general property tax imposed upon urban property increased from 23 mills in 1910 to 51 mills in 1928 on the basis of assessed value, which on a full cash value basis was an increase from 16 mills to 30 mills. On a sale value basis the rate was 14.7 mills in 1911 and 28.8 mills in 1928.<sup>5</sup>

In Arkansas the maximum rates of levy authorized by the constitution have increased steadily from 25 mills in 1874 to 46 mills in 1927. This rate is the total for the state, county and city governments and has usually been quickly approached except in the case of the state rate which has been an authorized maximum of 10 mills but has never exceeded 8.7 mills. There are no facts obtainable concerning the ratio of assessed value to full value which would permit the transfer of the above rates into real rates on full value.<sup>6</sup>

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<sup>3</sup> Two organizations undertake to estimate tax rates on real value for cities of over 30,000 population. They are the Federal Census Bureau and the Detroit Bureau of Governmental Research. The tax rates given by these two organizations are so variant that two entirely different conclusions can be arrived at by their use.

<sup>4</sup> Blough, J. Roy, *The Geographical Problem in Wisconsin Taxation*, Madison, Wisconsin Tax Commission, Bulletin 39, June, 1930, pp. 70-76.

<sup>5</sup> Dreesen, W. H., *Trends of Tax Levies in Oregon*, Corvallis, Agricultural Experiment Station, Oregon State Agricultural College, Bulletin 257, Nov., 1929, pp. 19-24.

<sup>6</sup> Brannen, C. O., *The Farm Tax Problem in Arkansas*, Fayetteville, Agricultural Experiment Station, University of Arkansas, Bulletin 223, Feb., 1928, p. 31.

In North Carolina a study was made of the relation of assessed to fair market value, and this relationship was then used to determine the tax rate on the basis of fair market value. In 1927 the average rate based on the sample studied was 15 mills. The average for small cities was 18 mills, for medium sized cities 17.6 mills, and for large cities 13.5 mills.<sup>7</sup>

**Percentage of Rental Income Taken in Taxes.** A rough measure of the severity of the general property tax is found in the proportion of rental income (before taxes) taken by the general property tax. Whitney Coombs summarizes the results of studies in nine states for selected years: Arkansas, 1923-1925, 17.1 per cent; Colorado, 1926, 27.1 per cent; Indiana, 1922-1923, 30.6

**Table II. Percentage of Net Rent Before Taxes Taken by the General Property Tax**

State	Business properties	Residential properties
Colorado (cities) <sup>1</sup>		
Colorado Springs.....	29.3	31.2
Delta.....	42.4	....
Fort Collins.....	22.6	30.3
Grand Junction.....	30.3	32.8
Monte Vista.....	23.0	29.1
Montrose.....	24.7	41.0
Rocky Ford.....	39.5	52.0
Average.....	27.4	34.3
Iowa (sections) <sup>2</sup>		
East.....	29.7	32.4
Central.....	29.9	41.8
West.....	35.8	26.5
Average.....	31.5	29.9
Pennsylvania (counties) <sup>3</sup>		
Lebanon.....	20	15
Lancaster.....	14	13
Westmoreland.....	....	....
Greensburg Section.....	22	....
New Kensington Section.....	19	15

<sup>1</sup> Coombs, Whitney, Moorhouse, L. A., and Seeley, Burton D., *Some Colorado Tax Problems*, Fort Collins, Colorado Experiment Station, Colorado Agricultural College, Bulletin 346, Sept., 1928, p. 19.

<sup>2</sup> Brindley, John, and Zorbaugh, Grace, *The Tax System of Iowa*, Ames, Iowa State College of Agriculture and Mechanic Arts, Extension Bulletin 150, Jan., 1929, p. 69.

<sup>3</sup> Weaver, F. P., *Rural Tax Problem in Pennsylvania*, State College, School of Agriculture and Experiment Station, Pennsylvania State College, Bulletin 263, Mar., 1931, p. 14.

<sup>7</sup> Report of the North Carolina Tax Commission, 1928, p. 217.

per cent; Iowa, 1927, 31.3 per cent; North Carolina, 1927, 29.5 per cent; Pennsylvania, 1924-1925, 20.9 per cent; South Dakota, 1922-1926, 29.9 per cent; Virginia, 1926, 16.0 per cent; and Washington, 1924-1926, 31.7 per cent.<sup>8</sup>

Studies from three states make it possible to show the percentage of net rental income before the deduction of taxes taken by the general property tax for business and residential properties. (Table II.)

An illuminating study of the taxation of urban real estate was made by the North Carolina Tax Commission and embodied in their report for 1928.<sup>9</sup> The following quotation from that report shows the ratio of taxes to rent for 859 properties, classified by use, region and value.

**Table III. Percentage of Net Rent Taken in Taxes and Percentages Earned on Fair Market Value of City Property in 1927**

Classification of property	Number of cases	Percentage of net rent (before taxes) taken in taxes	Percentage earned on fair value after expenses and taxes	
			Before depreciation	After depreciation
Business . . . . .	275	28.6	5.0	3.9
Residential . . . . .	584	34.5	5.5	3.2
Total . . . . .	859	29.5	5.1	3.8
Tidewater . . . . .	106	38.5	5.2	3.3
Coastal plain . . . . .	329	31.5	5.6	3.8
Piedmont . . . . .	330	26.9	5.0	3.9
Mountain . . . . .	94	32.2	4.5	3.3
Value classes:				
\$0-\$4,000 . . . . .	416	47.7	5.2	2.2
4,001-10,000 . . . . .	164	39.4	5.4	2.9
10,001-50,000 . . . . .	187	30.3	5.4	3.9
Over 50,000 . . . . .	92	27.4	5.0	3.9

For purposes of comparison with other kinds of property the following table is reproduced from the same report:<sup>10</sup>

<sup>8</sup> Coombs, Whitney, *Taxation of Farm Property*, Washington, U. S. Department of Agriculture, Technical Bulletin 172, Feb., 1930, p. 32.

<sup>9</sup> *Report of the North Carolina Tax Commission, 1928, p. 219.*

<sup>10</sup> *Report of the North Carolina Tax Commission, 1928, p. 220.*



**Table IV. Percentage of the Net Income Before Taxes Taken in Property Taxes for Certain Enterprises in the State in 1927**

Type of business	Percentage of net income before taxes taken in property taxes <sup>1</sup>
Class I railroads.....	25.2
Electric light and power companies.....	16.3
State banks.....	23.6
National banks.....	12.5
Rented farms.....	28.9
Rented city property.....	29.5

<sup>1</sup> Such taxes as are paid in lieu of the general property tax are included.

A similar study was made in Arkansas and the following table sets forth the results: <sup>11</sup>

**Table V. Percentage of Earnings Taken in Taxes for Major Property Groups in Arkansas, 1925**

Property groups	State and local taxes	All taxes
Railroads.....	18.5	21.3
Farm.....	18.1	27.1
City.....	16.7	20.2
Bank.....	15.7	24.0
Telephone.....	12.7	25.6

**Exemption of Property from Taxation.** The burden of the property tax is increased upon those who pay the tax by the large volume of exemptions. The extent of this exemption in certain states is shown in Table VI.

In 1923 the National Industrial Conference Board published a study, *Tax Burdens and Exemptions*, in which it is estimated that for the year 1921 the national wealth of the United States was 275 billions of dollars, and that taxable property represented 80.4 per cent of this total, while exempt real property represented 6.7 per cent, and other exempt property 12.9 per cent.

Careful studies, particularly of conditions in the States of New

<sup>11</sup> Brannen, C. O., op. cit., p. 15.

Table VI. Amount and Proportion of Exempt Property in Specified States<sup>1</sup>

	Year	Kind of property	Percentage of public exempt to taxable property	Percentage of private exempt to taxable property	Assessed valuation of taxable property
Arizona.....	1930	Real and personal	....	3.6	\$ 741,920,612
Colorado.....	1930	Real and personal	....	6.5	1,426,603,020
Connecticut...	1929	Property of service men, relatives, blind, and certain manufacturing concerns	....	.8	3,009,930,176
Kansas.....	1930	Personal	....	2.0	798,275,690
Kentucky.....	1929	Real and personal	....	2.0	2,328,990,223
Massachusetts	1930	Real and tangible personal	12.2	6.7	7,229,562,820
New Jersey...	1930	Real and personal	8.1	6.6	6,537,736,052
New York...	1929	Real	14.1	7.9	28,149,757,824
Rhode Island..	1930	Real and personal	7.2	4.4	1,419,219,663
Wyoming.....	1930	Property of service men	....	2.1	436,828,811

<sup>1</sup> Source: Tax Commission reports of the respective states.

York and Colorado,<sup>12</sup> indicate that while the exemption of property creates a real problem, the proportion of exempted property is probably not increasing, and such exemption does not cause a marked increase in tax rates. The general situation is probably well portrayed in the following quotation from the Preliminary Report of the Special Joint Commission on Taxation and Retrenchment, of New York:

"The problem of tax exemption in the State of New York is serious. A study of the facts, however, has led the committee to feel that the situation is not as serious as many have supposed. In the first place, though the

<sup>12</sup> *Preliminary Report* of the Special Joint Commission on Taxation and Retrenchment, New York, February 15, 1927, p. 13.

Jensen, Jens P., *Survey of Colorado State Tax System*, Denver, Denver Chamber of Commerce, 1930, p. 45.

amount of tax exempt property is 23.8 per cent of all taxable real estate, an analysis shows that 76.2 per cent of this is made up of publicly owned property. Of the \$3,828,000,000 of real property exempt from state and local taxes in 1925, only \$913,000,000 is made up of private property. . . . In the second place, the ratio of tax exempt property to taxable property excluding the temporarily exempt new buildings in New York City, has decreased gradually since 1917. In other words, taxable property has apparently increased faster in value than has exempt property. It is, therefore, our first conclusion that the situation is not as serious as it first seemed."

The above statement of the New York Commission perhaps holds true for a state as a whole, but it does not take into consideration smaller jurisdictions within a state that may be seriously handicapped by property tax exemptions. For example, in Saint Paul, Minnesota, figures show that exempt real estate, in comparison with the taxable, has increased from 19.5 per cent of the total valuation in 1914 to 22.5 per cent in 1930; also, that the total exempt valuation during the same period increased 113 per cent, while the taxable value increased only 80 per cent.<sup>13</sup> The following quotation is taken from the Report of the Department of Assessment:

"By reason of the fact that real property bears by far the largest proportion of the tax burden, the rapid increase in the amount and value of exempt property is becoming, year by year, a more serious problem.

"Abuse of the exemption privilege does arise, if business, or other income producing property, acquired by educational or religious institutions, and not used for or by those bodies is placed on the tax exempt register, on account of ownership. When such action is followed, it is unfair to all taxpayers, and is unjust to owners of real estate who must come into competition with the non-taxable property owners. Carry this theory to its logical conclusion, and certain institutions could become the owners of all desirable buildings in the city, to the detriment of every taxpayer.

"When property, owned by the city or county, which is not used for public purposes, is leased to private parties, the state will immediately order that it be placed on the tax roll. This being true, why should an institution be favored more than the public? When carefully restricted, certain exemptions are unquestionably proper, but the door can easily be opened too wide."

**Non-payment, Delinquency and Tax Sales.** Very little information relative to this subject has been developed in such form that might be used to show the general extent or magnitude of the failure of property owners to pay the taxes levied against their property. In the State of North Carolina in 1928 the tax delin-

<sup>13</sup> *Report of Assessor, Saint Paul, Minnesota, 1930, p. 34.*

quency amounted to 9.3 per cent of the gross tax levy. The amount of property that was actually sold because of the failure of the owners to pay the taxes represented 5.4 per cent of the gross tax levy.<sup>14</sup> Economic conditions accentuated the difficulties of tax payment, and in 1929, 117,300 items of real estate were advertised by the counties for non-payment of taxes; in 1928, 101,300 parcels were advertised. The taxes assessed against the property advertised in 1929 amounted to \$5,060,500; in 1928, they amounted to \$4,255,900.<sup>15</sup>

In Cook County, Illinois, approximately 300,000 parcels of land—more than three times the number involved in the last tax sale held in 1928—were advertised for sale in August, 1930, because of the failure of the owners to pay the taxes. These parcels of land represent approximately 25 per cent of the total number in the county. Out of the total number advertised for sale only 29,461 parcels were sold, while for 59,403 parcels there were no bidders and they were forfeited to the state. At the time of this sale there were 41,805 parcels representing a thirty-year accumulation of unsalable property upon which the taxes have been piling up annually with little prospect of redemption. In many cases the sum of taxes plus the delinquent penalties exceeds the market value of the property. Delinquent taxes for 1929 (offered for sale in September, 1931) amounted roughly to \$69,000,000, and because of taxpayers' suits in the courts, it was possible to offer only \$15,170,082 in delinquent taxes for sale.

The Minnesota Tax Commission reports that on January 1, 1930, unpaid taxes on real property in that state aggregated \$30,502,197. An average of 6.8 per cent of the 1928 taxes were uncollected amounting to \$8,848,883 out of \$130,684,839. The total of uncollected taxes for 1927 and prior years was \$21,653,314, which increased to \$28,875,987 in 1929, and the above amount for 1930.<sup>16</sup>

In Progress Report Number 13 of the Forest Taxation Inquiry, P. A. Herbert shows that 859,781 acres of land and 97,013 lots were deeded to the State of Michigan because of delinquency between 1910 and 1928. In 1900 the assessed value of all delinquent

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<sup>14</sup> *Report of the North Carolina Tax Commission, 1928, p. 429.*

<sup>15</sup> *Report of the North Carolina Tax Commission, 1930, p. 15.*

<sup>16</sup> *Report of the Minnesota Tax Commission, 1930, p. 172.*

real estate was \$75,185,014, while by 1928 it had increased to \$1,426,573,162. The delinquent taxes in 1900 and 1928 were \$1,419,653 and \$25,278,091 respectively.<sup>17</sup>

The New Jersey Commission to Investigate County and Municipal Taxation and Expenditures has found that delinquent taxes prior to 1928, in 24 municipalities having a population of 30,000 or over, amounted to 14.7 per cent of the 1928 tax levy; in 138 municipalities having a population below 30,000, the delinquent taxes prior to 1928 amounted to 15 per cent of the 1928 tax levy.<sup>18</sup>

In most tax jurisdictions the personal property tax delinquency presents an even more acute problem than real property tax delinquency, for in the case of delinquent personal taxes there is no

**Table VII. Showing Delinquent Personal Taxes with Penalties by Years, Collections and Unpaid Balances, Cuyahoga County, Ohio**

Year	Amount unpaid on each duplicate and appearing as delinquent with penalty	Annual payments to 1924 inclusive	Total unpaid balance, cumulative	Per cent of personal tax levy delinquent <sup>1</sup>
Balance prior years			\$4,085,086.80	
1914....	\$1,837,890.96	.....	5,922,977.76	11.0
1915....	197,261.74	\$ 82,096.72	6,038,142.78	3.8
1916....	371,309.36	743,146.90	5,666,305.24	6.5
1917....	654,960.03	60,639.42	6,260,625.85	7.7
1918....	366,818.67	46,843.91	6,580,600.61	4.2
1919....	.....	137,008.05	6,443,592.05	3.8
Less amount written off			6,043,592.56	
Balance			400,000.00	
1919....	416,189.08	.....	816,189.08	....
1920....	1,245,367.72	150,201.04	1,911,355.76	6.8
1921....	1,397,196.22	128,246.69	3,180,315.29	7.0
1922....	1,511,924.74	221,391.98	4,470,848.05	9.8
1923....	1,656,736.69	459,154.82	5,668,429.92	9.1
1924....	.....	636,649.72	5,031,780.20	....
TOTAL..	\$9,655,655.21	\$2,665,379.25	\$5,031,780.20	

<sup>1</sup> For the City of Cleveland only, not based on other figures in the table.

<sup>17</sup> See also Appendix III of this report, *Increasing Tax Delinquency*.

<sup>18</sup> Forthcoming report on *Local Financial Administration* to be published as Report No. 3.

underlying security for their ultimate collection. In Ohio, substantial revenues are secured through the personal property tax, but a large amount of the taxes levied are never collected. In 1925 The Municipal Research Bureau of Cleveland made a study of the situation in Cuyahoga County,<sup>19</sup> in which the facts shown in Table VII were brought to light.

The amazing proportions to which this problem may grow are to be found in the City of Chicago. The following table shows the personal property taxes extended and the percentage of these taxes that goes delinquent, for the eight City of Chicago townships for the years 1917 to 1927, inclusive:<sup>20</sup>

**Table VIII. Delinquent Personal Property Taxes, City of Chicago**

Year	Personal property taxes extended	Percentage delinquent
1917.....	\$16,541,061	14.6
1918.....	16,555,141	15.2
1919.....	21,071,881	13.9
1920.....	22,614,301	17.3
1921.....	34,038,537	27.4
1922.....	32,785,437	27.1
1923.....	33,383,379	31.4
1924.....	35,356,277	31.0
1925.....	39,539,827	32.9
1926.....	36,279,863	33.5
1927.....	39,152,398	37.1

The collections of the above delinquencies are not sufficient to cause the percentages to differ materially, so that the above figures represent approximately the percentage of personal property taxes that is never collected.

## II. INEQUALITIES IN ASSESSMENT AND VALUATION UNDER THE GENERAL PROPERTY TAX

The facts that have been presented in the above section apply in general to the burden of the general property tax upon all property, and real property in particular. If this burden were dis-

<sup>19</sup> *A Report upon the Administration of Delinquent Personal Tax Collection in Cuyahoga County, Ohio*, June, 1925.

<sup>20</sup> *Report IV*, Joint Commission on Real Estate Valuation, p. 26.

tributed equitably among all forms and individual units of property, it would not be necessary to include this section in the present report. This is not the case, however, and inequalities do exist in the preparation of the assessments that become the basis for the application of tax rates. These inequalities cause the tax burdens on certain groups to be even heavier than the facts in the above section would indicate, which means that for those taxpayers carrying more than the average burden of taxes, there are taxpayers who carry an equally lessened burden.

**Inequality in the Assessment of Real Estate and Other Forms of Property.** It is difficult to obtain actual facts concerning the inequalities that exist in the assessment of real estate under the general property tax as compared with other forms of property. There are no general statistics showing the true relation of personalty to realty. As shown above, 83 per cent of the general property tax base in cities of over 30,000 population was real property, while but 16 per cent was personal property. This situation does not conform either to the state of facts or the state of law. It is common knowledge that a far larger proportion of personalty than of realty escapes the assessment roll. To illustrate:

The Federal census statistics of 1922 reported a total value of manufacturing tools, machinery and equipment for Illinois of \$1,194,793,000 which was assessed that same year at a supposed full value of \$28,993,000 or 3 per cent of the census value. The same year the Federal census reported all Illinois personal property to have a value of \$7,461,200,000, which was assessed at \$1,655,117,000 or about 20 per cent of the census value.<sup>21</sup>

From 1921 to 1925 there was an increase of 60 per cent in the value of products made in Ohio factories. Despite this increase, the assessment rolls each year showed less and less manufacturing tools and equipment. As nearly as can be estimated, manufacturing tools and equipment are assessed at 15 per cent of full value, motor vehicles at 50 per cent, livestock at 60 per cent, and real estate at 65 per cent, although the law requires full 100 per cent assessment.<sup>22</sup>

It is impossible to state the amount of tangible personal property

<sup>21</sup> Leffler, G. L., *Wisconsin Industry and the Wisconsin Tax System*, Madison, Bureau of Business and Economic Research, University of Wisconsin, Bulletin No. 3, p. 61.

<sup>22</sup> *Ibid*, p. 64.

that is not listed for taxation, and about as impossible to determine the level of assessment for such property as is listed and assessed. However, as stated above, much more tangible personal property escapes taxation than does real property, and especially more than residential real estate. Whatever the true situation, it is to be remembered that most tax laws call for the uniform treatment of real and tangible personal property, and to the degree that the latter escapes a tax, real property carries an added burden.

The North Carolina Tax Commission made a study of the levels of assessment for different classes of business or property. Table IX shows the ratios of assessed to fair market value for the year 1927: <sup>23</sup>

**Table IX. Ratio of Assessed Value of Property to Estimated Market Value—1927**

Class of business or property	Average ratio
Public service corporations	
Steam railroads.....	68.8%
Electric light and power companies.....	68.8
Telephone companies.....	74.2
The Pullman company.....	61.0
Urban real estate	
Business property.....	57.6
Residence property.....	63.1
Farm property.....	75.3

**Inequality in the Assessment of Real Estate.** The inequalities that exist in the placing of assessments upon property do not stop with the different forms of property, but are found quite as well when one considers real estate itself. The irregularities in the assessment of real estate are too commonly known to require an extended presentation of the facts.

*Individual Properties.* Herbert D. Simpson, in *The Tax Situation in Illinois* and *Tax Racket and Tax Reform in Chicago*, has shown wide divergence of the assessment of individual properties from the average level of assessment as measured by the ratios of assessed to sale values. For the State of Illinois outside of Chicago

<sup>23</sup> *Report of the North Carolina Tax Commission, 1928, p. 227.*



it was shown that on the basis of 2,049 transfers in ten counties the assessments averaged 34.1 per cent of the sale values for 1927. With the average level at 34.1 per cent, only 10 per cent of the properties were assessed within the range 30 to 35 per cent, and only 19 per cent within the range 30 to 40 per cent, the remaining properties ranging from 2 to over 100 per cent, with an average deviation from the average level of 51.6 per cent. In the City of Chicago, a study of 6,017 transfers indicated that the assessment of 1927 averaged 39.8 per cent of sale values when completed by the Board of Assessors, and 35.9 per cent after revision by the Board of Review. Out of this sample 15.5 per cent of the properties were assessed between 1 and 20 per cent, while nearly 10 per cent were assessed from 60 to 100 per cent of sale value. The average deviation from uniformity of the 1927 assessment was 36.5 per cent.

A study made by R. W. Nelson and G. W. Mitchell of the Bureau of Business Research at the University of Iowa furnishes similar information concerning the assessment of real estate in mid-western states. The results are summarized in Table X.<sup>24</sup>

The deviation of individual assessments from the average level of assessment amounts to an under-assessment of some properties and an over-assessment of others. Dr. Simpson has called this over-assessment "confiscation" and the under-assessment "exemption." In the City of Chicago in 1927 this "confiscation" amounted to \$30,000,000 in taxes paid, while in the State of Illinois it was estimated to be about \$64,000,000.

C. B. Pond estimates that the misplacement of real estate taxes in the State of New York exceeds \$75,000,000 a year, the total injustice involved being twice this amount. Mr. Pond estimates that for the nation as a whole somewhere between 10 and 20 per cent of taxes on real property are "unjustly assigned," because of inequalities in assessment.<sup>25</sup>

*Kinds of Real Estate.* There are not sufficient studies concerning the comparative levels of assessment for different kinds of real estate to permit a generalization of the situation throughout the

<sup>24</sup> *Assessment of Real Estate in Iowa and other Mid-Western States*, Iowa Studies in Business, X, Iowa City, Bureau of Business Research, State University of Iowa, Jan., 1931, p. 151.

<sup>25</sup> Pond, C. B., *Full Value Real Estate Assessment as a Prerequisite to State Aid in New York*, Albany, Special Report of the State Tax Commission, No. 3, 1931, p. 29.

**Table X. Average Assessment Ratios and Percentage Deviations, City and Village Property—State Averages**

States	Average ratio <sup>1</sup>	Average deviation
Indiana		
12 cities and villages.....	73.03%	26.12%
Iowa		
8 cities.....	47.53	25.66
14 towns.....	46.23	28.03
Minnesota		
6 cities.....	79.85	23.10
Nebraska		
4 county-assessor cities.....	52.52	25.93
3 non-county-assessor cities.....	39.80	22.01
Wisconsin		
3 cities.....	67.37	17.31
11 villages.....	80.91	16.83

<sup>1</sup> Value basis.

United States. The North Carolina Tax Commission found that on the average, as determined by a study of 1,062 properties in 1927, business properties were assessed at a level of 57.6 per cent while residences were assessed at a level of 63.1 per cent.<sup>26</sup> On the other hand, Dr. Simpson's studies in the City of Chicago for a six-year period from 1923 to 1928 show that on the average between 1923 and 1926, residential real estate was favored to the expense of all other classes of property except vacant land. Table XI presents the facts for 1927 and 1928:<sup>27</sup>

It has been possible for the writer to study the assessment of residential, mercantile, manufacturing, and agricultural real estate in 134 cities in the State of Wisconsin for the year 1930. The Wisconsin Tax Commission supplied the assessments and its recommended full value for the four classes of real estate for that year. There has not been sufficient time to allow the proper development of these data, but Table XII gives a rough summary of the findings up to the present time.

In this table the 134 cities have been classified according to the treatment of residential real estate in relation to the other classes.

<sup>26</sup> Report of the North Carolina Tax Commission, 1928, p. 216.

<sup>27</sup> Simpson, H. D., *Tax Racket and Tax Reform in Chicago*, Chicago, The Institute for Economic Research, 1930, p. 174.

Table XI. Comparison of Assessments by Classes of Property

Classes of property	Average rate of assessment	
	Assessment of 1927	Reassessment
1. Vacant land.....	35.2%	35.0 %
2. Office and bank buildings.....	56.7	34.99
3. Hotels, theatres and amusements.....	33.1	34.96
4. Miscellaneous.....	35.3	30.6
5. Single-family residences.....	32.6	28.2
6. Duplexes and two-flats.....	33.1	27.8
7. Combined business and residence.....	34.7	27.0
8. Apartment buildings.....	34.9	27.0
9. Commercial—wholesale and retail.....	39.0	26.8
10. Industrial.....	43.8	24.2
<i>Average rate of assessment.....</i>	35.9	27.8

Table XII. Summary of Assessment Data for 134 Wisconsin Cities—1930. Ratio of Assessed to Tax Commission Recommended Full Value, by Classes of Property

Cities classified according to treatment of residential real estate	Percentage of total value of residential real estate	Number of cities	Average ratio—Weighted according to value				
			Residential	Manufacturing	Mercantile	Agricultural	Total
Lower than all other classes.....	22.9	29	69.0%	75.5%	78.6%	88.8%	72.0%
More than mercantile...	18.3	8	77.2	76.7	74.4 <sup>1</sup>	89.7	77.0
More than manufacturing.....	29.3	28	73.9	81.6	57.1	91.3	73.8
More than agricultural...	5.2	8	75.2	84.8	84.8	69.6	78.6
More than mercantile and manufacturing...	5.0	9	70.8	67.1	61.6	94.3	68.9
More than mercantile and agricultural.....	7.5	12	84.7	74.1	104.8	75.7	83.6
More than manufacturing and agricultural...	6.2	13	77.5	80.9	70.8	67.0	76.8
More than all other classes.....	5.6	27	84.0	79.0	59.0	79.0	78.9
TOTAL.....	100.0	134	74.9	77.8	71.9	82.7	75.2

<sup>1</sup> The ratio for manufacturing property was higher than the ratio for residential real estate in each city in this class, but the relatively large amount of manufacturing property in Madison and Kenosha causes the weighted average to appear lower than the weighted average for residential real estate.

For example, in 29 cities the average ratio of assessed to recommended full value was lower for residential real estate than for the other three classes. The value of the residential real estate in these 29 cities represented 22.9 per cent of the total for the 134 cities. Following down the table through the various combinations of the four classes of real estate it is found that in 27 cities residential property was, on the average, assessed at a higher level than the other three classes. However, the value of the residential real estate in these 27 cities represents but 5.6 per cent of the total for the 134 cities.

In general, it can be said that there is no marked difference in the assessment of residential and mercantile real estate in the State of Wisconsin. There does, however, seem to be a strong tendency to favor manufacturing real estate. The agricultural land that lies within the limits of the 134 cities is not typical of the general farming areas throughout the state, and the levels of assessment shown in this table for this class of real estate are not to be taken as representative of the state-wide treatment of agricultural real estate.

*Value Classes.* Where real properties are classified by value, and the assessments are compared with indexes of full value, there seems to be a general, but not universal, tendency toward regression, that is, to assess properties of a low value at a higher level of actual value than more valuable properties.

In the North Carolina study of the taxation of city real estate based on a sample of 1,062 properties, there was shown an even regression from a level of 66.5 per cent for property valued at less than \$4,000 to a level of 56.7 per cent for properties valued at more than \$50,000.<sup>28</sup>

Professor Weaver studied 178 properties in the City of Lancaster, Pennsylvania, for the year 1921, comparing the assessments with appraised value. The lower priced properties were assessed at almost twice the rate of the average for the entire group. Certain unusual properties raised the average level of the higher priced groups, but by eliminating 9 such cases out of the 178, the average level was 18.7 per cent, or a little over one third of the rate of assessment of the cheaper city properties.<sup>29</sup>

<sup>28</sup> *Report of the North Carolina Tax Commission, 1928, p. 216.*

<sup>29</sup> Weaver, F. P., and King, Clyde L., *Some Phases of Taxation in Pennsylvania*, Harrisburg, Bulletin of Pennsylvania Department of Agriculture, Dec. 15, 1926, p. 14.

W. H. Dreesen studied the ratios of assessed to sale values for 16,806 rural property and 23,327 city property transfers for the years 1921 to 1926, for the State of Oregon. The city properties in class A counties having a value of less than \$1,500 were assessed, on the average, at a decidedly higher level than the other properties. City properties in class B counties having a value less than \$1,400, were also assessed at a higher level of sale value than were the higher valued properties. Table XIII presents the facts for city properties in Multnomah County: <sup>30</sup>

**Table XIII. Ratios of Assessed to Sale Values of City Real Property in Multnomah County for Six Years, 1921 to 1926**

Value groups	Number of transfers	Average ratio
Below \$700.....	332	72.86%
\$ 700- 1,399.....	673	69.37
1,400- 2,099.....	544	43.83
2,100- 2,799.....	1,103	42.46
2,800- 3,499.....	671	36.99
3,500- 4,199.....	816	35.15
4,200- 4,899.....	909	35.69
4,900- 6,999.....	1,598	34.82
7,000- 9,999.....	908	37.64
10,000-19,999.....	540	44.33
20,000- and above.....	377	52.05

In a study of the assessment of real estate in Iowa and other mid-western states, R. W. Nelson and G. W. Mitchell found certain definite tendencies toward regression in assessment. They found "a mild but nevertheless unmistakable tendency towards regression" for the state of Iowa. A study of three cities in Wisconsin showed that there was but comparatively little regressivity present. In seven Nebraska cities there was no significant tendency toward regression. The data for the state of Indiana, as a whole, indicated the existence of a general tendency to assess urban property regressively. The authors studied 596 transfers

<sup>30</sup> *A Study in the Ratios of Assessed Values to Sale Values of Real Property in Oregon*, Corvallis, Agricultural Experiment Station, Oregon State Agricultural College, Bulletin 233, June, 1928, p. 29.

for the years 1927 to 1929 for Duluth, Minnesota. The exhibit shows no tendency whatsoever toward regression, with the exception of three value classes below \$2,250. The existence of vacant land in these classes is perhaps the reason for the higher assessment levels, rather than a bias against low-value improved property.

The Tables XIV and XV are reproduced from studies in Chicago and Illinois by Herbert D. Simpson.

**Table XIV. Chicago.<sup>1</sup> Single-Family Residences Classified According to Value**

Sales value	Average rate of assessment	
	Assessment of 1927	Reassessment of 1928
Less than \$15,000.....	33.5%	27.9%
\$15,000 and less than \$25,000.....	33.4	29.1
25,000 and less than 35,000.....	30.9	29.0
35,000 and less than 50,000.....	32.5	30.7
50,000 and over.....	28.0	24.1
<i>Average rate of assessment.....</i>	32.6	28.2

<sup>1</sup> Simpson, H. D., *Tax Racket and Tax Reform in Chicago*, Chicago, The Institute for Economic Research, 1930, p. 178.

**Table XV. Illinois.<sup>1</sup> Urban and Village Properties Classified According to Value**

Value of property	Number of properties		Percentage of assessed to sales value	
	1926 <sup>2</sup>	1927 <sup>3</sup>	1926	1927
Under \$1,000.....	378	548	46.5	44.6
\$ 1,000- 2,500.....	453	519	37.4	36.4
2,500- 5,000.....	344	361	33.0	30.0
5,000-10,000.....	210	178	24.8	26.8
10,000-20,000.....	37	43	29.0	27.4
20,000 and over.....	7	23	25.3	25.0
TOTAL.....	1,429	1,672	30.7	29.7

<sup>1</sup> Simpson, H. D., *The Tax Situation in Illinois*, Chicago, The Institute for Research in Land Economics and Public Utilities, 1929, p. 36.

<sup>2</sup> Seven counties.

<sup>3</sup> Ten counties.

**Table XVI. Assessed Valuation of City Real Estate in Per Cent of Sale Price in 16 Counties by Size Groups for 10 Years, 1913 to 1922, 10,231 Transfers**

Value groups	Average ratio
Below \$150.....	97.0%
\$ 150- 299.....	89.0
300- 449.....	82.9
450- 599.....	80.5
600- 999.....	76.5
1,000-1,399.....	74.5
1,400-1,849.....	70.9
1,850 and above.....	69.1
<b>TOTAL.....</b>	<b>73.3</b>

**Table XVII. Summary of 71,840 City Real Estate Sales in the State of New York, 1910-1925 Ratio of Assessed to Sale Value**

Consideration	Number of sales	Average ratio
Below \$1,000.....	834	92.7%
\$ 1,001-\$ 2,000.....	5,537	78.0
2,001- 3,000.....	10,625	70.4
3,001- 4,000.....	11,116	67.0
4,001- 5,000.....	9,828	65.2
5,001- 6,000.....	7,660	63.5
6,001- 7,000.....	6,476	62.5
7,001- 8,000.....	4,809	61.7
8,001- 9,000.....	3,332	62.1
9,001- 10,000.....	2,414	61.6
10,001- 11,000.....	1,465	61.7
11,001- 12,000.....	1,213	63.0
12,001- 13,000.....	925	60.9
13,001- 14,000.....	684	60.3
14,001- 15,000.....	699	62.6
15,001- 20,000.....	1,673	63.8
20,001- 25,000.....	758	64.0
25,001- 30,000.....	474	62.1
30,001- 40,000.....	529	64.1
40,001- 50,000.....	267	61.5
50,001- 60,000.....	137	62.4
60,001- 70,000.....	90	63.0
70,001- 80,000.....	67	55.1
80,001- 90,000.....	30	61.7
90,001-100,000.....	42	66.8
Over 100,000.....	156	58.4
<b>TOTAL.....</b>	<b>71,840</b>	<b>63.6</b>

Table XVI, page 169, is taken from a study of the assessment and equalization of farm and city real estate in Kansas by Eric Englund.<sup>31</sup>

The New York Tax Commission collected some 166,000 sales in the State of New York outside of Greater New York, Westchester, Erie, and Hamilton Counties for the years 1915 to 1925. These sales are tabulated according to value classes in the 1925 Report of that Commission. Out of 54 counties included in this study there were 16 counties that showed no marked regression in assessment. Table XVII shows the distribution of real estate sales in the cities in the 54 counties.<sup>32</sup>

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<sup>31</sup> *Assessment and Equalization of Farm and City Real Estate in Kansas*, Manhattan, Agricultural Experiment Station, Kansas State Agricultural College, Bulletin 232, July, 1924, p. 15.

<sup>32</sup> *Report of the New York Tax Commission*, 1925, p. 449.



## APPENDIX II

# THE SHIFTING AND INCIDENCE OF REAL ESTATE TAXES<sup>1</sup>

Intelligent policies of taxation with regard to homes and other forms of real estate depend upon some conception of what the final incidence of these taxes is. If the burden rests and remains on the property owner, that is one thing; if it is shifted *in toto* to tenants or others, that is a very different thing. If it is impossible to determine with reasonable assurance what the actual incidence is, we may have to be satisfied with considerably less precision in our remedies and may have to rely on very broad and flexible adjustments.

The prevailing theory of incidence in this field may be summarized as follows:

1. Taxes on land value cannot be shifted.
2. Taxes on homes or other types of property used for purposes of final consumption by the owners cannot be shifted.
3. Taxes on buildings and improvements used for business purposes, including rented homes and apartments, become an element of cost in the construction and maintenance of these improvements and are subject to much the same processes of shifting as taxes on any other field of production. That is, they have the effect of restricting the supply of the commodity (in this case, buildings), with the result that prices and rentals will advance to a level that will cover at least a portion of the taxes. What particular portion of the tax is shifted and what portion remains on the owner, will depend chiefly upon the relative elasticity of the supply and demand; that is, the relative degrees of pressure upon the owner to lease and the tenant to rent.

In the present paper we shall omit any discussion of 1 above, (taxation of land value) partly for want of space for an adequate treatment of the subject, and partly because it is only a minor element in our problem here, where we are chiefly concerned with the building and ownership of homes and apartments, as buildings. We shall likewise omit discussion of item 2, (taxation of homes occupied by their owners) since it is obvious that there is no one to

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<sup>1</sup> This paper was submitted by Mr. Herbert D. Simpson, member of the Committee on Taxation, as an appendix to the committee's report. A further treatment of this subject, somewhat broader in scope, will be found in the June, 1932, number of *The American Economic Review*, published by the American Economic Association, through whose courtesy this paper is here published.

whom such owners can shift the taxes on their own homes. We shall have occasion, however, to refer to this feature of the problem on account of a peculiar bearing it has on other fields of incidence.

This leaves as the subject of the present study the more specific problem of incidence in the case of buildings used for purposes of business income, including, of course, apartment buildings, rented homes, and all types of dwelling construction for purposes of sale or rent. With the prevalent theory in this field, so long as it is put forward only as a statement of a general tendency, the writer knows no ground for disagreeing; but in its application to taxes on buildings and improvements under modern conditions, the writer's observations over the past decade lead him to believe that it may require serious qualification. The grounds for this apprehension are:

1. That a large proportion of construction under modern conditions, and especially under urban conditions, is no longer governed by factors which make the theory applicable.

2. That modern methods of promotion, financing, and ownership of urban buildings has materially lessened the significance of any process of shifting taxes that do take place.

The remainder of this paper will be devoted to a statement of these grounds.

## I. CONDITIONS FOR APPLICATION OF THEORY

It is the duty of economists to keep theory and experience in close juxtaposition and to note constantly the coincidences and divergencies of the two things. In the great building expansion of the past decade, it is an unhappy commonplace to observe that much of this construction has been highly speculative. Much of it has been carried on with little reference to costs—of labor, materials, financing, or otherwise. The speculative element has probably been larger in Chicago, where the writer has had somewhat unusual opportunity for close observation of the movement, than in many other cities; but it has been a large element in Detroit, Cleveland, New York, and quite generally throughout the southern and western states. So much so that cities where it has not been present would be distinctly the exceptions.

Throughout this building expansion it would be extremely difficult to discover any way in which taxes have had any effect upon the amount of commercial and industrial construction or upon the

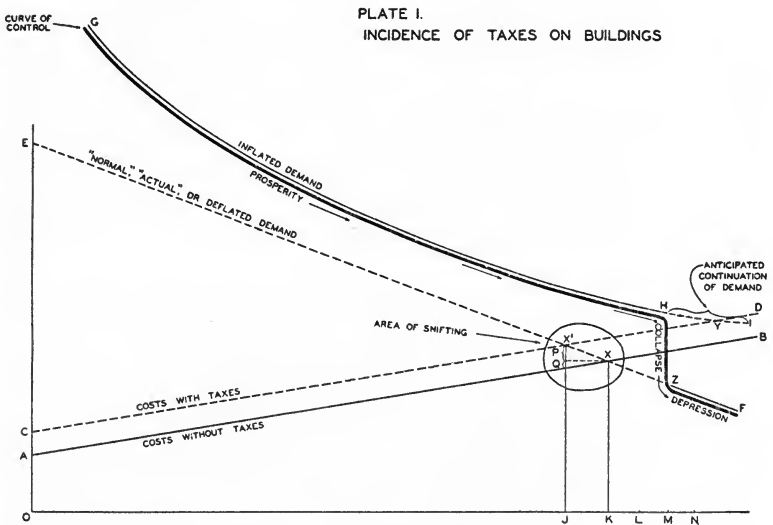
residential construction carried on by real estate and commercial companies. It is true that throughout most of this period taxes were more than "covered" in the rentals and sales prices of these properties. But that is not the question. The problem is *whether the amount of building would have been any greater, and rentals and prices any lower, if they had not been taxed.* The writer has quoted elsewhere the statement of a representative of one of the largest development companies in Chicago, in 1927, that "We don't figure on taxes at all." And that was the truth throughout most of this period. Speculative profits, actual and anticipated, were so liberal, that taxes scarcely entered into the decision where or when to build or whether to build or not.

It was the familiar case of surplus throughout a supermarginal field of activity, where costs were no longer determining factors. And if one sought diligently for a "marginal producer," whose option might determine the limit of production on the basis of costs, one found these marginal producers (marginal in every economic and business sense) the most reckless of all—unless with the exception of other sub-marginal producers still further down the scale.

Unreasonable, and unorthodox, as this situation may appear, the explanation is surprisingly simple. Shifting assumes a margin of production, which sets a limit to production under given conditions of cost, demand, and so forth. A tax raises this margin and cuts off supply at an earlier point, thereby raising the price. But this analysis, inescapable as it seems, is after all only a description of the supposed behavior of producers under a given set of conditions. It assumes—what is not ordinarily stated among the conditions—that producers will have sufficient intelligence to know where this margin is and "gumption" enough to stop when they get there. But what is going to happen if they have neither? And if furthermore, there really is no way in which to detect this margin, since the demand for buildings cannot register itself in homogeneous or comparable quotations, like commodity prices, from day to day or month to month? And if, still further, this is not a sporadic or exceptional situation, but very nearly the "normal" condition, so far as commercial building operations are concerned?

The best clue to what is going to happen would seem to be what has been happening for the past decade; and we have under-

taken to represent this in the graph below. (Plate 1.) Here lines AB and EF represent the familiar supply and demand graph. AB represents the costs of constructing and operating buildings, without taxes; CD the cost with taxes. OK represents the amount of construction that would have been absorbed by a "normal" demand, at prices to cover the costs without taxes; OJ represents the smaller amount that could have been absorbed at prices to cover costs with taxes. KX represents the level of prices or rentals for building accommodations, without the tax; JX' represents the supposed higher prices or rentals, which, in the usual theory, would



eventually be established as a result of the tax. P, therefore, represents the portion of the tax that is shifted, and Q the portion that remains with the property owner.

This is accepting the normal process of shifting and incidence in the case of any commodity whose supply is limited by the costs of production. It has been customary to apply this analysis to taxes on buildings and improvements, with only the perfunctory qualification that it requires a longer time for changes in taxes to register than in the case of ordinary commodities. For the sake of later reference, we have drawn a circle around the general price area within which this process of shifting is assumed to take place.

But on this theoretical analysis, we have superimposed one factor, which appears to the writer to have changed the whole situation. This is what we may call the "inflated demand" curve, which dominated building operations throughout the period of prosperity, represented by the line GHI on our graph. One is tempted to call this a "fictitious" or "anticipated demand," in contrast with the curve of "actual" demand below it; but of course this was the "actual" demand while it lasted. The fictitious element was the assumption that this curve would continue to hold indefinitely into the future; or, speaking more analytically, that the lower range of the curve, when subjected to the increased amount of construction going on, would not drop below the curve of costs, CD. This hypothetical continuation of the curve (which proved in the end not to be there), we have represented by the dotted extension HI. Y represents the point at which this anticipated demand might have intersected the cost curve, if it had continued far enough, and established another area of shifting.

As a matter of fact, before it reached any such point of equilibrium, the boom collapsed, and prices and rentals dropped to some lower curve of "normal" demand, but intersecting this curve at a still lower point now on account of the additional construction thrown on the market in the interim by ultra-marginal producers K, L, M, and N.

Alongside of line GH, dropping abruptly from H to Z, and thence following the line ZF, we have drawn another line, which we have designated "Line of Control," meaning to indicate thereby the factors that have actually governed building operations throughout past periods. In the boom period, extending in most cities from 1923 to 1929, the actual demand for building accommodations, in the sense of demand for actual use, had little, if anything, to do with the magnitude of building operations. Nobody knew what the actual demand was, and nobody seemed to care much. The only curve that development and construction companies and finance concerns saw was the rainbow curve of an unlimited future demand that would continue to fill their buildings or take properties off their hands at increasing prices. In other words, the ordinary demand curve ceased to function as a market factor and was replaced by a much higher curve of anticipated demand. It would be more accurate to say that in most fields of

building, any actual demand curve, in the sense of demand for actual use, ceased to exist; and a demand based, even in the minds of consumers, on anticipated "uses" took its place.

This psychological curve governed building activities until the collapse of the boom. Thereafter psychology dropped to the level of actual demand, intersecting that curve at a lower level, as we have pointed out, on account of the additions to the supply of buildings in the meantime. Needless to say, this deflated "normal" demand now governs the building situation. In our diagram we have unavoidably combined a static graph, representing theoretically a momentary demand and supply situation, with the histogrammatic element in our control curve; but if it succeeds in making our meaning clear, the cartographic anomaly may perhaps be tolerated.

It means, in so far as this describes the situation accurately, that the factors which actually have governed the volume of construction have not been such as to set up any level of marginal costs which would make shifting possible. The ingredients out of which to construct a parallelogram of shifting and incidence have not been present. The expansion, collapse, and depression in sequence *have carried the building industry clear around the area of any possible shifting* and have landed it in a trough of acute oversupply and deflation, where any shifting is obviously out of the question.

An interesting problem in market analysis is afforded by the segment ZF. Is it in reality a continuation of the curve GH, whose elasticity broke under the increased supply represented by L, M, and N, or is it a projection of an entirely different curve EZ? Among real estate men the consensus of opinion (translated into academic terminology) is that ZF is not merely the bottom of an inelastic curve, or a curve whose elasticity decreased rapidly throughout its lower ranges; that if this increased supply had been thrown upon the market in 1926 or 1927, while the demand curve might have dropped rapidly, it would not have fallen to anything approaching the level of Z; that the segment ZF is a projection from a very different curve, EZ, brought about by radical changes in the purchasing power and economic position of "consumers" as well as changes in the supply of buildings. In any case, it does not affect our inference that the factors which have governed construction throughout the past decade, and probably for a much

longer period, have been such as to create a wide surplus throughout one period and a deficit throughout the other, both of which would make shifting impossible; and the swiftness of the collapse would seem to preclude the maintenance of any intervening purgatory long enough for any one to shift any taxes before his descent to still lower regions.

The preceding discussion applies to commercial building operations and buildings of all kinds for business purposes. In the case of single-family residences, however, built by owners for the purpose of residence, taxes have been a serious factor, one upon which the prospective home builder has generally "figured" long and earnestly. But a home owner occupying his own home cannot shift the taxes, for the simple reason that there is no one to whom to shift them. It happens, therefore, that the one field of building in which taxes have been a serious deterrent is a field in which shifting has already been precluded by the nature of the ownership and use.

Consequently, while the writer subscribes to the general theory of incidence, as it has commonly been worked out by economists, and entertains no illusions about revolutionizing this theory, he has been forced by observation over the past decade to the conclusion *that the building industry does not afford the conditions which make an application of the theory possible*. The people who do the building have not behaved as, under the theory of incidence, they are expected to and as they should have behaved. They have done things which they should not have done and have left undone things which they should have done; and as long as they behave in this way, the Lord only can enable them to shift their taxes.

Of course, there are relatively static districts, sufficiently stabilized to avoid speculative movements and sufficiently isolated by their location or character to avoid the consequences of inflation and deflation elsewhere; but they are very rare. Particularly rare are those communities which, though free from speculation themselves, are sufficiently isolated to escape the consequences of general conditions of inflation and deflation.

Special situations also may be figured out, involving peculiar processes of shifting, some of which the writer has endeavored to trace. One such situation is interesting because it illustrates the

way in which a tax that can not be shifted itself, may make it possible to shift some other tax.

The impact of a tax depends on many other considerations than its amount. A lump-sum tax will ordinarily develop more prophylactics than the same amount of tax spread over an indefinite number of small payments; a direct and visible tax more than an indirect and invisible tax; and a permanent tax more than one which offers a gambling chance of discontinuance or modification. Now, it happens that the tax on private homes occupies the less favorable position under all these alternatives. In the first place, it is a painfully direct tax; whereas such portion of the taxes as the tenant pays on an apartment building are so indirect and unrecognized that it is necessary to write labored papers like the present one in order to determine whether he really does pay any of them or not. In the second place, it is a lump-sum tax, with "delinquent" and "penalty" dates, which the ordinary home owner has to begin to mark on his desk calendar two or three months ahead; whereas any taxes the apartment dweller pays are at least spread evenly over the twelve months of the year. In the third place, when one builds a home, he realizes that he is assuming not only a mortgage, interest payments, repairs, plumbers' bills, and other responsibilities of a permanent investment, but also an annual tax bill, whose recurrence is as certain as the existence of the lot on which he builds; whereas, if he rents an apartment, while he may be fully convinced that the owner is shifting some of the taxes to him, he is at least free to move at any time to some other location where rents are lower, salaries higher, or facilities more convenient.

The consequence is that even if assessments and taxes were exactly the same in the case of homes and apartments, the existence of the tax would be *a greater deterrent* to home building than to apartment renting on account of its directness, its lump-sum form, and its certainty and unavoidableness in the case of the home owner. This means more people looking for apartments—a greater demand for apartments than would be the case without the tax. Now to the extent that the tax has the effect of increasing the demand for apartments, it makes shifting possible. In smaller cities, where apartment buildings are few and there is a large proportion of single-family residences, the increased demand for



apartments in consequence of unwillingness to assume heavy taxes on homes could easily be a sufficient factor to make it possible, temporarily at least, to shift the tax on apartment buildings entirely. Such a situation probably does not occur frequently, but in suburban cities about Chicago the present heavy property taxes have undoubtedly been a factor in stimulating the movement from single-family residences to apartment buildings.

This roundabout process of shifting is interesting from a number of angles. It illustrates the way in which a taxpayer, in an effort to avoid an obvious tax, not infrequently puts himself more or less voluntarily in position to assume a tax shifted to him by someone else. Many a man has rented for years at a price greater than the annual cost of owning a home of his own, and assuming in that price a larger or smaller portion of the taxes on the building he rents. The owner may congratulate himself that he is shifting a good portion of the taxes to his tenant; but the tenant likewise may feel that he is getting his entire money's worth—he is paying for the privilege of retaining greater mobility of choice and of movement. His occupation or position may be such that permanent anchorage imposes liabilities, which heavy taxes would further aggravate. He is paying to retain an *option* on a certain variety of choices and movements.

And this in turn illustrates one of the unhappy consequences of present real estate taxes, in an industrial society where a considerable degree of mobility is necessary and desirable. In our earlier agricultural period the dilemma did not exist. People expected to stay on the same farm for a generation or two. The sons went west to other farms but the old community back home stayed there.

Now, with the development of transportation and industry, the emergence of new industries, and the movement of whole industries from one section to another, we have become almost a nomad people again, moving about—if measured in terms of mileage—more than any Arab tribe or Gypsy band could ever have hoped to do. But our tax system is still based on an assumption of general permanence of occupation and habitation. We tax the appurtenances of fixed habitation and ignore pretty nearly everything else. One who still travels about, Gypsy fashion or otherwise, may take with him large wealth, great income, extravagant

consumption, and still be very nearly ignored by the taxing agencies of the states and localities in which he sojourns. If it were not for the gasoline tax, he would still be furnished smooth roads and sprinkled streets for his migratory travels, at the expense of the more industrious dwellers in fixed habitations.

In short, our system of real estate taxes offers a reward for nomad habits of life and penalizes any inclination on the part of the citizens to adopt a fixed abode in a settled community. And even within the real estate field itself, the difference in incidence of the taxes on homes and apartment buildings tends to drive one into the least fixed and permanent type of abode that is available.

But this is a digression from our main line of analysis, justified, we hope, as an obvious implication of the incidence of taxes on homes and apartments. The indirect effect of the tax on homes in helping to shift the tax on apartment buildings was mentioned as an example of particular situations in which some process of shifting can be traced. But under the conditions of the past decade such situations appear to be rare. Presumably there are also smaller communities in which building operations have been free from speculative expansion and acute depression, though the writer would scarcely know where to find them.

But with all of these qualifications, the conclusion forced upon the writer, as a result of observation over the past decade, is that in most sections of the country throughout the greater part of this period, the *supply of buildings has been governed by factors and conditions, which make the application of the usual theory of incidence impossible*; and that, in consequence, the taxes on buildings and improvements have not been shifted to any appreciable extent, as one would expect, and as the writer himself has taught his classes for years.

## II. SIGNIFICANCE OF SHIFTING FROM STAND-POINT OF TAX POLICY

Next to the improbability of shifting taxes on improvements, under actual conditions of building supply, the thing that has most impressed the writer throughout the past decade is that even where these taxes may largely be shifted in accordance with the customary theory, the significance of this fact is much less than has commonly been assumed. Shifting means shifting the "burden," as

we have always been careful to explain, though the "payment" is still made by the party upon whom the tax was originally levied. But there are business relations, of importance to the community as well as to the individual directly concerned, in which the *payment* may be more significant than the *burden*. Let us take a hypothetical illustration, of a kind that can be reproduced in actual business thousands of times, except that in our illustration we will concede the shifting of the taxes.

Suppose that a small apartment building, built four or five years ago at an actual cost of \$125,000, is now worth only \$90,000, because similar buildings can now be constructed at the lower cost. Suppose that the overbuilding was so moderate that the supply has now been adjusted to the actual demand; and that both have been adjusted so nicely to costs, that rentals are now on a cost basis. Assume that this means a gross rental of 10 per cent on the value of the property, and that 2 per cent of this 10 per cent, represents taxes; so that taxes are entirely shifted to the tenants, and it is possible to show that none of the burden of real estate taxes rests upon the building owner.

But suppose the building was financed at the time of construction to the amount of \$100,000, including both first and junior liens—not excessive financing for well-located, established types of building of economical construction. But the second mortgage is due; it may even have been renewed once in that time; and the bank is refusing to renew without some reduction of the principal. The rental is yielding, on our supposition above, something less than sufficient to cover taxes and interest and of course nothing for payment of principal. The fact that the *burden* of the tax is shifted to the tenant does not prevent the disastrous results of a heavy concentration of fixed charges on the equity; and the tax, under most of our property taxes, falls entirely on the equity.

The result is what has happened thousands of times all over the United States in the past few years. Equities have been wiped out and properties sacrificed through forced sale or foreclosure, with disastrous effects upon real estate values and real estate credit, which in turn have precipitated failures of banks and financial houses and entailed the loss of millions of dollars by people who have supposed that they had no connection with any real estate investments.

The harm here is not the onerousness or the injustice of the tax, but the financial and industrial dislocation. And it does not help the situation to say that it is due to speculation and overbuilding. Some speculation, overproduction, and deflation are inevitable as long as we have our unstable price level. And no matter who is responsible, conservative as well as speculative builders are involved in the losses, and the whole community suffers the consequences.

Taxes are a factor in this process, not on account either of their amount or their incidence, but on account of the *rigidity of their payment*, which even a complete shifting of the tax will not alleviate. The building in our illustration ought to pay substantial taxes; or let us say, the wealth and income represented by this building ought to be a basis for contribution to public revenue *by some one* to whom it represents taxpaying ability. But if the same amount of revenue were contributed from the income of the mortgage holders, or were collected from some one who had an income rather than from someone on the verge of bankruptcy, the tax would at least not contribute to the conditions we have described, or aggravate those conditions when they already exist.

These conditions happen to be particularly fresh in mind on account of our recent experiences; but the rigidity of real estate taxes has worked hardship for many years and in many fields, entirely aside from any of our recent experiences. It has wrought havoc in farm taxes. And altogether it is probable that the rigidity of real estate taxes has been more painful and costly than their amount, large as this is. The thing we are pointing out in this paper is that *even shifting the burden of these taxes does not eliminate the ill consequences of the rigidity of their payment*.

**Implications.** If this is true, the moral is two-fold, one applying to the real estate owner, the other to the rest of us.

The moral for the realtor and real estate owner is that the one best way to reduce his taxes is to take steps to remove the flagrant speculative elements and speculative practices from his field. It is these elements that have prevented him from shifting his taxes in the past. If he will remove these elements and get the building business back upon some stable basis in relation to costs, he will

thereby give the orthodox laws of incidence at least a gambling chance to operate, which in the past they have not had. We sometimes speak of the impossibility of repealing economic laws, but that feat is not so impossible after all. The building business, through the behaviour of its members, has seemingly repealed the laws of incidence in that field; and this paper may be construed as a plea for a return to "law-abiding" habits in the field of economic law.

The second moral is that since realtors and builders will probably not heed this plea; and since, even if they do, shifting the real estate taxes will not eliminate the harmful consequences of the unyielding rigidity of these taxes, it behooves the rest of us to move, with such haste as we may, toward the adoption of less rigid forms of taxation. This is not intended to be an argument for an income tax or for any particular kind of tax. But our modern financial and industrial mechanism requires a tax that will be, not necessarily smaller in the aggregate, but one that will have a smaller "load-factor"; one in which the *payment*, regardless of shifting the *burden*, will have less of the element of an unvarying fixed charge and will be adjusted somewhat to the business situation and financial capacity of the taxpayer.

## APPENDIX III

### INCREASING TAX DELINQUENCY<sup>1</sup>

On every hand one hears of an alarming amount of tax delinquency and of governments being seriously embarrassed because of their inability to collect the taxes, but there have been very few studies made to determine the true situation. Delinquency figures have little significance unless it is known to what stage of delinquency reference is made, as well as the trend over a period of years.

Figures based on a few recent studies are presented below. Not all of them tell as much as it would be desirable to know.

#### MICHIGAN

The respective percentages of area, assessed value, and taxes returned delinquent in Michigan in selected years are as follows:

**Table I**

Year	Per cent of area	Delinquent	
		Per cent of assessed value	Per cent of taxes
1900.....	20	9	6
1905.....	15	6	5
1910.....	12	4	4
1915.....	14	5	4
1920.....	15	5	3
1925.....	21	12	7
1928.....	25	18	10

Stated in absolute figures, the area delinquent in 1900 was 6,995,973 acres, and in 1928, 8,756,732 acres. The assessed value of all delinquent real estate was \$75,185,014 in 1900 and \$1,146,573,162 in 1928, a fifteen-fold increase. The delinquent taxes in 1900 amounted to \$1,419,653, and in 1928 the amount was \$25,278,097, an even greater increase than in assessed value. Thus,

<sup>1</sup> This paper was submitted by Mr. Fred R. Fairchild, member of the Committee on Taxation, as an appendix to the committee's report.

the figures show a large amount of delinquency at the beginning of the century, a rather steady decrease for the next ten years, a fluctuating but slightly increasing amount for the next ten years, and a sharp and steady increase since 1920, the amount by every measure having risen above the 1900 level by 1925.

For recent years, data are available permitting the separation of the lots and the acreage property delinquent. The number of lots delinquent since 1922 has increased much more rapidly than the acreage delinquency, and this is especially true in the more wealthy counties.

The figures and statements given above refer to short-term delinquency, that is, taxes which remained unpaid 50 days after the first penalty of 3 per cent was added to the original tax bill. As the period of delinquency lengthens, the amount of delinquency is very much reduced. Thus, while 670,724 descriptions were returned delinquent in 1924, only about one-fourth of them (170,634) were advertised for sale two years and four months later. Even so, there has been a pronounced increase in long-term delinquency since 1905. In that year, the taxes, including interest and penalties on descriptions advertised, amounted to \$603,336, and in 1927 they amounted to \$4,764,005, an increase of 694 per cent. The taxes, including interest and penalties on descriptions sold (or redeemed prior to the sale) increased from \$295,385 to \$3,311,470, an increase of 1,021 per cent. The increases in long-term delinquency parallel very closely the increases in short-term delinquency.

In Michigan, lands on which taxes have not been paid for five years, and which are in fact abandoned, are deeded to the state with an absolute title. In 1930 the Conservation Commission held title to about 1,600,000 acres of such lands.

### MINNESOTA

Using the difference, between the levy each year and the actual collections (excluding interest and penalties) as a measure of short-term delinquency, the increase in 16 northern counties of Minnesota was from 0.5 per cent in 1919 to 5.5 per cent in 1927. If St. Louis County, which contains the city of Duluth and has rich iron deposits, is omitted, the increase was from 3.9 per cent to 12.3 per cent. State figures were obtainable only from 1921 to

1925, and during this period no consistent trend was discernible.

In the case of the cut-over counties of Minnesota, the large volume of short-term delinquency has proved a prelude to a large volume of long-term or absolute delinquency. In 15 northern counties, 1,619,028 acres, or 13.9 per cent of the area of taxable unplatted land, had been delinquent for three years or more at the time the records were examined three or four years ago. In 4 counties, more than 20 per cent of the area had been delinquent for three years or more. In selected townships in 4 counties, the delinquent areas in 1926 ranged from 1.6 to 49.7 per cent of the respective total areas. There was almost seven times as much long-term delinquency as in 1913.

In Minnesota, land offered at a tax sale may, if not redeemed within five years, be deeded to the state. Something over 4,000,000 acres in the northern counties have almost reached the stage of delinquency at which they become deedable.

### WISCONSIN

A study of tax delinquency in 17 counties of northern Wisconsin, made by the agricultural experiment station of the State University,<sup>2</sup> disclosed a rapid increase in delinquency in the region studied, the problem having developed almost entirely since 1920. The investigation revealed that 1,082,232 acres were sold at the tax sale in 1921 and that at subsequent sales the delinquent area had increased steadily until in 1927 it reached 2,593,163 acres, or nearly a quarter of the entire land area of these 17 counties. Only 73 per cent of the land sold in 1921, and only 57 per cent of that sold in the four years (1921 to 1924, inclusive) had been redeemed at the time of the investigation in 1927. Indeed, there were 1,266,330 acres already subject to forfeiture.

### OHIO

The Committee on Research of the Governor's Taxation Committee in Ohio reports that in that state delinquent taxes on real estate alone increased from less than \$8,000,000 in 1920 to \$36,000,000 in 1928—an average annual increase of 20 per cent. In Cuyahoga County (containing Cleveland) delinquent taxes on real estate increased from \$2,800,000 in 1920 to \$22,000,000 in 1929, and in Montgomery County (containing Dayton) from

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<sup>2</sup> Bulletin 399, June, 1928.



less than \$1,000,000 in 1927 to \$3,350,000 in 1930. The report does not indicate what stage of delinquency is referred to.

**Selected Cities.** J. L. Leonard, in a nation-wide study of delinquency, found delinquency ratios of 21.4 per cent in Jersey City, 20.5 in Newark, 15.9 in Cleveland, 14.2 in Chicago, 13.9 in Detroit, 12.3 in Houston, and only slightly lower ratios in a number of other cities selected at random.<sup>3</sup> He could not determine what degree of delinquency is referred to, or whether it is the same in every city. Presumably the figures refer to short-term delinquency, but, even so, there is probably a residuum of absolute delinquency.

In order to show the trend in city delinquency over an extended period and relate it to the increase in taxes, he selected the four largest cities of Ohio. These cities were selected solely because the figures were available and are not to be considered as either typical or extreme.

These four cities—Cleveland, Cincinnati, Columbus, and Toledo—show the following delinquency ratios for the indicated period of years.

Table II

Year	Cleveland	Cincinnati	Columbus	Toledo
1915.....	3.96%	0.12%	1.97%	2.07%
1916.....	4.58	1.64	1.67	1.58
1917.....	.....	.....	.....	.....
1918.....	7.78	2.01	2.53	2.81
1919.....	7.02	2.04	2.01	2.32
1920.....	5.49	1.65	1.82	2.41
1921.....	7.43	1.21	2.75	3.71
1922.....	8.44	1.32	2.37	2.78
1923.....	9.30	1.37	2.32	4.81
1924.....	9.61	1.79	3.10	4.68
1925.....	11.26	1.44	4.65	5.76
1926.....	12.26	2.51	4.90	5.59
1927.....	15.87	1.88	5.21	6.28

When compared with the total amount of tax levy it is found that in three of the cities the increase in delinquency has paralleled roughly the increase in taxes, but in Cincinnati delinquency seems to bear no relation to volume of taxes levied.

<sup>3</sup> Leonard, J. L. *Tax Delinquency in the States of the United States* (unpublished doctorate dissertation at Yale University).

## APPENDIX IV

### ASSESSMENTS OF PROPERTY IN WASHINGTON, D. C.<sup>1</sup>

#### I. TAXATION IN THE DISTRICT OF COLUMBIA

The District of Columbia, the seat of the government of the United States, has maintained its present form of government since the provisions of the Act approved June 11, 1878. (20 Stat. p. 102.) The Act provides that the said District shall continue a "municipal corporation." A clause in the eighth section of the first article of the Constitution of the United States gives Congress the power "to exercise exclusive legislation in all cases whatsoever over such District."

Three Commissioners appointed by the President of the United States, under certain requirements of law, constitute the governing board of the District. Each year the Commissioners estimate the necessary expenses of the District for the coming year. This is forwarded to the Bureau of the Budget, and after modification and approval by the President of the United States, it is forwarded to Congress.

Whatever amounts Congress deems necessary for the expenses of the District government are appropriated by that body, and these expenses are divided between the local government and the United States as provided by Congress. The part paid by the District is levied and assessed upon the taxable property and privileges in said District, other than the property of the United States, the District of Columbia, or foreign governments.

The District of Columbia has an area of seventy square miles or 44,800 acres, which includes a water area of 5,000 acres, United States property of 7,500 acres, District property of 1,000 acres, and miscellaneous exempt property of 1,300 acres. This leaves about 30,000 acres, one-half of which is improved and built on. The population in 1930 was 488,000.

Real and personal property is assessed annually at "not less

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<sup>1</sup>This paper was submitted by Mr. William P. Richards, member of the Committee on Taxation, as an appendix to the committee's report.

than the full and true value thereof in lawful money." Taxes are paid semi-annually in equal instalments in the months of September and March. The District of Columbia is unusual in having one unit for assessment purposes, undivided and unallied. That is, there are no assessment wards or districts and no questions complicated by city, county and state assessments. There is only one administrative head responsible for assessment results.

Therefore, equalization of assessments within the District of Columbia, under its requirements of law, is a simple matter when compared with difficulties inherent in other localities. Several of the assistant assessors and a number of the employees have been connected with the District from ten to twenty years, thus helping toward a stable and efficient organization.

### ASSESSMENT OFFICIALS

Assessments of both real and personal property are made by an assessor and a board of one deputy assessor and eight assistant assessors. Five assistant assessors are designated by the Assessor to act as the assessors of real estate, and the other three assistant assessors compose the Board of Personal Tax Appraisers. The Deputy Assessor and eight assistant assessors, with the Assessor as chairman, constitute the Board of Equalization and Review of real estate assessments, and also the Board of Personal Tax Appeals.

The above officials are appointed by the Commissioners of the District of Columbia as a permanent board and the law requires that they shall be "discreet persons who shall have been bona fide residents of the District of Columbia for the period of at least five years, and conversant with real estate values therein," and shall hold office until removed by said Commissioners for cause satisfactory to them.

In addition, a force of one hundred employees are engaged in field, map, and transfer work, calculations, typing of bills and ledgers, and miscellaneous duties. These are appointed by the Commissioners under civil service requirements.

The total value of real estate of any nature is about \$2,000,000,000; one-third of this amount pertaining to the exempt list. The United States property is estimated to be worth \$500,000,000; the

District has about \$70,000,000; and all other classes of exempt property like that of churches, schools, legations, and benevolent associations, etc. are worth \$100,000,000.

The revenues of the fiscal year 1931 were a little over \$30,000,000 and the expenditures about \$40,000,000, the United States contributing \$9,500,000 as its share of expenses. Two-thirds of the revenues was derived from the real estate levy and nearly 30 per cent from the gasoline tax and the so-called personal tax. Under the heading of personal tax, there was assessed against tangible personal property \$1,822,510 and against intangible personal property \$2,725,940, and a gross earning tax against public service corporations, banks, etc. amounting to \$2,228,456. All moneys paid by citizens of the District as assessments or taxes, are turned into the Treasury of the United States and applied to appropriations made under the various acts of Congress.

### SEVEN REQUIREMENTS IN EQUALIZING REAL ESTATE ASSESSMENTS

In the assessment of real estate *equalization* is of *paramount* importance and as an aid to such a purpose the following seven requirements are held to be essential:

1. Maps giving the boundary lines (length and bearing), the area, and distinctive numbers of each square, lot, parcel, and real estate holding.
2. Descriptive data of buildings, giving character and dimensions, cubic feet, (costs when possible), and full information of interior finish and arrangement.
3. Sales under normal conditions, monthly and yearly rentals, near sales, offers, and asking prices.
4. Relative unit values for lots of different depths and shapes, including tables for corner lots.
5. Factors of building values: The value per cubic foot or the value per square foot of floor space.
6. Publicity: Latest assessments to be published each year in book form and placed where the public may obtain ready access.
7. Assessors with experience, judgment and activity.

**Requirement No. 1; Maps for the Purpose of Assessment and Taxation.** Maps are now accepted as of absolute need in assessment work and their uses in the large cities have become general.

They should be drawn in convenient size and to scales suitable for various purposes. Maps of small scale, covering considerable territory, should be available for studies of unit prices. Large

scale maps on, say, cards of 15 inches by 20 inches should furnish details of depths, width and area of lots.

Maps used in the District of Columbia are drawn on scales of 50 and 100 feet to the inch, giving numbers or distinctive designations to all lots and parcels in accordance with the requirements of acts of Congress. These acts require, among other things:

That, "each square shall bear a number or other designation that will distinguish it from every other square. That each lot or parcel of ground in each square shall bear a number or other designation that will distinguish it from every other lot or parcel in the square."

That, "each piece or parcel of unsubdivided land, and each parcel of land deeded by metes and bounds in said District, shall have a distinctive designation."

The plats are subject to constant change so as to be current or up-to-date, as determined from daily transcripts of all deeds of conveyance, wills, condemnations, decrees, and other instruments or proceedings by which boundaries are changed.

Ledgers are prepared in numerical order, using these maps as a basis for listing. This enables a check to be made of each square, ensuring an assessment of the correct number of holdings or parcels. The numerical order of listing is probably the only way by which the accurate auditing of tax payments can be accomplished.

**Requirement No. 2; Descriptive Data of Buildings.** The amount and variety of descriptive data concerning improvements may be greatly extended, but, for the purposes of assessment, this data should be condensed and cover only the points that are necessary for the guidance of the assessor. Any omitted details should be supplied by an examination of the building, the ultimate factor being derived from the condensed data aided by the examination, but depending more particularly on the skill and judgment of the assessor. An example of data for a large residence follows herewith:

Square 164	Street	K
Lot 1	House No.	1701
Size of lot 45 x 121.42 =	Sq. ft.	5,464

Character of improvements:

Four story and cellar residence, well constructed, about thirty years old, and having ceilings of ten and twelve feet. In good state of repair and used since 1914 as a club house. Has four baths and three lavatories. Is heated by hot air and steam.

Dimensions 45 x 57 x 56, 24 x 17 x 48, 23.5 x 56 x 34.

Cubic feet 207,700

FACTOR 90 cents.<sup>1</sup>

Cost of Lot

Cost of Building

Total \$70,000

Year 1914

Rented: Owned and used by the Washington Club.

Asking price:

Remarks:

**Requirement No. 3; Sales, Rents and Leases.** Data as to the nature of sales and the amounts involved should be collected by a selected force of field men. The information is to be obtained from either the buyer or the seller, agent or trustee. Inquiry from two different sources of information is advisable. Several years ago considerations were indicated by revenue stamps attached to deeds, but this is no longer required by law. In some years it will be found that out of many transfers of real property not more than a third have an actual cash consideration or in terms that would allow an accurate cash estimate.

The field force should likewise gather data as to size and condition of buildings, rents, leases, cost of construction, offers, or any data useful in assessment work and to such extent as time will permit.

The field men will find a majority of the owners and the real estate brokers willing and even anxious to help them in the collection of data, but it is impossible to collect all sales and ascertain the facts bearing on them. The time consumed in following up one large and important sale is sometimes very great and this suggests legislation requiring the consideration to be carried in the deed or else to compel the owner to file an affidavit with the assessor, as confidential information, showing the nature of the sale and the amount involved.

<sup>1</sup> The factor of building value is determined by the assessor after taking into consideration the cost of construction, the depreciation, the condition or state of repair and whether the improvement is suitable to the site. In considering *suitability* it may be found that a well built structure in excellent condition has become unfit or obsolete. The question of depreciation is a troublesome one for which it is impossible to adopt any infallible rule or guide. Tables of average depreciation for different classes of buildings can be had from many sources. The quality of construction of buildings in the same class may vary greatly and consequently afford a difference in factors of depreciation. Moreover, the question of obsolescence, as noted above, may entirely eliminate the question of depreciation. In general, all dwellings of medium class or below may be considered to depreciate 5 per cent during the first year, 2 per cent per annum during the next five years, and between 1 and 2 per cent per annum thereafter. High class properties depreciate 1 to 2 per cent per annum but are peculiarly subject to the question of suitability to the site.

The field force should be given daily notices of any sales or transfers. This information should be on cards of suitable size for field work. It is the usual practice of any assessing division to obtain from the land records duplicate transcripts or condensed data regarding the changes in ownership, and it therefore becomes an easy matter to use this information in making up the cards or data required for the field force in the quest for true consideration.

Sales are the bed rock upon which assessments are built. Cost of construction, rents, leases, condition and adaptability of improvements, all enter into the fair market value of real estate. Sales are concrete expressions of the value of these elements. When sales are missing, real values must be determined by an examination of, or a comparison of, the above elements. Expressions of opinion from real estate experts are probably of help when enough ideas can be obtained. Jury awards are generally high and cannot be used as a basis for assessment purposes.

**Requirement No. 4; Relative Lot Values.** In the year 1866 Judge Murray Hoffman of New York, in deciding a law suit, ruled that an ordinary city lot fifty feet deep was worth two-thirds as much as a lot adjoining, one hundred feet deep. Since that time real estate experts throughout the country have prepared tables which embody Judge Hoffman's ruling or a modification of it. About the time of the ruling there was in use a guide to depth values known as the rule of four, three, two, one. Thus, for a rectangular lot one hundred feet deep, 40 per cent of its value was in the first 25 feet of depth; 30 per cent value in the next 25 feet of depth, etc.

In the District of Columbia lots are sold by the square foot, and this is of some advantage in making an analysis of irregular and of corner lots. In other cities land is rated, generally, by the front foot, which means that a standard lot 100 feet deep worth \$3,000 per front foot would be rated in the District of Columbia at \$30 per square foot.

The rules of relative depth values are particularly desirable in the business section where values are from \$5 per square foot up to \$150 per square foot. The rules should be modified in the residential sections or in places where large pieces of land are necessary for commercial purposes.

In determining the price of lots in any square, the custom is to

first fix the value of a strip one foot wide and 100 feet deep near the center of each frontage of the square. This value is to be determined from sales or by comparisons of similar property, and after such value is decided upon it may be used, not only to measure the values of other interior lots, but also to arrive at the worth of corner property.

Table I gives figures used in the District of Columbia in determining relative values of both interior and corner lots. The upper part of the table, A, presents figures for relative depth values of interior lots. The second part of the table, B, relates to side street influence. The depth rule used in the District of Columbia is very simple. Where lots are rectangular, the values squared are in exact proportion to the depths.

**Table I. Relative Values of Interior and Corner Lots**

A. RELATIVE DEPTH VALUES OF INTERIOR LOTS

Feet	0	1	2	3	4	5	6	7	8	9
0..	00.00	10.00	14.14	17.32	20.00	22.36	24.49	26.46	28.48	30.00
10..	31.62	33.17	34.64	36.06	37.42	38.73	40.00	41.23	42.42	43.59
20..	44.72	45.83	46.90	47.96	48.99	50.00	50.99	51.96	52.92	53.85
30..	54.77	55.68	56.57	57.45	58.31	59.16	60.00	60.83	61.64	62.45
40..	63.25	64.03	64.81	65.57	66.33	67.09	67.82	68.56	69.29	70.00
50..	70.71	71.42	72.11	72.80	73.48	74.16	74.83	75.50	76.16	76.81
60..	77.46	78.10	78.74	79.37	80.00	80.62	81.24	81.85	82.46	83.07
70..	83.67	84.26	84.85	85.44	86.02	86.60	87.18	87.75	88.32	88.88
80..	89.44	90.00	90.55	91.11	91.65	92.20	92.74	93.27	93.81	94.34
90..	94.87	95.39	95.92	96.44	96.95	97.47	97.98	98.49	99.00	99.50

B. FACTORS OF INFLUENCE OF SIDE STREET ON VALUE OF LOT

Feet	0	1	2	3	4	5	6	7	8	9
0..	00.00	10.00	14.10	17.30	20.00	22.50	24.50	26.00	27.50	29.00
10..	30.50	31.50	32.50	33.50	34.40	35.30	36.20	37.00	37.80	38.50
20..	39.15	39.80	40.40	41.00	41.50	42.00	42.50	43.00	43.45	43.90
30..	44.30	44.70	45.10	45.50	45.90	46.30	46.65	46.95	47.25	47.55
40..	47.85	48.15	48.45	48.75	49.00	49.25	49.50	49.75	50.00	50.20
50..	50.40	50.60	50.80	51.00	51.20	51.40	51.60	51.80	51.95	52.10
60..	52.25	52.40	52.55	52.70	52.85	53.00	53.10	53.20	53.30	53.40
70..	53.50	53.60	53.70	53.80	53.90	54.00	54.10	54.20	54.30	54.35
80..	54.40	54.45	54.50	54.55	54.60	54.65	54.70	54.75	54.80	54.85
90..	54.90	54.92	54.93	54.94	54.95	54.96	54.97	54.98	54.99	55.00



This table has been tested by sales over a number of years and has given satisfactory results. Actual sales have shown, for example, that the side street influence on a corner lot at 5 feet from the corner is 100 per cent; at 10 feet 95 per cent; and continues to diminish at each succeeding 5 foot interval of distance as follows:

15 feet—91 per cent	60 feet—68 per cent
20 feet—87 per cent	65 feet—66 per cent
25 feet—84 per cent	70 feet—64 per cent
30 feet—81 per cent	75 feet—62 per cent
35 feet—78 per cent	80 feet—61 per cent
40 feet—76 per cent	85 feet—59 per cent
45 feet—73 per cent	90 feet—58 per cent
50 feet—71 per cent	95 feet—56 per cent
55 feet—69 per cent	100 feet—55 per cent

With the foregoing in mind it will be seen that the figures for depth in table I, A, have been multiplied by these percentages to give the side street influence factors in table I, B. In applying the factors in a given case the low value street is used as the one of side street influence.

There follows an example of the application of the table in computing the value of a corner lot:

Lot 55 x 88 feet

55 foot frontage on X street where value is \$60 per square foot

88 foot frontage on Z street where value is \$35 per square foot

Factor for depth at right angles to X street, 88 foot factor

(See A. above) = ..... 93.81

Factor for depth at right angles to Z street, 55 foot factor

(see B. above) = ..... 51.40

\$60 (value per square foot on X street) x 55 (front footage  
on X street) x 93.81 (depth factor) = ..... \$309,573

\$35 (value per square foot on Z street) x 88 (front footage  
on Z street) x 51.40 (depth factor) = ..... \$158,312

Value of corner lot—(sum of the two) ..... \$467,885

**Requirement No. 5; Factors or Unit Prices in Construction Cost.** Building factors of all large structures should be the cost price reduced to a unit cost per cubic foot. Per square foot prices may be used for small houses or special construction. To separately assess land and buildings requires something more than the approximate division of the total value into two parts. Mutual

and related methods of appraisal should apply to the segregated amounts. Land has its surest disclosure of value in sales and rents and, in addition, buildings have their maximum influence from the market conditions of material and labor. Unit values afford ready methods of comparison for property similar in location and construction and unit values are the factors of main reliance for dividing land and buildings into their component values.

It cannot be accepted always that buildings exactly alike in construction, size and finish have the same value. Buildings are frequently misplaced or the change in ground values may call for an entirely different structure. Owners attempt to improve their property to the best advantage and generally do so, but buildings may and frequently do overload the land and thereupon are worth less than the cost of construction. The real test of value generally comes after several years of use by which revenue producing qualities tend to fix the value of the property in its entirety. Thereupon the building becomes worth the difference between the land and the total value.

It is patent to any experienced appraiser that a table of twenty-odd classes of improvements carrying a wide range of unit values for each class can be of use only as general information. This makes it necessary for sub-classes and special structures to be added as substantial aid to assessment work. Extra care and study should be given to building costs with reference to improvements of large size and monumental construction. The figures may be obtained from sworn statements, or from builders, architects, and owners, or from examination of books relating to actual cost and details of construction.

In order to compile, in the highest degree, data relating to building construction it is advisable to obtain photographs of all large and expensive structures, as well as prints of a number of types of smaller buildings. Each print or photograph should be on a card large enough to allow details of the cost of construction, and every kind of information obtainable should be entered on the card. A study of the cards by the assessor or an assistant will aid more in appraisal work than any categorical list of unit construction values. The tabulations on some of the following pages are inserted as suggesting working lines for larger data.

**Requirement No. 6; Relative Unit Values.** Each year the assessors of the District of Columbia complete a new appraisal on real estate which is open to the public for inspection and appeal on the first Monday in January and held for review during the following five months. These appraisals are spread on ninety-one field books and there is no law requiring publication of the amounts.

After the period of review the board completes the assessment work by July 1st of each year. Lithographs of the completed

**Table II. District of Columbia Building Factors, 1914<sup>1</sup>  
Cost per Cubic Foot**

Public buildings.....	\$0.30-\$1.00
Banks.....	0.40- 0.60
Clubs and fraternal houses.....	0.30- 0.50
Hotels:	
Non-fireproof, brick.....	0.20- 0.30
Fireproof, brick and stone.....	0.30- 0.45
Office buildings:	
Fireproof, brick and stone.....	0.30- 0.50
High-class, brick and stone.....	0.40- 0.50
Stores:	
Ordinary, brick.....	0.15- 0.20
High-class, brick and stone.....	0.25- 0.30
Apartments:	
Four stories, brick.....	0.18- 0.20
Fireproof, brick, 4 or more stories.....	0.20- 0.30
High-class, brick and stone.....	0.30- 0.40
Dwellings:	
Small frame.....	0.08- 0.10
Middle-class, frame.....	0.10- 0.15
High-class, frame.....	0.15- 0.20
Small brick.....	0.12- 0.15
Middle-class, brick.....	0.15- 0.20
First-class, stone and brick.....	0.25- 0.40
High-class, stone and brick.....	0.40- 1.00
Theatres.....	0.20- 0.30
Shops, brick.....	0.06- 0.08
Garages:	
Small private garages, brick or concrete.....	0.08- 0.10
Public garages, 2 or more stories, elevator, first-class construction.....	0.11- 0.14
Public garages, ordinary, 1 and 2 stories.....	0.09- 0.10
Warehouses:	
Brick, 1 and 2 stories, open space, loft plan.....	0.07- 0.08
Reinforced concrete, or brick and reinforced concrete, 2 stories, ordinary construction.....	0.09- 0.12
Reinforced concrete, or brick and reinforced concrete, 3 or more stories, with elevator and of first-class construction...	0.12- 0.16

<sup>1</sup> For the year 1929 add 70 per cent.

work are made by a private firm and distributed through sale to various concerns in the District. The work is included in four volumes with about five hundred pages to each volume. There is easy access to these tabulations by any one who cares to visit a real estate office or examine one of the dozen sets placed for inspection in the District Building.

Samples from these publications are shown on the following pages, one in relation to square number 253 located in the heart

Table III. Square 253. General Assessment, 1931-1932

LOT	SQ.FT.	RATE	GROUND	IMP'S	NAME ASSESSED
8	5,819	\$ 72.00	\$ 418,968	\$ 185,500	Myron P. Lewis, Wm. M. Madden & Albert O. Hagar
19	5,444	43.00	234,092	8,300	Anna R. Shoemaker
20	6,292	40.00	251,680	250,000	S. Jones Hill
21	5,818	40.00	232,720		S. Jones Hill
28	2,347	90.00	211,230	13,500	Arthur Burt Co., Inc.
29	2,481	185.00	458,985	107,300	Louis K. Liggett Co., Inc.
30	1,271	80.00	101,680		Geo. W. Harris
35	1,857	80.00	148,560	40,000	Eastman Kodak Stores, Inc.
36	2,100	75.00	157,500	11,100	Pauline Velati Beye
37	2,167	75.00	162,525	10,500	John H. Bartlett
39	2,288	75.00	171,600	25,000	Thos. B. Love Trustees
40	1,550	82.00	127,100		Myron P. Lewis, W. M. Madden & Albert O. Hagar, Trs. of the Adams Bldg. Trust
43	1,547	82.00	126,854	16,500	Julius Garfinckel
44	1,805	80.00	144,400	24,200	Wm. J. Dante
45	1,649	60.00	98,940	6,600	Benj. F. Adams, Tr.
53	1,595	50.00	79,750	26,500	Anna Carry
54	2,090	40.00	83,600	38,500	Walter M. Ballard
55	2,134	40.00	85,360	34,300	John H. Bartlett
56	6,274	70.00	439,180	60,600	G. F. Heilprin, Inc.
800	1,671	160.00	267,360	14,500	Jos. S. Justh
802	1,561	80.00	124,880	20,200	Alfred D. Foster et al, Trs.
803	2,284	80.00	182,720	32,000	John H. Bartlett
804	2,109	80.00	168,720	17,300	James H. Johnson, Edward R. Brownley, Ex. of will Walter Brownley, Dec'd.
805	1,708	70.00	119,560	60,000	Geo. W. Harris
806	6,027	70.00	421,890	175,000	Federal Amer. Nat'l. Bank of Wash., Inc.
807	6,677	70.00	467,390	244,300	John H. Bartlett & Albert Hislop
808	2,728	70.00	190,960	30,000	Thos. R. Marshall
809	3,148	70.00	220,360	22,000	Norvell L. Burchell, Tr.
812	3,168	70.00	221,760	22,500	Reyern Realty Co., Inc.
817	2,097	40.00	83,880	12,900	Sidney West & Louis Kronheimer
818	2,097	40.00	83,880	12,900	Sidney West & Louis Kronheimer
819	2,097	40.00	83,880	9,000	N. Landon Burchell
820	2,860	40.00	114,400	24,500	Homer L. Kitt Co.
821	2,069	48.00	99,312	13,700	Samuel J. Shoemaker
822	584	22.50	13,140	300	Norvell L. Burchell, Tr.
823	2,293	45.00	103,185	15,500	Adam P. & Besse A. Arnold
825	4,584	90.00	412,560	59,400	E. F. Droop & Sons Co., Inc.
824	2,293	45.00	103,185	12,600	Abner H. Young
826	2,280	45.00	113,005	9,200	The S. Kann Sons Co., Inc.
827	2,296	45.00	103,320	35,000	David B. & Bessie L. Edmonston
828	2,296	45.00	103,320	11,600	Margaret Jane Sherratt
829	2,288	45.00	102,960	6,800	Lee Yoh Line & Chin Hon Lee, Trs.
831	38	80.00	3,040		William J. Dante
832	1,695	80.00	135,600	36,000	Myron P. Lewis, Wm. M. Madden & Albert O. Hagar, Trs. of the Adams Bldg. Trust
833	7,523	105.00	789,915	590,000	Federal National Bank
			\$8,568,906	\$2,345,600	

of the retail district, and the other concerning square number 2607 located in the medium-class residential section. The squares are two and a half miles apart and in square 253 there is a preponderance of land values, and in the second square an excess of improvement values over land values.

The fact will be noted that these lithographed copies follow the completed assessment and are thereafter used as books of reference relating to the current taxes. They have been valuable

Table IV. Square 2607. General Assessment, 1931-1932

LOT	SQ.FT.	RATE	GROUND	IMP'S	NAME ASSESSED
1	2,838	\$1.35	\$ 3,831	\$ 8,500	John J. McAuliffe
2	2,750	1.25	3,438	7,900	Albert W. Tohms
4	2,750	1.25	3,438	7,900	Myrtle S. Sappington
5	2,750	1.25	3,438	7,900	Philander P. & Mary Hannah Claxton
11	2,750	1.25	3,438	6,300	John A. Saul
12	2,750	1.25	3,438	7,800	Julia E. R. Rea
13	2,750	1.25	3,438	6,300	Charles B. Campbell
25	2,805	1.25	3,506	9,600	Howard Ullrick
52	4,400	1.25	5,500	8,900	Harold S. & Rebecca F. Smith
53	2,035	1.25	2,544	7,100	Seventh Street Savings Bank, Inc.
54	1,590	1.75	2,783	9,900	Claude J. Sisk & Stanislaw Gruber
55	5,500	1.25	6,875	12,800	Wilbur R. Garrett
57	3,630	1.25	4,538	13,700	William C. Harlee
59	2,991	1.25	2,501	8,000	Mary Holloran
60	2,001	1.25	2,501	7,900	Elizabeth E. Dove
61	3,561	1.15	4,095	9,600	Margaret Smyth
62	2,503	1.15	2,878	9,000	James R. Tubman
63	2,900	1.50	4,350	9,200	Edwin P. $\frac{1}{2}$ , Marguerite C. Corbett & Anna May Lynch
64	2,400	1.50	3,600	9,000	Emma L. C. Johnson
65	2,400	1.50	3,600	9,200	Harriet S. Machen
66	2,600	1.50	3,900	8,900	J. Edwin Lawton & Helen Hubbard Lawton
67	1,925	2.00	3,850	14,700	Anna May & Josephine Stambaugh
68	1,925	1.50	2,888	8,700	Anna E. Mack
69	1,925	1.50	2,888	8,700	Caroline H. Gunnell
70	1,925	1.60	2,080	9,000	Juliette C. Robertson
71	4,564	1.10	5,020	9,700	Gertrude C. McNamara
72	4,783	1.00	4,783	9,500	Charles H. & Carrie L. Bauman
73	5,001	1.00	5,001	9,600	Catherine L. Herron
75	4,074	1.10	4,481	8,800	Mary Ellen Gatchell
76	3,884	1.10	4,272	8,800	William W. Georres
77	3,693	1.10	4,062	8,900	Carlton R. & Daisy S. Willett
78	2,418	1.15	2,781	8,600	Wm. G. & Christina Miller
79	5,218	1.00	5,218	8,800	William Jose
80	5,819	1.00	5,819	13,700	Mary L. Cole
81	4,333	1.15	4,983	11,600	Simon D. & Anna C. Bronson
83	2,855	1.25	3,569	12,700	Hayden H. Gordon
84	2,640	1.25	3,300	10,100	Lillie R. Coblentz
85	15,305	2.40	36,732	173,400	American Realty & Improvement Co., Inc.
86	2,750	1.25	3,438	11,000	Pearl W. Richardson
87	2,200	1.25	2,750	9,800	Harry C. Woodyard
88	2,750	1.25	3,438	10,800	Dorothy Page Cornwell
89	3,335	1.25	4,169	9,600	George M. Curtis
800	1,375	1.25	1,719		Albert W. Tohms
801	1,375	1.25	1,719		Myrtle S. Sappington
811	8,322	1.50	12,483	13,100	Rosa M. Camp
812	432	.50	216		Simon D. & Anna C. Bronson
815	1,650	1.25	2,063		Philander P. & Mary Hannah Claxton
816	432	.50	216	500	Anna May & Josephine Stambaugh
817	432	.50	216	500	Hubbard Lawton
			\$211,096	\$576,000	

in a historical way, pointing to the drift in assessments and have afforded at all times comparisons between properties far and near, inviting criticisms and suggestions that are helpful.

**Requirement No. 7; Assessors with Experience, Judgment and Activity.** In presenting the seven necessary needs for equalization of real estate assessments it is obvious that this last requirement far exceeds any of the others in importance. In fact, a staff of appraisers with shrewdness and experience may be able to present a seemingly balanced assessment without the use of many scientific helps. However, their results would be a mass of opinions varying with the days, places, and circumstances under which parts of the work were done.

Condemnation cases in all the large cities will afford instructive data on this point. A New York writer for the Record and Guide has this to say:

"I have followed the condemnation proceedings by this city for several years, but I have never yet found one appraiser who, when questioned in court, has been able to furnish any scientific basis for his valuation. They all refer to the prices that have been paid for land in the neighborhood, and as these differ as widely as the necessities of the sellers, or the requirements of the buyers, appraisers have a wide range of prices to select from."

The extent of agreement between "real estate experts" is forcibly illustrated in the following extract, New York Sun, March 23rd, 1923.

"Twenty-one real estate experts have placed valuations on some or all of the fifty parcels to be acquired by the city, and such a divergence of opinion is there that many disinterested persons are wondering whether the Commissioners in Condemnation are going to toss coins to reach their awards."

Every high class production of today reaches its excellence from experiments in the laboratory or extensive research, and even the disputed results of property valuations have a better chance to stand the storms of criticism when backed by a mass of data and aided by scientific helps.

*Data, publicity, criticism, constant discussion, and scientific helps handled by experienced and capable assessors:* these are real needs and give all that is humanly possible for the equalization of real estate assessments. In the selection of assessors politics plays an important part in most of the states and cities; it presents a question as to what means may be adopted to obtain persons best fitted for the work.

The administration of the assessment work should, preferably, be under one head with assistants, the majority of whom could be allocated to special work with which they have become familiar through years of service. Boards of review should be selected from those in the active duty of assessing. Rival boards of equalization, county and city, frequently produce assessment evils rather than any cure of them. To require qualifications incident to the appointment of employees and to promote those worthy of retention is one method that will tend to produce a competent assessing force.

*All of the foregoing requirements not only have been in vogue in the District of Columbia for a number of years but many of our cities have produced excellent results under practically the same working rules.*

### THE TAX ON FAIR MARKET VALUE

**Is it a Fair Tax?** Nearly every state in the country has a law requiring real estate to be assessed at "fair market value," and there is no great difference of opinion as to what such term may mean in its application.

The Supreme Court of the District of Columbia has said that:

"by market value is meant what the property would sell for in cash or on terms equivalent to cash, when offered for sale by one who desires but is not obliged to sell, to one who desires but is not obliged to buy."

A New York authority states that the fair market value "is the price obtained when voluntarily offered for sale in the open market under equitable and normal market conditions, to the competition of buyers." A real estate expert of the District of Columbia tersely says that "true value is disclosed by sales made under favorable circumstances."

In equalizing assessments great weight cannot be given to any single sale but rather to the average of several sales; so that we may say that a community determines its own tax basis, since, whatever value the community places on its property, as evidenced by average sales, is generally conceded to be the basis of fair assessment values or the test as to the fairness of assessment results.

And so, application of the above principles, and foregoing requirements, present as a tax basis what is known as "selling price," "market value," or "capital value." This method, however, is held

by some to be inequitable when compared to European systems in which the assessment of real estate is based on "annual use value."

Taking a half a dozen pieces of property in the retail section we find that Mr. A, a shrewd and fair landlord, keeps his property continually rented. Mr. B, who is grasping in his nature, asks a rental so high that the property remains idle during the year. Mr. C, easy going, allows his tenant to get off with a low rental. Mr. D, having had a good tenant for some years on a long lease, finds that bankruptcy throws his property idle for several months. Mr. E, runs a department store and owns ground and building; and when presented with a rent value of his property claims large profit as a going concern due to his unusually good management. Mr. F, has a lease on his ground for ninety-nine years and will not agree with any man as to what the rental value should be for assessment purposes. Mr. G, is buying his property and claims that he is making no profits. All of this is to be a part of the hodgepodge for working out "annual use value"; and by whom??? Probably by the same parties who are endeavoring to levy on true market value with indifferent success.

## II. ASSESSMENTS OF NEW HOMES

The term "annual use value" directs our attention to a certain disparity that may exist between assessments of high-class retail property and the assessment of the small home; assuming that sale prices have been used for assessment purposes in both cases.

The sale of retail property, or any kind of rentable property, is in effect a bid for revenue. But, the small home has been purchased somewhat through the pride of home ownership and, possibly, with the idea that care of the home and work in the home by the occupants, may become an economic factor not possible under other conditions. It is a fact, too, that even large homes are built with the same pride of ownership and in consequence are lavishly decorated beyond any possible sale value. It has been the practice in some localities to deliberately cut off a third the cost price of handsome homes as an assessment basis.

To revert to the small home, it can be asserted that the price paid for new and medium-class houses will not often justify purchase for renting purposes. It is only after years of use and neighborhood changes that such properties fall into the renting list. The question then arises, shall small homes be given special consideration for assessment purposes, and can this consideration be justified on the grounds of equalization when comparing the ultimate tax paid in this class of property with the tax paid in other classes.



The following reasons are advanced as substantial justification for assessing small homes at a proportional cost of sale value:

1. The desire of a home without primary consideration of revenue causes its purchase to be above the normal unit price. It includes a large overhead and many special assessments, which may or may not be completed at the time of the purchase.

2. There is a depreciation of 5 per cent in the first year of use and if misfortune causes a sale of the property there will be a loss of interest and cost of commission.

3. The property will depreciate 2 per cent per year after the first year and this depreciation is not generally offset by any increase in ground values.

4. If the sale price is accepted as an assessment basis the figures fixed in the initial stage are likely to remain as the assessment for several years, since the owner, through pride, desires no reduction.

5. Small homes are more generally erected on the city's edge or the outer belt of new improvements. All additions to the population in that locality and all the expenses and efforts of the small home owner are reflected in advanced prices on the ground values of the business center and from which the small home owner derives little or no benefit.

The statement that the small home owner does pay a large overhead of cost in the purchase of his home is readily measured by the fact that the sale of small box houses *often* exceeds in unit price the cost per unit of large, fireproof and substantially built apartments.

### III. THE COMPETITOR OF THE SMALL HOME

As stated, the small home owner builds on the city's rim and, in fact, the advent of the automobile has enabled him to go many miles beyond the city boundary. However, he finds that his ownership can only be completed or maintained by extraordinary effort, both mental and physical, and that rental properties are constantly offering inducements with a showing of saving in money and effort. Around the rim of the business center are boarding houses and rentable property within walking distance of places of commercial activities. He finds apartment houses being erected under mass production which cheapen their cost; that apartments have a degree of comfort and freedom from drudgery that makes them attractive; and that the apartment house owes its existence in part to the fact that there is a degree of economic management in the combination of certain functions of repair and upkeep. One plant furnishes the heat for *all* units and the ordinary distribution of many activities are localized.

The manner in which the home owner's efforts are being reflected in the business section by the rise in the prices of ground, and the relations of ground and building values by sections in the District, is hereinafter illustrated.

In the District of Columbia or in any similar city there will be found a dozen contiguous squares in the retail section having the highest land values of the municipality. In the District such values center around the intersection of 14th and G Streets, and using this as a pivotal point and constructing a circle of one thousand feet radius, we enclose one-tenth of the District's real estate wealth. Within this circle are the largest banks, theatres, and office buildings, beside high class rental stores.

Other circles are drawn from the same pivotal point or center, each one a thousand feet greater in radius. The twenty-fourth circle may be considered an approximate District boundary. Within the twelfth circle will be found two-thirds of the real estate wealth. The area in the twelfth circle is over seven thousand acres or about one-fourth of the usable building area in the District of Columbia.

Table V gives, at first, the assessment of both land and build-

**Table V. District of Columbia Assessment Values by Circular Zones**

Zones	No. of squares	ASSESSMENTS			Area, acres
		Land	Improvements	Totals	
1.....	14	\$71,598,000	\$32,388,000	\$103,986,000	72
2.....	34	61,791,000	30,848,000	92,639,000	216
3.....	57	64,486,000	34,818,000	99,304,000	361
4.....	71	38,759,000	31,861,000	70,630,000	505
5.....	92	27,566,000	30,069,000	57,635,000	649
6.....	129	25,733,000	34,049,000	59,782,000	763
7.....	116	23,648,000	31,408,000	55,056,000	938
8.....	145	24,032,000	36,900,000	60,932,000	1,081
9.....	155	26,388,000	45,497,000	71,885,000	1,226
10.....	160	18,800,000	34,296,000	53,096,000	1,370
11.....	155	15,000,000	28,585,000	43,585,000	1,515
12.....	178	15,170,000	34,219,000	50,389,000	1,659
13.....	120	10,200,000	26,633,000	36,833,000	1,803
14.....	113	9,100,000	23,500,000	32,600,000	1,947
15.....	120	7,500,000	18,704,000	26,204,000	2,092
TOTALS...		\$440,781,000	\$473,775,000	\$914,556,000	

## Improvement Assessments

	Cumulative totals by zones	Multiples of first zone	Area, acres
First zone.....	\$32,388,000	1.00	72.1
First two zones.....	63,236,000	1.95	288.5
First three zones.....	98,054,000	3.03	649.1
First four zones.....	129,915,000	4.00	1,153.9
First five zones.....	159,984,000	4.94	1,803.0
First six zones.....	194,033,000	6.00	2,596.4
First seven zones.....	225,441,000	6.96	3,533.9
First eight zones.....	262,341,000	8.10	4,615.8
First nine zones.....	307,838,000	9.50	5,841.8
First ten zones.....	342,134,000	10.56	7,212.1
First eleven zones.....	370,719,000	11.45	8,726.7
First twelve zones.....	404,938,000	12.50	10,385.5
First thirteen zones.....	431,571,000	13.32	12,188.5
First fourteen zones.....	455,071,000	14.04	14,135.8
First fifteen zones.....	473,775,000	14.62	16,227.3

## Land Assessments

	Cumulative totals by zones	Assessments in relative percentages	D. C. depth rule	Area, acres
First zone.....	\$71,598,000	18.7	31.62	72.1
First two zones.....	133,389,000	34.8	44.72	288.5
First three zones.....	197,875,000	51.7	54.77	649.1
First four zones.....	236,644,000	61.8	63.25	1,153.9
First five zones.....	264,210,000	69.0	70.71	1,803.0
First six zones.....	289,943,000	75.7	77.46	2,596.4
First seven zones.....	313,591,000	81.9	83.67	3,533.9
First eight zones.....	337,623,000	88.2	89.44	4,615.8
First nine zones.....	364,011,000	95.1	94.87	5,841.8
First ten zones.....	382,811,000	100.0	100.00	7,212.1
First eleven zones.....	397,811,000	103.9	104.88	8,726.7
First twelve zones.....	413,981,000	108.1	109.55	10,385.5
First thirteen zones.....	424,181,000	110.8	114.02	12,188.5
First fourteen zones.....	433,281,000	113.2	118.32	14,135.8
First fifteen zones.....	440,781,000	115.2	122.48	16,227.3

ings within each zone, and by zone is meant the area between any two circles that are radially one thousand feet apart. The various combinations are worked out in relation to the zones. The first three zones contain about 500 acres of taxable area. The next nine zones contain about 7,000 acres of taxable area, and the

rest of the District has over 20,000 acres of taxable area, *yet each area has a land value approximately the same or about \$200,000,000.*

In the first case (high class retail) the improvement value is one-half of the land value. In the second case the improvement value is one and a half times the land value. In the third case (area of small homes) the improvement value is double the land value. Here again the home owner is presented with a disadvantage in the combination between land and buildings. His larger item—two-thirds—is perishable, while in the high class retail section only one-third of the total value is perishable.

#### IV. ASSESSMENTS OF HOMES IN THE DISTRICT OF COLUMBIA

A policy regarding the assessment of small homes has been adopted, at least in part, in the District of Columbia, by giving certain relief in the amount of the assessment based on ideas herein set forth. For example, properties within the twelve thousand foot circle are assessed at approximately 90 per cent of selling value, as evidenced by several thousand sales. Beyond the circle the suburban small homes will average two-thirds of selling value.

A late report from the Census Bureau giving some data desired is not available, but the following is taken from the census of January, 1920, when the District had 437,414 population :

“In January, 1920, when the population was enumerated by the Census Bureau, there were 96,195 homes, of which 28,503, or 29.6 per cent were owned by the occupants; and 65,655, or 68.3 per cent, were rented; leaving 2,037, or 2.1 per cent for which the tenure was not reported. Of the 28,503 homes owned by the occupants, 12,354 were free from encumbrance; 15,375 were encumbered, and there were 774 for which no information was supplied.

“In counting the above homes each apartment occupied by a family was counted as a home.”

From the above it may be judged now that not much more than 10 per cent of homes are purchased outright or are free from encumbrances. Home seekers doing business in the District have tried to meet the conditions of high rents and high construction costs, as well as high taxes, by erecting or purchasing small homes around the edge of the District. Probably outside of the District and within seven miles of the boundary, over one hundred thousand

people are dwelling in all classes of houses, some of them mere makeshifts.

Although the real estate assessments in the District of Columbia, in many cases, are close to 100 per cent in large properties, and in small homes close to 60 per cent of selling value, nevertheless the assessments are guided by the same consideration, namely, *that the total assessed value is a full ground value plus BARE construction cost.*

## V. PERSONAL PROPERTY

Of equal aid to the small owner in assessment matters is the requirement of law that \$1,000 of household goods are exempted. The rate of \$5.00 per thousand on intangibles helps to establish a basis of assessment of nearly \$600,000,000, notwithstanding that there are certain exemptions in this class, among them \$500 in saving funds. Banks are assessed at 6 per cent on gross earnings and public utilities at 4 per cent. The tangible property tax amounts to \$2,000,000 and from these three personal tax items nearly \$7,000,000 is collected.

The results in the real estate field may be judged from the fact that with 488,000 people the real estate assessment is \$1,250,000,000.

## APPENDIX V

# THE EFFECT OF A PROPERTY TAX OFFSET UNDER AN INCOME TAX<sup>1</sup>

### I. METHOD

The purpose of a property tax offset under an income tax is to reach the incomes of those classes who now pay little or no property taxes, without imposing additional taxes on already over-taxed owners of real estate. The actual operation of such an offset, however, has been one of the most uncertain and elusive things in the whole field of income taxation. The purpose of the present study was to ascertain, as far as it is possible to do so, the actual effects of such an offset.

The study was undertaken at the request of a committee of the Chicago Real Estate Board, which appropriated a small amount toward financing its cost. Our method in brief has been this. In the first place, we have ascertained the property holdings, the income received, and the real estate taxes, personal property taxes, and income taxes, paid by 5,100 individual taxpayers in Dane County, Wisconsin, for the year 1928. In the second place, through the courtesy of the Wisconsin Tax Commission and the cooperation of Mr. J. Roy Blough, in charge of their statistical department, we have been able during the past year to ascertain the similar facts for all corporations in Wisconsin reporting to the State Tax Commission for the same year, 1928. The total number of such corporations, after eliminations for incomplete data, was 13,104. The financial cost involved made it impossible to ascertain the facts for any considerable proportion of the total number of individual taxpayers in the state, and Dane County, containing the city of Madison, was therefore selected as representing probably a fairly typical cross-section of the state.

With the exact facts available for these corporations and indi-

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<sup>1</sup> This paper, read at the annual conference of the National Tax Association in 1931, was submitted by Mr. Herbert D. Simpson, member of the Committee on Taxation, as an appendix to the committee's report. It is reproduced with the permission of the National Tax Association.

viduals, we have assumed that a given amount of revenue was to be raised by three alternative types of taxation:

1. A straight property tax.
2. A property tax combined with an income tax—without offset.
3. A property tax combined with an income tax—with property tax offset.

The problem, then, is to determine how differently the total tax burden would rest on all these corporations and individuals under the three alternative forms of raising revenue.

We reported last year the results for individuals. We are prepared now to report the results for corporations and the combined results for both, weighted according to the proportions represented by the individual and corporate payments in the total income tax revenue for Wisconsin. These results will be concerned with two things, namely:

1. The effect upon total revenue, and
2. The effect upon distribution of tax burdens.

## II. RESULTS

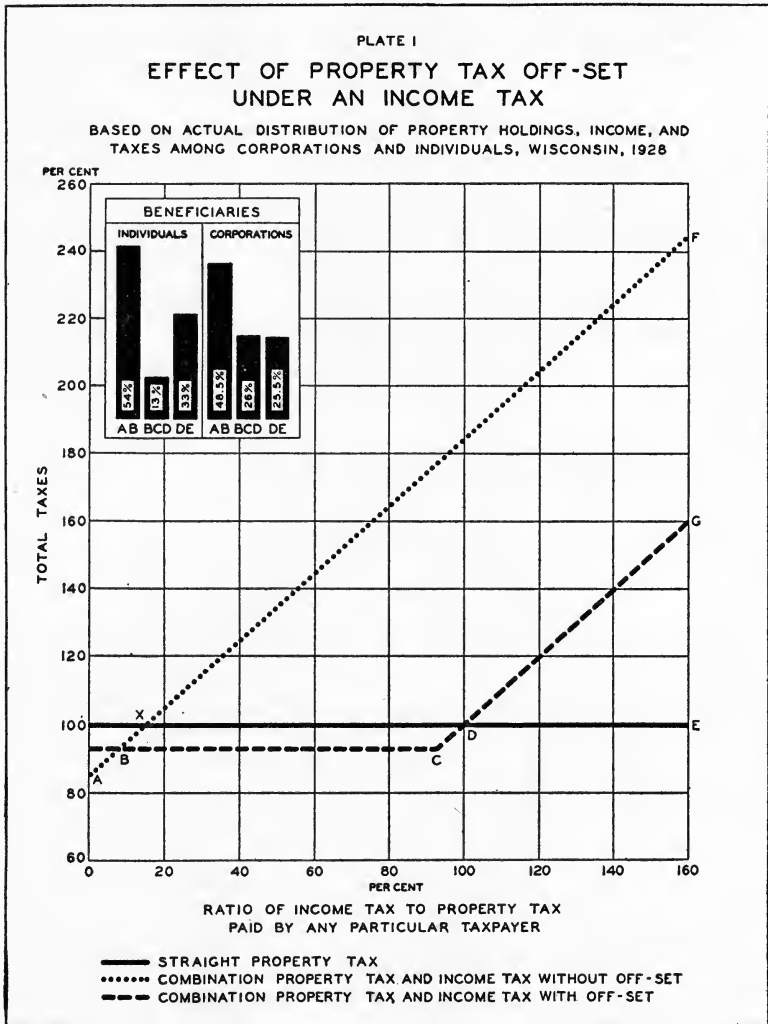
### EFFECT UPON REVENUE

A property tax offset under the Wisconsin income tax would reduce the yield of the individual income tax 49 per cent, of the corporate income tax 53 per cent, and the total yield of the tax  $51\frac{1}{2}$  per cent. Or an income tax without offset would make it possible to reduce property tax rates by 15 per cent; an income tax with offset would reduce property tax rates by  $7\frac{1}{2}$  per cent.

### DISTRIBUTION OF BURDEN

**Governing Factor.** In the distribution of burden the first and most fundamental thing to be grasped—and the thing that most discussion of the subject has entirely failed to grasp—is that the governing factor here is not the *amount of property* one owns but the ratio of his income to his property, or more accurately, the ratio of his income tax to his property tax. The exact effects of these various ratios have been worked out and are represented on the accompanying chart (Plate 1). It is the same chart that was

presented a year ago, modified now by the inclusion of the data for corporations.



The figures at the left represent the total taxes paid by any individual or group, expressed in percentage of his property taxes. That is, the property taxes he pays, or would pay, if all revenue were raised through property taxation, are taken as 100 per cent ;



and the taxes he would pay under alternative forms of taxation are indicated as percentages of this base. The figures at the bottom of the chart represent the ratio of *the income tax one would pay* (under such an income tax as that in Wisconsin) to his property taxes.

The three lines represent the effects of the three types of taxes we are considering. The heavy horizontal line assumes that all revenue is raised through a general property tax, and the amount of tax each one pays under that system is taken as 100 per cent. The dotted line AF represents the effect of an income tax without offset; the broken line BGG, the effect of an income tax with property tax offset.

The chart thus becomes a kind of automatic calculator, by which, if you know your property holdings and probable income, you can locate yourself along that base line, and then read up the chart to the points at which you intersect the three designated lines. The point at which you intersect each one will tell exactly how you individually would be affected by the adoption of a straight income tax, in one case, or an income tax with property offset in the other, or by a continuance of the general property tax.

Suppose, for example, one owns property, either a large or small amount, but that he is making no net income. He is situated at 0 per cent. Under a general property tax he pays, we will say, \$100 on his property. Under an income tax without offset, he pays no income tax, and he gets the full benefit of the reduction in property taxes brought about by those who do pay income taxes, which brings his total tax down to A, or \$85. Under an income tax with offset, he pays no income tax himself and makes no use of the offset, but the diminished revenue from those who do avail themselves of the offset lessens the relief he gets in his property tax, and brings his tax down only to \$92.50.

A minimum burden will be secured through a straight income tax, with no offset; and this will hold true until the income tax is large enough to equal more than  $7\frac{1}{2}$  per cent of one's property taxes. At that point the situation will change.

Suppose, for example, one has property to the amount of \$50,000, an income of around \$11,200, and pays property taxes of \$1,000

and an income tax of \$200 (that is, his income tax is 20 per cent of his property tax). He is situated at 20 per cent on the base line. An income tax without offset will raise his total taxes to 106 per cent, an increase of 6 per cent; an income tax with offset will reduce them to 92½ per cent, a decrease of 7½ per cent. And so on, to the point where one's income tax is 100 per cent of his property taxes, at point D. But beyond that point, those who, on account of either high incomes or small property holdings, are so situated that their income taxes will be in excess of 100 per cent of their property taxes, will secure minimum tax burdens through a continuance of the property tax, with no income tax of any kind.

The chart indicates three groups of taxpayers:

Group AB, who will benefit through a straight income tax with no offset.

Group BCD, who will benefit from an income tax with property tax offset.

Group DE, who will benefit from continuance of the general property tax.

**General Numerical Distribution.** *Individuals.* Group AB contains 54 per cent of the total number of individual taxpayers, group BCD 13 per cent, and group DE 33 per cent. The explanation of the large number in group AB is the wide distribution of property ownership—one of the things we are anxious to encourage. But this means that on these 54 per cent, the general property tax rests very heavily in relation to any measure of tax-paying ability. It means that to these 54 per cent, an income tax would be a blessing, because, having small incomes, the additional tax imposed in the form of an income tax is *more than offset* by the relief afforded through reduction of the property tax rates; so that for these 54 per cent, the adoption of an income tax means a reduction of from 7½ to 15 per cent in their total tax burdens. But these small income classes have so little income taxes to offset that the value of an offset to them is less than the reduction of property taxes that would be made possible if no offset were permitted. Any reduction of property taxes, in other words, is more important to them than the little use they are in position to make of an offset against an income tax.

So much for the number in these groups. But more important still is the composition of these groups.

In the AB group (income tax beneficiaries) are found 96½ per cent of all the farmers, 61 per cent of the laborers, 58 per cent of the skilled tradesmen, and 50 per cent of the business men operating their own individual businesses. The most conspicuous element in this group is the farmer. Ninety-six and one-half per cent of the farmers should in self defense support an income tax and, so far as their own interest is concerned, should drop immediately all talk about a property offset. Only three and a fraction out of 100 farmers have any chance to gain from an offset. The explanation is simple—if our facts from Wisconsin are at all typical of the situation in general. The adoption of an offset reduces the yield of the income tax 51 per cent. That loss of potential income tax means 7½ per cent more to be raised in the form of property taxes. The offset, in other words, will increase the farmers' property tax by 7½ per cent. His income under present conditions is so small that he rarely has an opportunity to offset an amount equal to anything like 7½ per cent of his property tax bill.

*Corporations.* If we classify the corporations under business and industrial groupings, we find these results. The groups, a *majority* of the members of which are found in AB (income tax beneficiaries) include:

- Agricultural corporations.
- Real estate.
- Mining and quarrying.
- Manufacturing.
- Mercantile—wholesale and retail.
- Local public utilities.

Only one group finds a majority of its members in Class BCD (offset beneficiaries); this group is the banks—state and national.

One group exhibits a majority of its members in Class DE (property tax beneficiaries); this group is the brokerage and investment companies.

Or, if we eliminate the third alternative—sole dependence on the property tax—and are considering definitely the adoption of an

income tax, and the only problem is offset or no offset, the alignment becomes :

Groups a majority of the members of which would benefit by an offset	Groups a majority of the members of which would be injured by an offset
Manufacturing	Mining
Banks	Agricultural
Brokerage	Real estate
Local public utilities	Mercantile

**Table I. Distribution of Offset Relief Among Real Estate Owners by Income Classes**

<i>Real estate owners by income classes</i>	<i>Average tax offset</i>
<b>Individuals</b>	
\$ 0-\$ 2,000.....	\$ .38
2,000- 5,000.....	10.88
5,000- 10,000.....	73.83
10,000- 20,000.....	240.85
Over \$20,000.....	680.08
<i>Average</i> .....	<b>\$ 15.05</b>
<b>Mercantile corporations</b>	
\$ 0-\$ 5,000.....	\$ 49.00
5,000- 10,000.....	288.00
10,000- 25,000.....	883.00
25,000- 50,000.....	2,185.00
50,000- 100,000.....	4,506.00
100,000- 500,000.....	11,770.00
500,000- 1,000,000.....	47,236.00
Over \$1,000,000.....	.....
<i>Average</i> .....	<b>\$ 534.00</b>
<b>Manufacturing corporations</b>	
\$ 0-\$ 5,000.....	\$ 43.00
5,000- 10,000.....	322.00
10,000- 25,000.....	906.00
25,000- 50,000.....	2,191.00
50,000- 100,000.....	3,955.00
100,000- 500,000.....	10,670.00
500,000- 1,000,000.....	33,914.00
Over \$1,000,000.....	115,060.00
<i>Average</i> .....	<b>\$ 1,461.00</b>

**Actual Location of Offset.** But the mere distribution of individuals and corporations numerically does not tell us much; and so, in an effort to apply almost a chemical type of analysis to the ingredients of our problem, we have taken all of our individual taxpayers and two of the largest groups of corporations—manufacturing and mercantile—and classified them according to net income, in the classes indicated. Then, since the offset is intended primarily as a relief to real estate, within each of these income groups we have separated out those individuals and corporations who own real estate and those who do not, and have gone down the list and figured exactly how much income each of these real estate owners—individuals and corporations—would be able to offset with “his, her, or its” property taxes. In chemical terms, we have put each of these groups of real estate owners into a test tube, so to speak, have poured in on top of them the various elements and ingredients involved, and have *precipitated* the offset. Table I shows the amount of “precipitate” in the various groups.

Of the total amount of offset appropriated by these 5,100 taxpayers, 20.7 per cent would go to 14 taxpayers, all of whom have incomes of over \$20,000. Of the total offset (\$804,264) appropriated by all mercantile corporations, 23½ per cent would go to 4 corporations, each of which has an income in excess of \$500,000. Of the total offset appropriated by all manufacturing corporations (1,930 corporations, with offset of \$2,859,833), 28½ per cent would go to 7 corporations, each of which has net income in excess of \$1,000,000.

### III. GENERAL CONCLUSIONS

You may recall that a year ago we refrained from drawing any general conclusions and exercised great restraint in drawing such deductions as we did. Now, with the additional facts before us, we feel that we can draw some general conclusions with a large measure of assurance.

1. In the first place, the effect of an offset on the yield of an income tax would be substantial, amounting, on the basis of our Wisconsin facts, to 51 per cent of the yield.

2. In the second place, the past discussion of the problem on the assump-

tion that it is an issue between property holders and non-property holders, or real estate owners and non-real estate owners, is entirely erroneous. The relationships and adjustments involved are all among different classes of property holders, not between property holders and somebody else. Indeed, under a given schedule of rates and other provisions of an income tax, it is largely immaterial to non-property holders whether there is an offset or not. Their taxes will be the same regardless of any offset. The varying gains and losses all lie among various groups of property owners. For example, a farmer with a farm worth \$10,000, a property tax of \$200, and an income of \$2,000 or \$3,000, little more than enough to cover his exemptions and deductions (and that description would cover 99 per cent of the farmers in the United States), can get no benefit from an offset. To him an offset is as much a dead letter as certain well known provisions of our tariff laws. On the other hand, the owner of an office building worth \$1,000,000, with an income of \$50,000, a property tax of \$15,000 to \$20,000 and an income tax of \$2,600, would be able to offset his entire income tax. The result would be not only to benefit the large property owner (which would be no cause for regret), but to injure the small one, since the \$2,600 of revenue lost to the income tax would have to be raised from property; and on the figures in one illustration, this would increase the farmer's taxes exactly \$25.00.

3. In the third place, we find that the governing factor in the distribution of benefits and losses is not the amount of property one owns, but the ratio of his income to his property. But the size of this abstract, mathematical ratio, 1:10, 2:7, or whatever it may happen to be, shows nothing about the situation of the taxpayer from the standpoint of the amount of his property or income, his taxpaying ability, or his need for relief. And the facts make it clear beyond any doubt that the actual results are to benefit the recipients of the largest incomes among both individuals and corporations. In short, the offset confers its largest relief in exactly the quarters where relief is least needed.

4. In the fourth place, the facts bring out the fundamental illogicalness of any offset device, by which taxes are distributed not on one basis of taxation or another but on the ratio of one tax basis to another. If we felt that tobacco consumers were unduly taxed and that cosmetics could well carry a share of excise taxation, we should hardly provide that the taxes paid on cigarettes should offset taxes on cosmetics. If we did, the final amount of excise tax any one family would pay would depend not on the amount of tobacco the husband smoked or the amount of cosmetics his wife used, but upon the ratio of the husband's tobacco to his wife's cosmetics; or *vice versa*, as the practice in different families may be. Now, whatever virtue may inhere either in cigarettes or in cosmetics as a basis for taxation, certainly the *ratio* of one's cigarette consumption to his cosmetic consumption is absolutely meaningless for purposes of taxation. Yet the property tax offset against an income tax rests upon exactly the same illogical relationship.

It will be understood, of course, that I am discussing the problem from the standpoint of taxation. If it is a matter of politics, where it may be necessary to concede an offset in order to secure support for an income tax which, it may be felt, is better than none, I have nothing to say. Still more, if the offset is proposed as part of a campaign to boom real estate and stimulate the purchase of lots and bungalows, these facts do not bear upon it. But if we are talking taxation, all the facts embraced in this study would indicate that the offset is one of the most unsound and misleading proposals that has made its appearance in tax discussion in recent years.

## APPENDIX VI

### TAXATION OF LAND VALUES IN CANADA<sup>1</sup>

The taxation of property by the Canadian provinces and municipalities differs in several respects from state and local property taxation in the United States. While there is no marked uniformity among the tax systems of the various provinces, as there is no marked uniformity among the tax systems of the various states, it is still possible to differentiate between the systems in the two countries. In the first place, the provinces themselves have not leaned as heavily on property taxes as have the states, owing largely to the receipt of generous subventions from the Dominion, and in some instances to large returns from land sales. In the second place, personal property, as such, has been more generally exempted from taxation in Canada than in the United States. In the third place, there has been a tendency to place the bulk of the real estate tax burden on land values by exempting improvements partially or wholly, and by imposing both unearned increment taxes and special taxes on "wild lands." It is this movement to exempt improvements, at least in part, from taxation, which is considered here.

Discrimination against unimproved land begins with a provincial wild-land tax in British Columbia imposed first in 1873.<sup>2</sup> The option of assessing improvements at a lower rate than land for municipal taxation appears in British Columbia in 1891, in Alberta and Saskatchewan (then part of the Northwest Territories) in 1894,<sup>3</sup> and in Manitoba in 1919.<sup>4</sup> Attempts have been made to

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<sup>1</sup> This paper was submitted by Prof. Mabel Newcomer and Dr. Ruth Gillette Hutchinson, of Vassar College, as an appendix to the report of the Committee on Taxation.

<sup>2</sup> Scheffel, Y., *Taxation of Land Values* (Hart Shaffner and Marx Prize Essay), Boston, Houghton Mifflin Co., 1916, p. 258.

<sup>3</sup> Scheffel, pp. 261-63.

<sup>4</sup> Laws of 1919, ch. 67, 68. Winnipeg had been assessing improvements at 66 2/3 per cent of full value under special charter provisions since 1909. In 1914 St. Boniface, by the direction of the council, was underassessing buildings 50 per cent while assessing land full value. The assessment of buildings was raised in 1930. (Haig, R. M., *Exemption of Improvements from Taxation in Canada and the United States*, 1915, a report prepared for the Committee on Taxation of the City of New York, and letter from the Mayor of St. Boniface, 1931.)



Table I. Municipal Taxation of Improvements, 1914<sup>1</sup>

Province	Governmental unit to which tax applies	Base of tax	Improvements exempted	Rate of assessment on improvements not exempt	Year in which rate of assessment or total exemption was first in force
Alberta.....	Edmonton Calgary Municipalities other than cities	Land Real estate Land	All All <sup>2</sup>	25	1905 1912 1912
British Columbia.....	All municipalities	Real estate	All may be exempted	50	1892
Manitoba.....	Winnipeg All municipalities except Winnipeg and St. Boniface	Real estate Real estate	All farm improvements: 50% local industry improvements	66 $\frac{2}{3}$ 100	1909 1902
Saskatchewan.....	Regina Moose Jaw Saskatoon Rural municipalities and improvement districts Villages and towns	Real estate Real estate Real estate Land Real estate	All All may be exempted	30 45 25 60	1912 1913 1913 1914 1908

<sup>1</sup> Compiled from Haig, R. M., *Exemption of Improvements from Taxation in Canada and the United States*, a report prepared for the Committee on Taxation of the City of New York, 1915. Since this time the tendency to exempt improvements has declined. The one notable exception to this is the exemption of one-third of the value of improvements in certain municipalities in Manitoba in 1919.

<sup>2</sup> In some cases optional.

Table II. Provincial and Local Real Estate Tax in Western Canada, 1931

Province	Governmental unit to which tax applies	Name of tax	Base of tax	Rate of assessment	Rate of tax	Year in which present rate of tax or assessment was first in force	Exemption	Legal citations
Alberta.....	Province	Unearned increment	Increase in land value between transfers	100	5%	1913	Farm under 640 acres	1922, ch. 32
	Province	Wild land	Land value	100	1%	1914	Farm; grazing; holdings $\frac{1}{4}$ under cultivation; land in cities, towns, and villages	1922, ch. 31
	Province	Timber	Timber acreage		3c per acre	1923		1922, ch. 35
	Province	School district	Land value	100	Fixed annually	....	Land outside organized school district	1923, ch. 5 1931, ch. 33
	Province	Educational	Land value outside organized school districts	100	.3% <sup>1</sup>	1921		1922, ch. 30 1922, ch. 255
	Province	Supplementary revenue	Land value in municipalities	100	.2%	1920	Grazing lands	1922, ch. 40

Edmonton <sup>2</sup>	Real estate	Land value Improvements	100 60	Fixed annually	1918	Special char- ter provi- sions
Calgary <sup>2</sup>	Real estate	Land value Improvements	100 50	Fixed annually	1919	Special char- ter provi- sions
Towns, vil- lages, im- provement districts, and rural municipal- ities	Real estate	Land Improvements	100 66 $\frac{2}{3}$ -100 <sup>3</sup>	Fixed annually <sup>4</sup>	1927 <sup>5</sup>	Buildings in rural munici- palities out- side of ham- lets
British Columbia...	Real estate	Value of land and im- provements	100	Farm land, $\frac{1}{2}\%$ Wild land, 3% Worked coal mines, 1% Unworked coal mines, 2% Timber land, $1\frac{1}{2}\%$ Other real es- tate, 1% Fixed annual- ly, maximum 2% <sup>7</sup>	1922 1930 1896 1928 1925 1922	Real estate in municipal- ities; farm im- provements up to \$1,500; buildings; machinery; homestead entries
Cities, town- ships, districts Province	Real estate	Land value Improvements <sup>8</sup>	100 50	$\frac{1}{2}\%$ 20c per acre maximum	1892	1924, ch. 179 and 183
Manitoba <sup>8</sup> ....	Unoccupied land	Land value	100		1918	1918, ch. 90 1921, ch. 81 1924, ch. 73 1931, ch. 54

Land in city,  
town, or vil-  
lage; home-  
stead or graz-  
ing land; land  
unit for culti-  
vation or land  
 $\frac{1}{4}$  under cul-  
tivation.

Table II. (Continued)

Province	Governmental unit to which tax applies	Name of tax	Base of tax	Rate of assessment	Rate of tax	Year in which present rate of tax or assessment was first in force	Exemption	Legal citations
Saskatchewan	Province	Supplementary revenue	Real estate value in municipalities and school districts in unorganized territory	100	.2%	1920		1918, ch. 65 1919, ch. 102 1920, ch. 129
	Province	Public school	Same as above	100	Fixed annually	....		1913, ch. 165 1930, ch. 34
	Winnipeg <sup>9</sup>	Real estate	Land value Improvements	100 66 $\frac{2}{3}$	Fixed annually	1909		Special charter provisions 1913, ch. 133 and 134
Saskatchewan	Cities, <sup>10</sup> towns, villages, and rural municipalities	Property	Land value Improvements	100 <sup>11</sup> 66 $\frac{2}{3}$	Fixed annually	1919	Live stock; produce for shipment; farm implements; machinery; and household effects; farm improvements	1915, ch. 43 1917, ch. 59 1919, ch. 67 and 68 1920, ch. 84 1921, ch. 87 1923, ch. 62 1929, ch. 68 1920, ch. 29 1923, ch. 12 1927, ch. 5
	Province	Public revenue	Land value and acreage	100	Cities and villages .2%; rural municipalities .15%; local improvement dis-	1917 1917		

Province	Supplementary revenue	Land acreage		tracts 1c per acre; grazing land 1/5c per acre	1927	Land in towns, cities, and school districts	1920, ch. 28
Province	Timber land	Land acreage		Grazing land 3/8c per acre	1917		
Province	Wild land	Land value	100	Other land 1c per acre	1917	Homestead; land unfit for cultivation and small holdings partly under cultivation; land in cities, towns, and villages	1923, ch. 14 1928, ch. 16
Cities, towns, villages, and rural municipalities	Real estate	Land value Improvements	100 60 <sup>12</sup>	Fixed annually <sup>13</sup>	1908		1920, ch. 86 and 89 1921-22, ch. 39 1925-26, ch. 21 1927, ch. 24 and 26 1928, ch. 8 and 26 1920, ch. 90 1927, ch. 27
Improvement district	Land	Land acreage		3 1/8c per acre	1920		

<sup>1</sup> Land under grazing permits taxed 3/4 cents per acre since 1926.  
<sup>2</sup> Charters in all cities determine tax provision.  
<sup>3</sup> Limited to 66 2/3% in improvement districts and rural municipalities.  
<sup>4</sup> Limited to 2% in rural municipalities.  
<sup>5</sup> Rural municipalities, 1926.  
<sup>6</sup> Maximum.  
<sup>7</sup> Wild land, 5%.  
<sup>8</sup> Data for 1928. <sup>9</sup> Charter provision.  
<sup>10</sup> Excluding Winnipeg and St. Boniface which are governed by charter provisions.  
<sup>11</sup> Improvements for local industry may be assessed at 50 per cent. Other building in rural municipalities not specifically excepted, at 100 per cent.  
<sup>12</sup> Cities, towns, and villages may assess improvements at less.  
<sup>13</sup> Rate not to exceed 2% in villages; 1% in rural municipalities.

Table III.<sup>1</sup> Assessments, Levies, and Arrears in Cities of 20,000 Population or Over in Western Provinces

	Year	Popula- tion	Rate of assessment of im- provements	Assessed value of land before exemptions	Total net assessed valuation	Tax rate  (without discount for prompt payment)	Tax levy	Tax arrears out- stand- ing
ALBERTA	1914	52,000	0	209,065	191,284	17.50	3,770	2,360
	1917	53,846 <sup>2</sup>	0	100,917	100,197	26.50	3,189	6,157
	1918	60,000	60	76,833	92,405	30.00	3,655	6,775
	1930	77,557	60	36,942 <sup>3</sup>	65,687	47.50	4,075	1,084
CALGARY	1914	90,324	25	119,892	134,886	20.75	note <sup>4</sup>	527 <sup>5</sup>
	1918	70,000	25	65,728	78,473	32.00	"	4,540
	1919	75,000	50	77,943	88,153	35.25	"	note <sup>4</sup>
	1930	85,000	50	note <sup>4</sup>	64,180	46.00	3,889	706
BRITISH COLUMBIA	1914	106,110	0	150,466	150,466	24.20 <sup>6</sup>	4,183	1,864
	1917	102,550	0	139,923	139,923	26.40 <sup>6</sup>	4,348	5,043
	1918	109,250	25	132,910	158,909	26.40 <sup>6</sup>	4,660	5,456
	1919	123,050	50	132,245	168,645	26.40 <sup>6</sup>	4,991	3,216
	1930 <sup>7</sup>	242,629	50	167,403	258,036	43.82	11,956	2,285

Victoria.....	1914	55,000 <sup>b</sup>	0	89,152	89,152	22.35	1,886	261
	1918	55,000 <sup>b</sup>	0	45,968	45,968	24.99	1,247	3,429
	1922	38,727 <sup>a</sup>	33½%	38,873	47,863	32.06	1,639	1,318
	1930	59,000	50	24,967	56,747	36.40	note <sup>4</sup>	498 <sup>a,10</sup>
MANITOBA								
Winnipeg.....	1914	203,255	66½%	199,083	236,638	14.80	5,816	1,432
	1917	182,848	66½%	162,863	212,026	17.00	5,953	3,214
	1922	199,129	66½%	144,074	196,389	30.50	10,071	5,205
	1930	209,286	66½%	113,059	192,237	33.50	10,771	4,166
SASKATCHEWAN								
Regina.....	1914	50,000	30	68,403	59,185	13.00	875	note <sup>4</sup>
	1922	40,000	30	41,963	43,927	41.00	1,785	500
	1929	52,000	30	23,487	44,285	41.00	2,040	308
Moose Jaw.....	1914	18,000	45	44,038	43,142	17.55	712	note <sup>4</sup>
	1917	19,000	45	20,038	26,344	27.70	764	619
	1925	20,498	50	12,347	22,325	47.40	1,156	921
	1929	20,250	50	10,209	21,129	48.70	1,123	335
Saskatoon.....	1913	12,000	25	54,461	51,997	18.00	1,223	25
	1917	25,000	25	34,254	26,327	21.00	920	288
	1925	27,540	45	18,133	29,004	43.60	1,396	670
	1929	40,000	45	17,304	31,988	42.40	1,527	297

<sup>1</sup> Data from Haig and municipal reports—Years are chosen for outstanding charges in arrears, tax levy, population, or rate of assessment.

<sup>2</sup> 1916.

<sup>3</sup> 1929.

<sup>4</sup> Not available.

<sup>5</sup> 1913.

<sup>6</sup> Estimated from rates discounted for immediate payment.

<sup>7</sup> In 1929 boundaries extended to include South Vancouver and Grey Point.

<sup>8</sup> 1921.

<sup>9</sup> Estimated population for greater Victoria.

<sup>10</sup> Partly estimated.

extend this privilege of exempting improvements (or assessing them at a lower rate than land) to the more settled eastern provinces, but such attempts have thus far failed.

The exemption of improvements from local taxes in the western provinces grew steadily for some twenty years, reaching a peak about 1913 or 1914. This was a period of rapid settlement in this region. Building may have been stimulated by the promise of tax exemption but in any case land values increased rapidly enough to more than compensate for rising land taxes.<sup>5</sup>

The movement was checked by the decline in land values accompanying the business depression of 1913. Except for the Rural Municipalities Act of 1914 in Saskatchewan exempting all improvements in such municipalities, and the exemption of one-third of the value of improvements in towns, villages, and certain cities in Manitoba in 1919, no further provisions for exemptions have been made.<sup>6</sup>

On the contrary, exemptions have been removed. The exemption of all improvements in Edmonton, Alberta, was given up in 1918. Such improvements have since been assessed at 60 per cent. In Calgary in 1919 the rate of assessment for improvements was increased from 25 to 50 per cent. In the other municipalities of Alberta, total exemption of improvements has been replaced by assessment at two-thirds of full value.

In other provinces the following large cities have increased the taxation of improvements as follows: Vancouver changed from total exemption to 25 per cent assessment in 1918 and to 50 per cent assessment in 1919; Victoria changed from total exemption to 33 $\frac{1}{3}$  per cent assessment in 1922 and to 50 per cent assessment later; Moose Jaw has increased the assessment of improvements from 45 per cent to 50 per cent; and Saskatoon has increased such assessments from 25 per cent to 45 per cent.

It is apparent from the preceding tables that while the provinces have considerably modified their policy of exempting improve-

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<sup>5</sup> See Haig, *passim*.

<sup>6</sup> In 1919 Ontario passed an act permitting partial exemption of dwellings valued at \$4,000 or less, but only Toronto has taken advantage of this thus far. The total exemptions amounted to about 7 per cent of the total assessment in 1930. Consequently this is not an important change. Laws of 1919, ch. 50; *Annual Report* of the Assessment Commissioner of the city of Toronto, 1930; and correspondence with City Assessment Commissioner.



ments from local taxation during the past fifteen years, they have by no means abandoned it.

After a most thorough and complete study of the Canadian situation in 1915, Professor Haig of Columbia University reached the following conclusions as to land value tax: It is a tax which may be put into effect under certain favorable circumstances, notably at a time when the real estate market is showing a rapid rise due to the opening and developing of a new country. However, the effects depend largely on local conditions, and conditions are not favorable if the exemption raises the tax rate on land or decreases the tax base.<sup>7</sup>

There was some talk in Alberta, at the time Professor Haig wrote, of abandoning the policy of entire exemption of improvements. But the movement for exemption was backed by such strong public opinion that little was done until 1917 and 1918 tax arrears put the cities into such serious financial straits that drastic measures were necessary. Several special commissions both provincial and municipal were appointed to study the situation and make recommendations for relief.

The conditions revealed in these studies were quite general throughout the four provinces. They are vividly described by the Manitoba Assessment and Tax Commission of 1919. After a brief statement of the development of the movement it says:

"All went well until 1912, when prosperity began to wane, and the chilling frosts of monetary stringency began to be felt. Then taxation again became a burning question. Land values had commenced to depreciate and collapse, thus imperilling the solvency of municipalities which had taken the leap in the dark. Real estate values, formerly considered an appreciating asset, shrank with alarming rapidity and became to the owner an increasing burdensome liability. Taxes, based on extravagantly inflated assessments, ceased to be met."<sup>8</sup>

The extent of these fiscal difficulties for the eight cities in the provinces with more than 20,000 population is shown in Table III. With the decreasing tax base due to shrinkage in land values the tax rates rose. While prices of real estate were falling the owners were unable or unwilling to pay the increasing taxes and arrears were allowed to accumulate. In the City of Edmonton arrears out-

<sup>7</sup> Haig, *op. cit.*, pp. 277-80.

<sup>8</sup> *Report of the Assessment and Taxation Commission, Manitoba, 1919, p. 19.*

standing increased from \$2,360,000 in 1914 to \$6,775,760 in 1918 and the tax rate rose from 17.5 mills to 30 mills per dollar of assessed valuation. Calgary showed an increase in tax arrears from \$527,544 in 1913 to \$4,539,718 in 1918, probably caused in part by the decrease in population from more than 90,000 in 1914 to 70,000 in 1918. Vancouver arrears grew to more than \$5,000,000 as population and assessed value decreased. In Victoria the assessed value had fallen by 1918 to 50 per cent of the 1914 value and arrears increased from about \$250,000 to nearly \$3,500,000. Tax arrears in 1918 in Victoria amounted to nearly three times the tax levy for that year. The difficulties were general throughout British Columbia. Mr. R. Baird, Inspector of Municipalities, reported that in 1917 the municipalities of the province collected a revenue of \$10,700,000, out of which they had to set aside more than \$9,000,000 to meet "uncontrollable" expenditures such as sinking funds and bond interest, which left about \$1,500,000 for ordinary expenses.<sup>9</sup> The situation in Winnipeg was never as serious as in the far-western cities. Winnipeg has taxed buildings and improvements at 66⅔ per cent of their full value throughout the period. Even so, the depression left Winnipeg with relatively high tax arrears, and there was agitation for a still broader tax base. One Winnipeg taxpayer characterized the tax on property and the right to sell for arrears as "camouflaged confiscation."<sup>10</sup>

Reporting on the situation in Saskatchewan in 1917, Professor Haig pointed out the fact that during the boom when land assessments had been high and rates low, few objections had been made to the high assessments because they justified the speculator in his claims as to the value of his land. But in the depression he refused to pay the tax. In answer to the possible objection that this would be true regardless of the type of tax used, Professor Haig's findings on the cities of Saskatchewan are of interest:

"... Such data as are available tend to show that land values form the least stable portion of the tax bases, and that those cities which have depended upon land most heavily are those which have had the greatest difficulty in collecting taxes. Taking, for example, the cities of Saskatchewan, it is found that the order in which they stand with regard to success

<sup>9</sup> Manitoba Assessment and Tax Commission, *op. cit.*, p. 133.

<sup>10</sup> Fraser, Arthur M., President of the Winnipeg Taxpayers Association, *Readers' Forum*. Winnipeg, November 15, 1926.

in making collections promptly is almost exactly the reverse of the order in which they stand in regard to their dependence upon land as a source of revenue."<sup>11</sup>

Professor Haig concluded that the taxation of land had been carried too far in Saskatchewan.<sup>12</sup>

The dissatisfaction in various commission reports reflects a rather general change of attitude throughout Canada. The enthusiasm for exemption of improvements has diminished, not only among real estate brokers but also among other taxpayers and tax officials. The criticism against land value taxation has been mostly that it has been a fiscal rather than a social failure<sup>13</sup> and the reform advocated has been a broader tax base. The Manitoba Assessment and Taxation Commission advocated taxation according to ability rather than benefit. They regarded as unstable a revenue system based largely on land taxes, and also cited instances of the unwise use of large revenues obtained during the boom period. They particularly stressed the undue extension of city boundaries and the overdevelopment of public utilities.<sup>14</sup>

The situation clearly called for relief. Temporary relief was afforded in various ways. Edmonton issued short-term debentures to cover part of the arrears. In Regina the banks advanced money and in South Vancouver a provincial administrator was appointed to straighten out the finances of the city. It soon became evident that more permanent relief in the way of the enforcement of collection, and revision of the tax base were necessary.

Although there were laws providing for the sale of land for arrears of taxes, cities hesitated to enforce these laws for fear the land would revert to them for lack of outside bidders. Tax sales were finally held in many cities. Although it often meant substituting real estate for tax arrears in the cities' books, it seems to have had a wholesome effect on many taxpayers.<sup>15</sup> The reduction

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<sup>11</sup> Haig, R. M., *Limited Single Tax*, National Tax Association Proceedings, November, 1917, p. 377.

<sup>12</sup> Haig, R. M., *Report to the Government of the Province of Saskatchewan*, Regina, 1917, p. 31.

<sup>13</sup> There has been some criticism, however, of the social effects of the exemption of improvements. For instance, C. J. Yorath, City Commissioner of Edmonton, states that it led to overdevelopment of property and failed to prevent land speculation. *Report of the Committee on Taxation of the City of Toronto re Single Tax*, 1923.

<sup>14</sup> Manitoba Assessment and Taxation Commission, *op. cit.*, pp. 43, 118, and 182.

<sup>15</sup> *Annual Report of Municipal Affairs*, Saskatchewan, 1917-18, pp. 17-18.

of tax arrears in Vancouver from a high point of \$5,500,000 in 1918 to \$2,000,000 in 1930 is an example of the effectiveness of tax sales. In this city in 1925, 627 of the 839 lots offered for sale were purchased by the city.<sup>16</sup> As late as 1930, 502 lots were purchased by the city, and only 157 by private individuals.<sup>17</sup>

The extent of the reduction of arrears outstanding in the eight largest cities of the provinces is shown in Table III. All of the provincial laws give permission to sell land when taxes are a year in arrears but they vary the period allowed for redemption.

In order to encourage payment of arrears, relief acts were passed both by the provinces and the municipalities to allow a moratorium on back taxes. For example, Victoria passed a relief act in 1919 by which back taxes could be funded at 7 per cent. This debt was to be paid off in ten annual instalments along with the current taxes on the property.<sup>18</sup> This plan did stimulate payment of taxes and helped to relieve the financial difficulties of Victoria by restoring to taxation land which had not been a source of revenue for some time.

The provinces of Alberta and Manitoba also passed relief measures. Alberta's is similar to the act passed by the City of Victoria and is much more thoroughgoing in its effort at adjustment than the Manitoba relief act which only provides for exemption from penalties.

The second type of more permanent relief was a revision of the tax base. This was a step which roused sufficient public opinion to be used only in serious cases or only to a limited extent. In South Vancouver, after issuing treasury notes in 1917, it was necessary for the city to default in meeting its obligations. An administrator was appointed by the government to administer affairs and he finally announced:

"After careful investigation of the financial situation, I find it absolutely necessary to depart from the straight tax on land, drastic though it be."<sup>19</sup>

Of the eight cities for which data were obtained, six raised the rate of assessment on buildings and improvements as noted above. The largest increase was that of Edmonton from complete exemp-

<sup>16</sup> *Report of the City of Vancouver, 1925.*

<sup>17</sup> *Report of the City of Vancouver, 1930.*

<sup>18</sup> Manitoba Assessment and Taxation Commission, *op. cit.*, pp. 138-9.

<sup>19</sup> *Report of the Committee on Taxation of the City of Toronto, re Single Tax, 1923, p. 51.*

tion to a 60 per cent assessment. Winnipeg and Regina have maintained the same rate of assessment throughout the period considered but have at no time shown such serious tax arrears as Victoria, Edmonton and Vancouver.

That the partial exemption of improvements has not proved a failure is evidenced by the fact that improvements in all cases are still given at least a  $33\frac{1}{3}$  per cent differential in western Canada. That the desire for social reform in land holding is still strong in these provinces cannot be doubted, if we consider also the other provincial legislation penalizing the wild or unoccupied lands. Table II shows each province to have a wild land or unoccupied land tax to encourage the use of land. In Alberta they have both a wild land tax and an unearned increment tax on land. Both of these, as well as the wild land tax in Saskatchewan, exempt small holdings thereby encouraging the breaking up of large estates. These taxes are of fiscal as well as social importance, however, and when high rates threaten confiscation, as in the case of the British Columbia tax, these rates are reduced.

It is significant that under the more static economic conditions prevailing in the eastern provinces, exemption of improvements from taxation has never gained any real foothold. Nevertheless, the experiment being carried on in western Canada has successfully passed through an extremely critical period. Tax arrears are being steadily reduced. The result has been achieved by a compromise and the improvements once wholly or almost wholly exempt are now assessed at a higher percentage of their full value. Also the real estate tax has been more generally supported by business and income taxes. It is apparent, however, that if the amount of the exemption is flexible and if, further, too much dependence is not placed on the one tax, a limited exemption of improvements is feasible and possibly useful in achieving certain social ends.

## APPENDIX VII

# GOVERNMENTAL ORGANIZATION AND PUBLIC EXPENDITURES<sup>1</sup>

### I. SUMMARY

This report is designed to support the general thesis that heavy taxation is produced by the following factors, acting singly or in combination:

1. Large aggregate public expenditures.
2. Maladjustments in the tax system.

The following report is a contribution under 1 above. It outlines the effect of improper governmental organization on the aggregate of public expenditures.

I. The term "Governmental Organization" may have two meanings:

1. The structural organization of governmental units, or
2. The territorial organization and jurisdiction of these units.

II. Structural organization varies greatly. The principal defects leading to excessive or unnecessary expenditure are the following:

1. Diffusion of financial and administrative responsibility,
2. Confusion of policy-determining and administrative functions,
3. Lack of adequate exercise of the controller function,
4. Lack of an independent audit.

III. Territorial organization also varies greatly. The defects which give rise to unnecessary or excessive costs are the following:

1. Too many small units endowed with corporate powers,
2. Too many layers of administrative units over the same area,
3. Improper allocation of functional responsibilities to the governmental units.

### II. VARIATION OF STRUCTURAL ORGANIZATION

**1. Diffusion of financial and administrative responsibility.** This diffusion is more marked in local than in state governments. Some state reorganization plans have concentrated administrative responsibility under department heads, while the state budget

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<sup>1</sup> This paper was submitted by Mr. Harley L. Lutz, member of the Committee on Taxation, as an appendix to the committee's report.

movement has tended to emphasize the executive responsibility in framing and executing the financial plan. These improvements are as yet far from universal. There is still great need, in state administrative organization, for a more definite concentration of responsibility for expenditure planning and control.

A bewildering variety of organization types is found in county and municipal government, which is hereafter designated collectively as "local" government unless a different meaning is indicated. Uniform budget and accounting systems are found, but their use is still by no means general. The manner in which expenditures are authorized and controlled, whether a budget is prepared under a general act or not, varies widely. The mayor or chief executive official may have much, little, or no authority and influence in framing the budget. The commission form, once widely advertised as the ideal type, provides for no independent criticism of expenditure proposals. Each commissioner, as a departmental head, gets his own appropriation through by supporting the uncriticised appropriations of the other department heads, his fellow commissioners. The tendency of legislatures to create independent local boards with authority to levy a certain tax or to borrow money for their specific purposes, such as parks, libraries or mosquito extermination, undermines the unity of the local financial plan. The manager type, or the strong mayor—weak council type, when left sufficiently free from partisan influences, offers the greatest promise of an adequate degree of concentrated financial and administrative responsibility, although the continuance of tax-levying or borrowing powers to be exercised by numerous independent boards would still be a fatal obstacle to unity.

Local financial responsibility is also undermined by mandatory legislation, requiring stated local expenditures for express purposes. This legislative practice has no relation to local structural types since it affects all types alike. In general it must be condemned as demoralizing to sound local financial management. The conflict of authority involved may be settled in one of two ways. The legislature may set out a requirement, leaving the local unit to budget the expenditure to be made in compliance with the order. If the legislature believes that local units will not spend

proper amounts, and if it still believes that the service should be given, then the cost should appear in the state budget.

**2. Confusion of policy-determining and administrative functions.** This confusion is more marked in local than in state or federal governments. The separation of legislative or policy-determining powers from the executive powers, established by constitutional theory for the federal government and introduced imitatively in state organization, has found almost no place in local organization. The governing body of the city or the county determines the local policy by its ordinances, and its members, acting individually or as committees, execute the policies.

The most serious result is an application of partisanship and of political viewpoints and methods in a field which requires expert, unbiased administrative qualities. Even if the actual work is done by an employee with technical qualifications, his domination by a nominal executive head actuated by political motives is destructive of the best administrative results. All local government is seriously in need of a reorganization which will confine the partisan and the politician to the field of policy determination and leave the field of actual administration, or the execution of the policies determined upon, to expert administrators. The taxpayer is paying a heavy price for the bungling interference, in those fields which demand expert qualifications, of the administrative chiefs whose sole qualification is their political power or influence.

**3. Lack of adequate exercise of the controller function.** This lack is also far more serious in local than in state or federal governments, although it cannot be said that all states now have an adequate performance of the controller function.

The larger cities and counties may have an adequate current financial control. This defect is most conspicuous in the smaller units, where the common practice is to have the bills and claims subject to no inspection before being paid than that which may be given by the official or the committee which incurred the obligation. Obviously, this kind of inspection is no safeguard at all against the allowance of claims and bills for improper purposes, or for improper amounts.

**4. Lack of an independent audit.** Local governments are likewise the most conspicuous offenders in this respect. Many of



the smaller units do not even have a competent bookkeeper, while a number of states have not as yet provided uniform, standardized local accounting systems with a periodic independent audit. The errors, defalcations, and other irregularities which are disclosed by such audits in the states that have made provision therefor reveal the extent to which the lack of careful, rigorous auditing permits a waste of public funds.

### III. VARIATION OF TERRITORIAL ORGANIZATION

The other sense in which governmental organization is defective, namely, the territorial maladjustment of units, applies peculiarly to the field of local government. No recognition is given here of the contentions which have been advanced in criticism of the existing territorial division into states on an arbitrary, historical basis. This aspect of the problem may be germane to the subject in its broadest application, but its consideration in the present connection would be futile.

The territorial organization within each state, that is, the grouping into counties, municipalities and other districts, is, however, a matter which can be controlled and influenced, although the modification of the existing structure of local units involves difficulties that arise from the fact that local traditions, prejudices, and preferences have played an important part in establishing the existing local configuration.

**1. An excessive number of local units.** This aspect of defective governmental organization has been emphasized in the report of another sub-committee (see report by F. M. McWhirter) and it may, in consequence be dealt with briefly here. An extreme case of the congestion of small units is presented by the metropolitan region of northern New Jersey.<sup>1</sup> Five counties, Hudson, Essex, Union, Bergen and Passaic, have a combined area of 700 square miles, and an aggregate population of 2,500,000. In addition to the five counties, this area, which is the equivalent of a tract

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<sup>1</sup> Cf. *Report No. 1*, by the Commission to Investigate County and Municipal Taxation and Expenditures, Trenton, 1931. Cited hereafter by title only.

35 miles long and 20 miles wide, contains 140 municipalities, 137 school districts, and a number of special districts for various purposes. Excessive costs are being paid in this region for many governmental services because of this minute subdivision of administrative areas. Newark and Jersey City spend more per capita on police protection, for example, than any other cities in the United States, regardless of size.<sup>2</sup> Hudson County, with an area of 42.5 square miles is divided into 12 municipalities. The aggregate expenditure for fire protection in this county in 1928 was \$3,800,000. This was more absolutely, and far more in relation to area, population, or value of property, than was spent in Cleveland, St. Louis, Baltimore, or Pittsburgh in that year. A forthcoming report by the New Jersey Commission which is investigating local finances estimates that a county unit for fire protection in Hudson County, with equipment and manning reduced to the standards set by the National Board of Fire Underwriters, would effect an annual saving of more than \$1,000,000 in the taxes paid for fire protection.

These conditions are typical of the wastes occasioned by an excessive number of small administrative units, particularly in congested metropolitan territory. At the other end of the scale, there were more than 100 rural townships in New Jersey which did not spend, in 1928, as much as \$1,000 on any governmental function other than roads and schools.<sup>3</sup> Since very small units are not suitable areas for the economical administration of either roads or schools, action to disorganize them is obviously called for.

**2. Overlap of administrative units upon the same area.** Data indicative of the multiplication of special districts and other units with varying degrees of financial and administrative authority over the same area are given in the report of Mr. McWhirter referred to above. This multiplication of agencies promotes and contributes to the diffusion of financial and administrative responsibility referred to in section II, 1, of this appendix. It makes impossible any presentation and consideration of a unified

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<sup>2</sup> Cf. *Financial Statistics of Cities, 1928*, Table 13. Jersey City spent \$9.61 per capita on police and Newark \$7.67, as against \$6.22 in New York, \$5.24 in Chicago, \$5.51 in Philadelphia, and so on.

<sup>3</sup> *Report No. 1*, p. 221.

financial program, since these overlapping agencies are entirely independent of each other. Yet their separate tax levies all fall upon the same mass of wealth, and are borne by the same group of taxpayers. In some parts of the New Jersey metropolitan region indicated above the following duplication of police agencies occurs: municipal police, park police, county boulevard police, county detectives, and state police. There is no evidence that the multiplication of police authorities has reduced the expenditure for this purpose by any of these agencies.

**3. An improper allocation of functions to units.** One of the most fundamental reasons for the high cost of local governments is the faulty allocation of service responsibilities that now exists.<sup>4</sup> With population growth and the changing economic and social environment, the size of the economical administrative area expands, while that of the small municipality which is obliged to perform the service does not. The latter is thus constantly struggling against a rising cost level in the effort to perform services for which a larger administrative area is demanded in the interests of economy. The home rule tradition has promoted local officials to resist transfers of responsibility, even when the evidence and the logic alike demanded it. The *impasse* has been evaded in some instances by the creation of special districts for water supply, sewage disposal, and other matters, but in New Jersey the legislature was unwilling to compel complete municipal participation within these larger districts and the matter was left to each municipality. Those that did join were to be associated together on a contract basis, somewhat analogous to a partnership, and the projects thus far carried out in this way have proved to be extremely costly, both of time and of money.

#### IV. RECOMMENDATIONS

The recommendations to be offered for the correction of these structural and organization defects are probably sufficiently obvious from the foregoing discussion. They are summarized here for convenience:

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<sup>4</sup> Cf. Lutz, H. L., *Public Finance*, 2d Ed., pp. 116-120.

1. Financial responsibility for the flow of all local governmental services into any area should be concentrated as nearly as possible into a single agency, with a unified budget for the area. If both a county and a municipal government are deemed to be necessary (that is, if conditions are such that neither a strong county government nor a county-municipal segregation plan is feasible)<sup>5</sup> the county and municipal budgets should be exhibited together in order to give the taxpayer a comprehensive view of the total of his local obligations. A capital improvement budget should be prepared and submitted at the same time, with complete details as to the method of financing and its effect upon local taxes.<sup>6</sup>

2. The distinction between policy and determination and administration should be recognized and enforced.<sup>7</sup> The manager type and the strong mayor—weak council types of organization offer greatest possibilities for the realization of this standard.

3. The controller function should be exercised over every governmental unit having authority to spend money.<sup>8</sup>

4. The state should prescribe uniform accounting systems and an independent audit over every local unit having authority to spend money.<sup>9</sup>

5. Simplification of the local governmental organization is essential to economy of operation and to expenditure control.<sup>10</sup> No formula of simplification is capable, however, of universal application. Some units should obviously be disorganized. Consolidation is desirable in other cases, but compulsory consolidation by legislative action is not practical in view of the local attitude. A general recommendation can be made in favor of legislation to facilitate and encourage consolidation, thus eliminating all obstacles except that of local prejudice.

6. The elimination of overlapping districts can be recommended. This is in line with recommendation number 1, which calls for a unified budget and for concentrated financial responsibility.

7. Reallocation of functions is sorely needed. Again no formula is generally applicable. In order to be intelligently done, reallocation should be preceded by careful analysis of each function in order to determine the proper basis of reassigning the function. Some studies of this sort have been made by the New Jersey Commission which is investigating local finances, but it has not been possible to cover the entire field of local functions. The results that have been found show clearly, however, that it is impossible to determine *a priori* whether the city, the county, the

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<sup>5</sup> For an explanation, see *Report No. 1*, Ch. VII.

<sup>6</sup> Cf. *Report No. 2, County and Municipal Debt*, by the New Jersey Commission to Investigate County and Municipal Taxation and Expenditures, Trenton, 1931.

<sup>7</sup> Cf. *Report No. 1*, pp. 257-260.

<sup>8</sup> Cf. Forthcoming report on *Local Financing Administration*, to be published as *Report No. 3*, by the New Jersey investigating commission.

<sup>9</sup> Cf. *Report No. 3*, cited in note 8 above.

<sup>10</sup> Cf. *Report No. 1*, Chs. VII and VIII.

state, or some new intermediary unit, such as the region, is the proper repository of the responsibility in individual cases.

Functional reallocation may prove to be a solution which will either hasten consolidation or will make it unnecessary. The local units, confronted by a transfer of their functions to larger areas, may be quickened to provide somewhat larger areas through consolidation. This may result in preserving for the enlarged jurisdictions some matters which would otherwise go to the county or to some other area. Consolidation can hardly be expected, however, to be carried out on a scale which would avoid the necessity for transferring some responsibilities to the county, the region or even to the state.

## APPENDIX VIII

# RELATION OF GOVERNMENTAL ORGANIZATIONS AND PUBLIC EXPENDITURES TO TAXATION OF HOMES<sup>1</sup>

## I. SUMMARY

### INTRODUCTION

The relation between taxes and governmental expenditures. Reduction of taxes depends on lowered expenditures.

### GOVERNMENTAL ORGANIZATIONS

**Reduction of the Number of Local Governments.** The number of local governments is excessive. This number should be reduced by combining some and eliminating others. Groups of small counties should be combined. School districts should be combined upon a county-unit basis. Outside of New England, townships should be abolished and their functions transferred to counties, municipalities and/or the state.

The many special districts should, where possible, be eliminated and their functions transferred to counties or municipalities. In metropolitan regions the number of governmental units should be reduced.

**Improvement in the Forms of Government.** Governments should be organized on a basis of efficiency, with centralized responsibility and control, and proper departmental organization.

Administrative practices should be improved, along the lines of:

1. Sound budgetary procedure.
2. Accrual accounting.
3. Centralized purchasing.

### GOVERNMENTAL FUNCTIONS AND SERVICES

The rapid increase in governmental functions in recent years has been to a considerable extent responsible for the heavy increase in the cost of government.

These functions should be examined critically, with the object

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<sup>1</sup> This paper was submitted by Mr. Felix M. McWhirter, member of the Committee on Taxation, as an appendix to the committee's report.

of eliminating those which are unnecessary or unduly costly, in order to reduce governmental expenditures.

### ADMINISTRATIVE PROCEDURE

The adoption of some or all of the following safeguards against extravagance by local governments should carefully be considered:

1. State administrative control over local budget making and debt incurrence.
2. Limitations on the power to levy taxes.
3. Limitations on borrowing power such as more restrictive debt limits, pay-as-you-go for recurring capital expenditures, and rapid debt retirement.
4. Long-term financial planning by governmental units.

### INTRODUCTION

Inseparably related to the problem of taxation on homes are questions concerning governmental costs and expenditures. Obviously the only reason for taxes is for the maintenance and support of governmental functions and services. As the cost of these increase, or as they increase in number, or both, so increase the demands of government for additional revenues. Any attempt at solution of the problem of taxation of homes cannot overlook questions of public expenditures. As one writer has expressed it, to say that taxes are too high is only another way of saying that government is spending too much.

Some approaches to this problem attack it from the angle of revenues. That is, questions of sources of revenue, the incidence of taxation and possible inequalities of certain forms of taxes are considered with the object of eliminating, so far as is practicable, such inequalities as may exist. However desirable such an approach may be, there nevertheless remains the fact that if government is to spend a certain amount of money, this money must be obtained somehow and in the long run a good part of it, regardless of the form of taxation used, is likely to come from the pockets of the home owner.

As discussed in previous sections of this report, real estate taxes are, of course, a direct burden upon the home owner. Furthermore, so far as the taxes of any character paid by the builder and real estate agent are reflected in the prices of homes (and while this reflection cannot be precisely determined it exists everywhere

to some little extent at least), such taxes are also a burden upon the home owner. Sales taxes may increase the cost of building materials. Income taxes paid by builders, architects and others, especially corporation taxes, may be reflected in the price of home building. The costs of public construction projects financed through special assessments are paid by the property owner.

These taxes are definitely a burden upon the home owner. Determination of methods of lightening this burden is the purpose of this report. The tax burden on the home owner could, of course, be lightened to some extent by shifting part of the tax now collected from the owners of real property to other groups in the population. This, however, would look toward an increase in other forms of taxation. Increased taxation of incomes, with low exemptions, would be collected directly from a large number of home owners. If a sales tax were adopted, it would be collected very widely from among the entire population and would thus bear directly upon the home owner. Such taxes would thus simply take money from a different pocket of the home owner in many cases.

In this connection it ought to be understood that the home owner should not ask for special favors. He, like everyone else, must bear his fair share of the cost of government. Attempts to shift the burden of taxation by the substitution of new taxes for old, take on the appearance, if not the actuality, of special favoritism. It is far better, therefore, for the home owner to avoid the appearance of asking for special treatment. Instead he should look toward a final solution of the problem by an attack upon its fundamentals.

To reduce the total burden of taxation in any permanent fashion requires the reduction of governmental expenditures. Obviously if government spends less, its taxes are less.

There is a close relationship between governmental organization and services on the one hand, and the taxation of homes on the other. Governments which are efficiently organized and operated, spend less in doing the same amount of work than do governments whose organizations are ill-adapted to the tasks which they must perform. Likewise, the services rendered by government have a close relationship to its cost. Clearly, the more activities which a government carries on, the more money it must spend and, unless these activities are self-supporting, this means an increase in taxes.



The foregoing discussion is but a restatement of obvious truths which have long been familiar to those who have given the operations of government their close attention. Their restatement here, however, is necessary by way of background for consideration of the recommendations which follow. The operations of government will be considered from two standpoints in the following pages: First, the organization for conducting and administering governmental functions and services; and second, the nature of the services performed. In connection with this discussion will also be considered certain safeguards which may be adopted for the protection of home owners against extraordinary demands for governmental expenditures.

This consideration will take, for the most part, the form of a discussion of the practices and principles which would underlie an efficient and economically administered government. The adoption of these recommendations should logically result in a reduction of governmental expenditures.

## II. GOVERNMENTAL ORGANIZATIONS

Two subjects must be considered under the head of governmental organizations. First, there is the type and number of agencies created to perform the tasks allotted to government. Second, there is the organization adopted and procedure followed by these various units in performing their functions. The effectuation of economies here will make it possible to reduce the cost of government, and hence taxes, without materially curtailing the performance of necessary services.

### REDUCTION OF THE NUMBER OF LOCAL GOVERNMENTS

It will be universally conceded that local government in the United States today is in a chaotic condition as a result of the haphazard growth and development of local government itself. Historically speaking, this is understandable. Like Topsy, these governments, for the most part, "just grew." Practically speaking, it is essential that the number of governments be reduced in the interest of efficiency and economy. And it can be done.

Various authorities estimate that there are from 250,000 to 500,000 governmental agencies in the United States. Certainly we could spare some of this number without destroying either the

character of our representative government or the efficiency of governmental services. A few figures will indicate the extent of the present chaos.

There were 3,072 counties in the United States on June 1, 1929. Some states have very few counties, others more than 100. Delaware has 3 and Rhode Island, 5. Kentucky has 120, Georgia, 161, and Texas, 254. The areas vary from a few to several thousand square miles.

In Indiana there are 92 counties with more than 1,000 township trustees, about 275 county commissioners, and nearly 650 county councilmen. In addition, there are more than 3,000 members of various county advisory boards and more than 1,000 elected county administrative officials. In Pennsylvania, there are 67 counties with more than 1,500 administrative officials. In New York there are 62 counties.

When other agencies of local governments are considered, the situation is even more complex. In Michigan there are about 6,800 school districts with more than 27,000 directing officers and more than 1,200 townships with more than 15,000 officers. Illinois has about 12,000 school districts, more than 1,400 road districts and more than 1,500 townships. All told, there are about 16,000 local governments in Illinois. In Ohio, there are a total of more than 10,000 officers for 1,300 townships. Pennsylvania has 1,500 townships with more than 13,000 officers and there are more than 2,500 school districts with nearly 13,500 officials. New York has 932 towns, 520 villages, 2,000 special districts and nearly 10,000 school districts.

In addition to the traditional forms of local government—the county, township city, town and village—there are many special governmental agencies. These are commonly referred to as *ad hoc* bodies, created ordinarily to serve one special purpose. In these is found an excellent illustration of the haphazard growth of local governments in the United States. One investigator classified 47 varieties of such special governmental agencies which exist under 89 names. The school district alone exists under 34 names and in 8 varieties. Other agencies are agricultural districts, conservancy districts, drainage districts, fire districts, flood control districts, library districts, forest reserve districts, lamp or lighting districts, levee districts, mosquito abatement districts, park dis-

tricts, power districts, public sanitary districts, river-improvement districts, road districts, sea wall districts, sewage districts, and water-works districts, to name only a few.<sup>2</sup>

In many places these local governments coincide and overlap with resulting duplication of effort and authority, and a consequent high operating cost. It is well known, for example, that there are about 415 local governmental agencies in Cook County, Illinois; in Wayne County, Michigan, nearly 150; and in Cuyahoga County, Ohio, more than 90. At the other extreme, there are New York City where there are five counties which exist solely for judicial purposes, and one city government; the City and County of San Francisco; and the City and County of Denver, to mention a few instances of city-county consolidation. It has been estimated that by eliminating the duplications of jurisdiction, function and authority of the 400-odd taxing and administrative units in the Chicago area, there will be saved \$156,000,000 annually. Similar savings on a lessened scale could likewise be made in Wayne County, Cuyahoga County, or any one of the other counties where there now is a mixed aggregation of local governments.

The county as originally devised for the horse-and-buggy age and an agricultural civilization was often so blocked out in size that any person within the county would not be more than one day's journey to and from the county seat. This was not always true, but there would appear to have been such an attempt on the part of those originally responsible for the boundaries of many of the present day counties. In the more recently laid out states, this tendency is not as pronounced as it is in the older portions of the country. There one will find many counties of considerable size.

Today, however, the average county can be traversed in from one to three hours by automobile. In fact a number of states are sufficiently small to enable a motorist to cross them in a day. The need from this standpoint for the small-sized county has thus passed. At the same time some areas, formerly prosperous agricultural communities, have retrograded economically, and to maintain within their small boundaries a full complement of county officials is more costly than is justifiable.

For this reason, the New York State Tax Commission recently

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<sup>2</sup> Guild, F. H., *Special Municipal Corporations*, in *National Municipal Review*, May, 1929.

suggested that groups of economically backward counties be combined into a smaller number of self-sustaining units.<sup>3</sup> This would reduce the cost of maintaining county governments through the elimination of several sets of county boards, administrative officials, judges, county legal officers, etc. Similar recommendations were made in a special report on local government in North Carolina recently made by The Brookings Institution of Washington.<sup>4</sup>

In 1918, with the approval of the voters, James County, Tenn., was absorbed by Hamilton County. In twelve years the county tax rate dropped off from \$2.60 to \$1.30. Despite these lower rates, highway construction increased; the number of schools in James County was cut from 19 with but one teacher each, to 10 with a greater number of teachers and longer terms; better hospitals were established; and the facilities for poor relief improved.

It would appear desirable therefore for public authorities to develop ways and means of combining counties into larger, more economically administered and self-sustaining units of government.

The New York State Tax Commission recommended also the abolition of towns (townships), characterizing them as too small to have the facilities or the taxable resources necessary for adequate administration of highways, assessments, and the other functions they now perform. Each town in New York has at least three officers as required by the state constitution. Most have eight or more. Furthermore, the functions of townships have gradually got beyond them; that is, as a type of governmental unit, they have become obsolete for performing the functions for which they were originally created. The abolition of towns would eliminate a large number of officials whose functions could be more efficiently handled if transferred to the county governments enlarged as already recommended.

In a similar way, it is conceivable that the large number of school districts could be consolidated—perhaps on a county basis—into larger and more efficient units.

Many special-purpose districts could also be abandoned, their functions being transferred to the states, cities, villages, or coun-

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<sup>3</sup> Compton, Ralph T., *Fiscal Problems of Rural Decline*, special report of New York State Tax Commission, 1930.

<sup>4</sup> Institute for Government Research of The Brookings Institution, *Report on a Survey of the Organization and Administration of the State of North Carolina*, Washington, D. C., 1930.

ties, depending upon the nature of the work performed. Possibly some of their activities could be dropped at no loss to their inhabitants.

In metropolitan areas with numerous local governments, such as Cook County, Ill., Cuyahoga County, Ohio, and Allegheny County, Pa., consolidation of governmental units into a fewer number of well coordinated and carefully planned and organized agencies could well be undertaken. This step would facilitate the organization of agencies equipped to cope with the complex problems of modern metropolitan life, such as police and fire protection on a large scale, long-term financial planning, sewage disposal, and the like, and permit the administration of their governance in a well regulated and economical fashion.<sup>5</sup>

It is accordingly recommended that in the interests of increased economy the following steps be taken:

1. Consolidation of groups of small counties into larger and more efficiently administered units of county government with provisions for handling increased services to be transferred from smaller units of government and special districts.
2. That the abolition of township government (outside of New England) be considered, with the transfer of the administrative functions of the township to counties.
3. The consolidation of small school districts into larger and more efficient units, and possibly upon a county basis.
4. The amalgamation or abolition of many of the special districts and governmental agencies. (If amalgamated, such combination should be on the basis of units capable of handling efficient service at low cost. If abolished, the functions, if necessary, should be transferred to the strengthened county or other local governments.)
5. Special effort should be made to effect a unification of the many local governments in certain metropolitan areas.

Such consolidation of overlapping and coextensive units of government would result in:

1. The centralization of authority and responsibility in units whose size and scope of work would be determined by existing conditions.
2. Increased efficiency in budgeting, accounting and auditing, and purchasing.
3. The elimination of costly delays and waste caused by division of authority.
4. The elimination of unnecessary personnel.

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<sup>5</sup> See further *The Government of Metropolitan Areas*, a report of the Committee on Metropolitan Government of the National Municipal League, New York, National Municipal League, 1930.

## IMPROVEMENT IN THE FORMS OF GOVERNMENT

It is not only the number and kinds of governmental units which have an effect upon expenditures and upon taxation. The organization evolved by a governmental unit for carrying on its daily work is fully as important. Decentralization, lack of centralized responsibility and unified control, duplicating and conflicting jurisdictions among administrative departments, division of the tax levying authority among several quasi-autonomous branches of a government, and other defects have characterized many of our administrative agencies in the past. While in recent years there has been a trend away from this condition, it is still prevalent among numerous state and local governmental agencies.

As an example, the taxes of one city government are levied by the city council, by a separate school board, a library board and a park board, each with the authority to make out its own schedule of expenditures, independent of the needs of the other tax levying branches of its government. Such a government cannot be expected to render the most efficient and economical service. In this city, furthermore, there is lack of administrative responsibility. Part of its affairs are administered by the city council, part by the mayor and part by the various boards. It is obvious that under such circumstances, with no one authority responsible for the conduct of the city administration, conflicts of jurisdiction arise, resulting in costly delays, disputes, and other difficulties.

Fortunately, however, the trend in recent years has been away from such practices, though there is much that remains to be done in this regard. Thought on this matter has been fairly well crystallized in the past ten or fifteen years and it will suffice to summarize briefly the principles of organization which have been found by the test of experience to produce the most effective governmental organization, and which should be followed in continuing this trend toward more efficient organization. These principles are applicable to state, city, county and other local governmental agencies. It is recommended that these be generally adopted.

**Principles of Administration.** First, there should be centralized responsibility and control for the conduct of administration, in order to insure its efficient performance and coordination among its various branches of work. Such an organization commonly becomes hierarchical, with a chief executive who is popularly

elected or appointed by some representative body and who in turn appoints his own department heads and other subordinate officials. He is responsible for their acts and they are responsible to him. A corollary to this principle is the concept that purely administrative officials should for the most part be appointed by the chief executive or his immediate subordinates, and not elected.

Second, related functions should all be grouped in one department and each department should be subdivided into as many bureaus and divisions as are necessary for the efficient performance of its work. As a corollary of this principle it is desirable that duplicating functions of the various governmental agencies be eliminated by this grouping of related functions.

Third, through the chief executive, there should be complete coordination and supervision over the various subordinate administrative units.

It is along these lines that a large number of state governments, such as New York, Illinois and Tennessee, to mention only three, have been reorganized in recent years. In New York, for example, there was a complete reorganization and a reduction of 180 administrative departments and bureaus to 20 major departments with all state executive officers, except the governor, lieutenant governor, comptroller, and attorney general, who are popularly elected, appointed by the governor. The major department heads constitute the governor's cabinet.

In city government, two forms, the strong mayor form and the city manager form, follow these lines. Under the strong mayor plan the chief executive is the mayor who is popularly elected. Under the city manager plan the chief executive is the city manager who is appointed by the city council. It is not the purpose of this report to discuss the relative merits of these two plans. Suffice it to say that under either there is a reasonable centralization and coordination of authority. Under each the subordinate administrative officials are appointed by and responsible to the chief executive.

In counties, there has been a development within the past few years in this same direction. For the most part it has taken the form of a county manager plan, with a manager appointed by the county board. In 1930, there were nine counties in the United States, five in Virginia and four in North Carolina, which had adopted the county manager plan. There would appear no

reason, however, why a chief executive of a county could not be popularly elected, making the county government roughly analogous to the strong mayor plan for cities. If the county is enlarged in scope and absorbs the functions of subordinate local government as recommended in the preceding section of this report, it would appear desirable that some such centralization of power and authority, coupled with complete responsibility for administration be provided for.

**Administrative Practices.** Such unification of authority as is recommended above makes possible the adoption and proper use of important administrative practices which in turn look toward greater efficiency. These will be briefly outlined below.

1. *Budgets and Budgetary Control.* Most governmental agencies today adopt annually a plan of expenditures for the coming year known as a budget. Too often, however, these budgets are not real budgets, but merely appropriation ordinances. Under such circumstances it is very often found that proposed expenditures are not balanced against estimated receipts. Frequently there is little consideration given to the ability of the community to pay increased taxes, budgets being balanced, if at all, by increasing taxes, rather than by reducing expenditures.

One great difficulty with budgetary practice today is the lack of budget control. Nearly all governmental units of any size make more or less of a gesture in the direction of a budget; that is, an attempt is made to block out a schedule of expenditures. The difficulty comes with the enforcement of this schedule. Far too many governmental units today fail to provide an adequate system of budgetary control or enforcement of the provisions of such budgets as are adopted. Clearly without such control a budget is of little, if any, value, and it is to the interest of governments and taxpayers alike to see to it that sound budgets are adopted and are properly enforced.

With the development of centralized responsibility in administration, however, has come a development of improved and sound budgetary practice. Consideration should be given by governmental agencies to the adoption of budgetary procedure which provides for the following:<sup>6</sup>

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<sup>6</sup> A comprehensive and authoritative treatment of budgetary practice will be found in Buck, A. E., *Public Budgeting*, New York, Harper and Brothers, 1929.



1. A complete schedule of proposed expenditures worked out according to the needs of the various departments as determined by existing circumstances, considered in the light of expenditures for the last year or two years, and with due regard for economies and savings to be effected through efficient procedure.

2. A balanced financial program with a schedule of anticipated revenues estimated to balance the proposed expenditures, due regard being had for the ability of the community to pay.

3. Adequate provision for public hearings on the proposed budget, thus affording citizens an opportunity to give an expression of opinion as to the desirability and advisability of proposed expenditures. Such practice affords an opportunity for effective cooperation between public officials and citizen agencies working for better and more economical administrative methods.

4. Provision for budgetary control, that is, the rigid enforcement of the expenditure schedules set forth in the budget.

5. A complete and effective system of auditing city expenditures. The system of auditing should do more than merely see that all expenses are legal. An effective audit reveals possible defects in administrative practice.

Ordinarily it is preferable for the budget to be prepared in the first instance under the supervision of the chief executive, and for him to submit it to the legislative body for final action.

Such a system provides for a balanced financial administration, enables public executives to have at hand more accurate information, and allows citizens to keep a close watch on the activities of their city government and to participate in the budget making process, thereby informing public officials as to their views on the relative importance of proposed expenditures.

The problem of the budget as related to coextensive and overlapping units of local government deserves special consideration. Under ordinary procedure each unit of government makes out its own budget, independently. In areas where there are many local governments, it is obvious that if no consideration is given by each separate budget making authority to the cumulative effect upon the taxpayers of all budgets in the region, the result may be an unduly heavy program of expenditures. This, unfortunately, is far too often the case.

Under a system of simplified local government brought about through consolidation of some units and abolition of others, as discussed above, this situation is cured to some extent. There is still the likelihood, however, of more than one budget for the same ter-

ritorial area and the same lack of coordination may exist although in a lesser degree.

It is therefore advisable that budgets for the different units of local government, covering all or part of the same area, be considered by some authority as a unit, in order that they may be related one to another and the needs of the area as a whole considered. In metropolitan areas it would appear desirable for city and county budgets to be considered simultaneously when possible. With city-county consolidation, of course, but one budget need be considered. Where a large city is but a part of a county, there are likely to be two budgets. Some agency within the area, therefore, should be vested with the power to consider the various budgets as a whole and to hold public hearings upon the combined totals.

Possibly a new regional authority might be necessary for this purpose. Perhaps the authority could be vested in either the city or county government.

In rural areas a similar situation is likely to arise. There it would appear feasible for the county authorities to act as the necessary clearing house in this matter.

2. *Accrual Accounting.* The most effective method of enforcing a properly devised budget is by means of a well planned system of accounting. To be really effective such accounting should not merely record receipts and disbursements, but should be on an accrual basis, the various departmental appropriations as provided in the budget being encumbered by the accounting office as expenditures are made or authorized. In this way budgetary control can be an effective process, when coupled with a system of periodic allotments of funds.

3. *Centralized Purchasing.* Purchase of the commodities and supplies needed by the various city departments should not be carried on in a haphazard fashion by each of the departments concerned, but should be centralized in the hands of one administrative agency directly responsible to the chief executive. This practice has been followed for a number of years by the more efficient units of private business. Only recently, however, has there been any general attempt to adapt it to the needs of public administrative agencies.

Where it has been adopted, substantial savings have been the

rule. These savings are brought about through lower unit costs as a result of buying in large quantities and standardizing supplies; reduction in overhead costs through reduction in purchasing personnel; and reduction in the volume of paper work.

There are many instances of savings due to centralized purchasing. Before centralized purchasing was adopted in one middle-western city, it was found that two separate departments in the city were buying coal from one dealer. One department was paying \$4.25 for the same coal for which another was paying \$2.62 per ton. Centralized purchasing in school supplies in Fresno County, California, resulted in an average saving of 45 per cent on all commodities purchased during the first three years centralized purchasing was in effect, as compared with the prices paid in 1927, the last year under the old, decentralized system. Following the adoption of centralized purchasing in Maryland, 17 different brands of toilet soap and 15 different brands of scrubbing soap previously purchased were reduced to three kinds of toilet soap and two kinds of scrubbing soap, with resultant savings to taxpayers. Examples of savings thus effected could be added indefinitely. These however, will serve to illustrate the advantages of such a system.<sup>7</sup>

### III. GOVERNMENTAL FUNCTIONS AND SERVICES

A second factor in the cost of government is the extremely rapid growth of governmental functions which has occurred in recent years. The growth in fact has been so rapid that, to judge by the current nation-wide protest against high taxes, there is now some question as to whether the number of governmental functions has not increased more rapidly than the capacity of the taxpayers to pay for them.

A recent study of the growth of the functions of the city of Detroit reveals that in 1824, when that city was organized, it had but 23 functions. By the close of the century the number had increased to 129 and by 1910 to 170. The growth from 1824 to 1910 was at the rate of about one and one-half activities or functions

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<sup>7</sup> For a complete discussion of the administration of centralized purchasing see Forbes, Russell, *Governmental Purchasing*, New York, Harper, 1929. For a brief but complete discussion of the principles and advantages of centralized purchasing, see Forbes, Russell, *Centralized Purchasing*, New York, National Association of Purchasing Agents, 1931 (pamphlet).

per year. By 1920, however, 81 more had been added, at the rate of slightly more than eight functions per year, and by 1930, 55 additional functions had been assumed by the city, making a total of 306 separate and distinct municipal activities.<sup>8</sup>

In 1824 functions were comparatively simple. The city exercised such functions as legislation, conduct of elections, custody and disbursement of funds, law enforcement, the operation of a city jail, fire protection, and other simple functions commonly regarded as pertaining to city government. The functions later assumed reveal a tendency for the city to undertake the performance of a more diverse set of activities. The functions assumed in recent years include a municipal university, a junior college, a parental school, a children's museum, an educational conference, a library for the blind, a city employment bureau, psychiatric examination of offenders, instruction in instrumental music, boat wells, golf courses, library for foreign languages, bedside instruction, city forestry, negro housing inspection, inspection of hair dressers and cosmeticians, airplane landing field and hangar, street railway, bus transportation, sewer pumping, traffic lights, police auto patrol, etc., to name only a few of the 136 added since 1910.

It is significant to note the increase in general property taxes, special assessments, total governmental expenditures and capital outlays in Detroit between 1910 and 1928 (the latest year for which figures are available), in view of the rapid increase in functions by the Detroit city government during the same period. The figures, as obtained from *Financial Statistics of Cities for 1910 and 1928*, are as follows:

**Table I. Detroit—Taxes and Expenditures, 1910 and 1928<sup>9</sup>**

Year	Population	General property tax		Special assessments	
		Total	Per capita	Total	Per capita
1910. . . .	465,786	\$ 6,841,409	\$14.69	\$ 942,337	\$ 2.02
1928. . . .	1,414,300	74,384,076	52.59	21,366,608	15.11

<sup>8</sup> Upson, Lent D., *The Growth of City Government*, in *Public Management*, June, 1931.

<sup>9</sup> Table I is not a statement of the entire revenue of Detroit, but only of general property taxes and special assessments. It does not include receipts from the sale of bonds, license fees, earnings of public service enterprises, etc.

Year	Total governmental cost payments including capital outlays		Capital outlays	
	Total	Per capita	Total	Per capita
1910.....	\$ 10,892,264	\$ 23.39	\$ 2,898,569	\$ 6.22
1928.....	169,881,305	120.12	72,738,524	51.43

Detroit, of course, grew unusually rapidly during that period, and part of the heavy increases in per capita taxes, expenditures, and outlays may be attributed to this fact. It is also true that per capita governmental expenditures increase in more or less direct ratio to increases in population; that is, the larger the city, the larger the proportionate cost of government. In spite of these facts, however, it would appear reasonable to assume that a substantial part of this increase as given in the above table is due to the increase in the number of functions undertaken by the city of Detroit.

It is not intended to single out Detroit as a particular "horrible example" in this connection. Detroit is used as an illustration because of the study of its functions already referred to. No such complete analysis has been made of the functions of other cities. It is safe, however, to conclude that there has been an unprecedented extension of governmental services and functions throughout the country during the past 20 or 30 years, and that similar conditions will be found in virtually every other city in the country.

Other cities today make per capita general property tax levies that are comparable with those of Detroit. To cite just a few, in Cleveland, the 1928 figure was \$55.80; in Cincinnati, \$57.31; in New York City, \$60.80; in Buffalo, \$60.30; in Rochester, \$68.34; in New Rochelle, N. Y., \$75.80; and in Highland Park, Mich., \$57.06. Among some of these cities the increases would appear to have been roughly proportionate to those of Detroit.

The increase in the cost of state and local government in the United States in recent years is shown by the following figures compiled by the National Industrial Conference Board.<sup>10</sup>

<sup>10</sup> National Industrial Conference Board, *The Cost of Government in the United States, 1928-1929*, New York, 1931.

**Table II. Gross Expenditures**

(Totals are given in millions of dollars)

Year	State government		Local government	
	Total	Per capita	Total	Per capita
1913.....	\$ 383	\$ 3.97	\$1,844	\$19.10
1923.....	1,242	11.13	5,136	46.05
1928.....	1,826	15.24	6,813	56.84

**Table III. Tax Collections**

(Totals are given in millions of dollars)

Year	State government	Local government
1913.....	\$ 300	\$1,219
1923.....	917	3,285
1928.....	1,507	4,641

Again, it is not contended that all of the above increases are due to increased functions of government. There are other factors to consider. A substantial part of this increase, however, may be attributed to this cause.

Since increases in public functions result in larger governmental expenditures, the home owner may well pause and ask himself whether he is deriving sufficient benefit from some of these activities to warrant their performance by the city at a direct cost to him. Certainly the elimination of some of these functions, if found desirable, would result in a lowering of the cost of city government.

Some cities, however, have gone much further than Detroit in this assumption of new functions. Instances may be cited of cities in various parts of the country conducting activities which usually are regarded as the proper function of private enterprise. Among such functions are ice plants, central heating plants, the sale of fuel, gasoline and oil, maintenance of abattoirs, public laundries, sale of refreshments and meals, and rendering various medical services, including dental work.

The performance of such functions by cities indicates a tendency to embark upon collectivistic or socialistic enterprises. If governments embark upon such a tendency, where are they going to stop? Clearly, if this tendency continues, it is quite possible that, without being fully aware of it, the United States may gradually drift into some form of state socialism.

That such services cost money must be admitted. Certainly the home owner may well pause and consider the cost of these services as reflected in taxes. It would be well to examine objectively the present functions of government, with the object of eliminating those which are unnecessary, or unduly costly.

It is not within the scope of this report to consider separate functions of government in detail or on their merits. Attention is drawn, however, to the present trend toward expansion in the thought that home owners and other taxpayers who are interested in lower taxes, may desire to do so with reference to the activities of their own governments.

#### IV. ADMINISTRATIVE PROCEDURE

In the foregoing sections of this report have been discussed certain changes and improvements in the organization and operations of government which look toward reductions in governmental expenditures as a result of increased efficiency and better administrative organization and methods. Attention was also drawn to the recent rapid growth in the number of functions assumed by government, and the tendency of this growth to increase taxes. In this regard it was urged that home owners and other taxpayers scrutinize the functions of local government with a view to abandoning those that have unduly increased costs or are unnecessary.

It remains to consider certain aspects of and restrictions upon public financial procedure—particularly of local governments—which have the effect of checking too rapid increases in governmental expenditures, and which may afford means of reducing such expenditures. In the light of what has been said in Section II concerning the functions of government, these safeguards are of considerable importance. If the voters themselves should be reluctant to turn the course of governmental functions away from their present socialistic direction, it may well be that the capacity of property owners to pay taxes will be exceeded. In view of this

possibility it is well to consider restrictions upon public expenditures that will protect the taxpaying group against unduly heavy expenditures voted or urged by that portion of the electorate which does not pay taxes directly.

### STATE CONTROL OVER LOCAL BUDGET MAKING

If the taxpayers feel that government is spending too much, what recourse have they if public authorities—particularly local authorities—ignore requests for reductions? The answer is, none in most states. On some occasions appeals have been carried to the courts, but unless the nature of the tax or expenditure, or the procedure followed in voting and levying it, is illegal in one or more aspects, the courts have generally treated protests against high taxes as political questions and replied that the remedy for the taxpayers in such cases was to be found in the ballot box and not in the courts. From the legal standpoint but little can be said against this view, as it is the function of the courts to rule on matters of legal procedure and not on the advisability or inadvisability of certain expenditures.

The complexities of present-day politics, however, often leave the taxpayer high and dry so far as his "remedy at the ballot box" is concerned. Elections are fought upon too many issues to offer a universal remedy against governmental extravagance. Furthermore, such an issue would not generally appeal to large bodies of voters who pay no direct taxes. Another aspect of this problem is that decisions of legislative bodies are often made to satisfy pressure brought to bear by special political groups which of themselves do not represent a majority of the electors, but which, in view of possible divisions among the electorate, may have the controlling vote in an election. For these reasons political measures would hardly be of much avail in many instances.

As a means of dealing with this situation, various groups of taxpayers have been demanding in increasing numbers review of proposed local expenditures by impartial state administrative bodies. In order to provide adequate safeguards against governmental extravagance, such review has been provided in limited form, by Oregon. Ohio and Wyoming regulate local accounting procedure. Massachusetts and New Jersey provide for state supervision of local indebtedness. In other states there also have been some developments in this direction.



It has remained for Indiana, Iowa and North Carolina to develop what appear to be the most extensive systems of state control over the accounts of local expenditures. North Carolina, in fact, has given well nigh all important power over local finance to a state local government commission.

The scheme developed in Indiana was the model for the procedure adopted in Iowa. In view of its origin, this procedure has been known as "The Indiana Plan."

In Indiana the plan provides for the review of proposed bond issues and/or tax levies of any local government (involving, of course, an analysis of local expenditures programs) by the state tax commission upon appeal by ten or more taxpayers of any local unit. In Iowa, bond issues are reviewed by the state budget director upon the petition of five or more local taxpayers, but the budget director does not have as direct control over local tax levies. He is, however, empowered to review local contracts and budgets under certain circumstances. No bond appeals below \$5,000 are reviewed in Indiana. There are no minimum figures for bond issues subject to review in Iowa or for tax levies in Indiana. In both states the authorities to which appeal is taken have the power to reduce but not to increase the amounts in matters on which appeal is taken.

In 1919, the first year in which the plan was in operation in Indiana, the state tax board approved local budgets whose aggregate increase was nearly \$4,740,000 over the previous year. That figure represented less than one-third of the increases requested, proposals amounting to more than \$11,600,000 being denied. Of bond issues reviewed by the board, \$58,570,000 were approved and \$9,193,000 disapproved.

There was an immediate and general reaction against this review power. At a special session of the legislature held in 1920, the law of 1919 (which was somewhat more stringent than the present law) was repealed, to be replaced by a comparatively innocuous statute conferring similar jurisdiction upon county councils.

In 1920, under the new law, local tax levies increased by more than 50 per cent, from \$64,821,000 to \$99,311,000. Following this increase, the present law was enacted in 1921.

The following table shows the reductions in local tax levies from 1921 to 1930.

Table IV

Year	Number of tax districts from which appeals filed	Number of districts for which reductions made	Amount of reduction
1921.....	42	39	\$1,254,448.00
1922.....	74	46	1,034,572.00
1923.....	37	25	1,874,070.00
1924.....	42	34	1,479,000.00
1925.....	114	69	1,574,667.00
1926.....	95	51	1,639,187.00
1927.....	134	77	4,674,623.50
1928.....	142	80	1,290,031.00
1929.....	134	83	3,269,091.59
1930.....	116	73	1,304,826.19

From 1921-25 the commission approved \$26,900,000 in bond issues and disapproved \$18,400,000. In 1927, 166 bond issues were reviewed by the commission of which \$3,819,000 were approved and \$3,887,000 disapproved. In 1928, 94 bond issues were reviewed of which \$909,926 were approved and \$2,267,319 disapproved. In 1929, \$4,056,147 were approved and \$3,649,212 disapproved. In 1930, of \$4,917,343 appealed \$2,681,033 were approved and \$2,236,310 were disapproved.

A valuable service has been rendered by the Indiana Tax Commission by cutting padding from budgets and removing illegal expenditures.<sup>11</sup>

Much has been written both for and against the plan. Against it is charged that it is an invasion by the state into the field of local autonomy and that the review of proposed local expenditures is handled by a group which is not necessarily familiar with the needs and problems of the local government.

However this may be, the fact remains that in Indiana and in Iowa taxpayers do have the right of appeal against expenditures which they consider unwise or unjustified. Likewise, that reductions have been made in proposed expenditures cannot be questioned. A study made by the United States Chamber of Com-

<sup>11</sup> For a full discussion of the Indiana plan, see Kilpatrick, Wylie, *State Administrative Review of Local Budget Making*, New York, Municipal Administration Service, 1927, and *Relations Between State and Local Governments*, Report of Committee on State and Local Taxation and Expenditures of the Chamber of Commerce of the United States.

merce revealed that the rate of increase in local taxes in Indiana was slower than that of nearby comparable states.

North Carolina, with the adoption of its new local government act in 1931, has gone much further in the direction of state supervision over local finance than has any other state. Under this act there was created a state Local Government Commission of nine members, three of whom, the auditor, the state treasurer and commissioner of review, are members ex-officio, the remaining members being appointed by the governor to hold office at his pleasure. One of these six, the secretary of the commission, is Director of Local Government.

All bonds and note issues by North Carolina local governments must be approved by the commission, with the exception of securities approved by the state Sinking Fund Commission prior to the appointment of the Local Government Commission. The commission is not to approve bonds or notes unless it believes that the issuance is necessary or expedient and that the amount proposed is adequate and not excessive. Furthermore, the commission must be satisfied that adequate sinking funds have been or will be maintained; that the increase in tax rate, if any, due to debt service charges on the bonds, will not be unduly burdensome; that the unit of government is not in default as to the payment of principal or interest of any of its indebtedness; that the requirements for budgetary control have been substantially complied with; and that 80 per cent of the general taxes of the unit of government for the preceding fiscal year have been collected.

The commission sells all municipal bonds and notes at the state capitol under sealed bids, to be awarded to the highest bidder or to the bidder offering to take the bonds at the lowest rate of interest.

The commission is vested with authority over the maintenance and administration of local sinking funds, it being its duty to order the local officials to maintain them on an adequate basis. Provision for a "municipal receiver" to be appointed by the Director of Local Government is provided for in the case of municipalities which are in default for service charges on their indebtedness.

The commission also exercises certain supervisory powers over tax levies and local budgetary administration. The levy of taxes to provide for debt service charges is compelled by law. Tax levies also are required to be sufficient to meet annual appropria-

tion bills, deficits and probable tax delinquencies. Orders, contracts, warrants, etc., are declared void, by law, unless they bear statements signed by the municipal or county accountant (the local budget officer) that the amount to be paid has been appropriated and remains unencumbered. Tax anticipation notes are void unless they bear a similar statement to the effect that their payment has been provided for by appropriations.

It is not yet possible, of course, to generalize as to the efficacy of the North Carolina act, it having been in operation for only a few months. It is significant to note, however, that already investment bankers are pointing to recent sales of North Carolina municipal bonds at low interest rates as a distinct and immediate benefit from this legislation.<sup>12</sup>

The adoption by any state of such restrictions upon local financial procedure as have been outlined above must, of course, from the practical standpoint be governed by local circumstances. In Indiana fear of increases in municipal expenditures was the cause of the adoption of the Indiana plan. In North Carolina the financial difficulties of city governments were underlying causes for the local government law of 1931. Whether other states will or should go as far is another question. Certainly the taxpayers deserve some protection against abuses of financial power by local authorities. The feasibility of providing in other states some such protective device is worthy of serious attention of all property owners.

### TAX LIMITS

In contrast to the state supervision of local financial affairs as outlined in the preceding subsection, there is another type of restriction the object of which is economy in local government. This is the adoption of limitations upon the power of local authorities to levy taxes. Such restrictions are frequently found in state constitutions and statutes, and in city charters. Another is a limitation made upon a per capita basis; that is, that a city may not levy a total tax of more than a maximum amount per capita. Still another scheme provides that the taxes levied should not exceed those of the previous year by more than a fixed percentage.

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<sup>12</sup> See Massalich, Chester B., *North Carolina's New Plan for Controlling Local Fiscal Affairs*, National Municipal Review, June, 1931.

Nation-wide attention was focused at one time upon an Ohio experiment with the first of these methods, through the enactment of what was known as the Smith 1 per cent Law. This law limited local taxes for ordinary purposes to 1 per cent of the assessed valuation of taxable property.

While apparently the law worked fairly well in some of the smaller communities of the state, its effect upon the finances of larger cities was little short of disastrous, due to inability or unwillingness of officials to curtail municipal administrative programs to meet the exigencies of the new law. Again, the law resulted in comparatively less hardship during the earlier years of its effectuation. With the rise in prices during and following the World War, and the expansion of municipal construction programs which came in 1920 at the end of the period of rigid wartime economy, the larger cities found themselves in a serious position. Many were forced to borrow for current expenses, having insufficient money to pay salaries and other operating costs. The result was the replacement of the 1 per cent law by a new act which limited taxes for routine purposes of local governments to 1½ per cent and allowed additional expenditures for certain specified purposes upon authorization by the voters. This limitation was put into the Ohio constitution in an amendment adopted in 1930.

Following the enactment of this latter law, Ohio cities would not appear to have suffered from any particular financial handicap. Superficially, at least, they would seem to render about the same services as do comparable cities in other parts of the country.

It is of interest to note in this connection that the 14 Ohio cities of over 30,000 population in 1928, levied a per capita general property tax of \$38.30. The 20 cities of over 30,000 population in New York in the same year levied a per capita general property tax of \$44.76. The total average per capita revenue of Ohio cities was \$59.04 and for New York cities, \$69.08. It would thus appear that while rendering presumably the same services, Ohio cities operated at somewhat less cost than those in New York, which imposes no such limit. In addition, it must be remembered that New York cities received a certain portion of the state income tax receipts collected from their residents, whereas there

is no state income tax in Ohio. It would appear that there is some direct benefit from a limit of this sort.

One difficulty with such limits, however, appears to be that they are applied equally to well-established communities which have small increases in population, and to rapidly growing industrial centers whose needs for capital expenditures, in particular, and new services may be somewhat greater. If the Ohio experience is to be taken as typical, however, it appears reasonable to assume that a 1 per cent limit is too low, but that a partial limit of 1½ per cent or possibly a general limit of 2 per cent may be of assistance in keeping taxes within reasonable bounds.

On the other hand, limitation such as has been discussed above along the lines of the Indiana or North Carolina plans might be preferable to an out-and-out tax limit as affording a greater amount of flexibility. Possibly some combination of the two plans would be feasible. Such a scheme might, for example, have state review of local budgets and bond issues, coupled with a general maximum tax levy, and with the provision that under extraordinary circumstances this levy may be exceeded with the permission of the state supervising authority.

**Bonding Procedure.** There are three aspects of debt administration and the issuance of bonds which should be discussed here; debt limits, pay-as-you-go plans, and debt retirement. Other aspects of debt administration might be discussed, but the points to be made have already become so familiar through constant reiteration by financial experts, and the trend toward their universal adoption is so pronounced, that mention of them here is, perhaps, redundant.

**Debt Limitation.** Most states have placed limits either by statute or in their constitutions upon their authority and the authority of local governments to incur debt. These limitations have been imposed for the most part in order to prevent borrowing by governments beyond their means. In the main they take the form of limiting the amount of bonded debt to a fixed percentage of the assessed valuation of taxable property. In some cases they run as high as 10 per cent. For the most part, however, it would appear that the limits are about 5 per cent, with frequent exemptions of special assessments, and debts incurred for emergencies and for self-supporting enterprises, such as water

works. Ordinarily these percentages are in terms of assessed valuation. To quote one well-known authority on the subject:

"The general desirability of some type of debt limitation is generally recognized; otherwise the demand for public improvement would frequently raise the local debt beyond the limit of wisdom and jeopardize public credit, or impose unfair burdens upon future taxpayers. Without such regulations a city might issue an excessive amount of bonds, extend the life of the bonds beyond the life of the improvements, or fail to make adequate provisions for the retirement of bonds."<sup>13</sup>

There are certain other factors, however, which control debt limits and which must be considered. Where separate limits are provided for each unit of government, the total debt limit will be several times the figure for any one government, in regions where more than one government has jurisdiction over the same territory. For example, in a large part of the Chicago area, the debt limit is not 5 per cent as provided by state regulation, but actually 25 per cent. The City of Chicago has a 5 per cent limit as does Cook County and a number of the other units of government whose authorities extend, all told, in five "layers" over the same territory.

Such a scheme offers hardly any real limit upon indebtedness; at least, the limit provided is far in excess of that which presumably was originally intended by its framers. Furthermore, in times past more than one state has created new units of government to make it possible to avoid existing debt limits.

It would appear far better, therefore, to treat each territorial area as a unit for debt purposes regardless of the number of governments involved, and to establish one limit for the entire area. If local government is consolidated and reorganized along the line suggested in Section I of this report, such a scheme as this should prove entirely feasible. In view of the general practice of making limits, a limit of from 5 to 10 per cent would not appear to be unduly restrictive.

**Pay-As-You-Go vs. Bonds.** In order to avoid the payment of interest charges, some municipalities have considered the adoption of the pay-as-you-go method. This method, in brief, proposes that instead of borrowing to construct public improvements, such

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<sup>13</sup> Upson, Lent D., *Practice of Municipal Administration*, New York, The Century Company, 1926.

improvements should be paid for out of annual revenue receipts, thus saving interest charges.

The argument in favor of it runs somewhat as follows: If a city finds it necessary to build a new school building every year, there is no reason why the money for such purposes should be borrowed, if all the school buildings cost about the same amount. It could, instead, well be made an annual charge in the city budget. Similarly, if the city builds a school house one year, spends about the same amount of money the following year for sewer extensions, the next year for street paving, the next year for police and fire stations, etc., this annual amount is a recurring capital expenditure and could well be financed out of current revenue receipts, saving the city the annual interest instalments. The interest charges on bonded debts are appreciable items in city budgets. On a \$1,000,000 issue, \$50,000 of which is retired each year for twenty years, the total interest payments would be \$472,500. Obviously, savings of such amounts are worthwhile.

At the same time, however, it must be remembered that not all municipal expenditures are recurring in nature. A community of from 20,000 to 50,000 population does not build a school house every year, nor does it necessarily have, under ordinary circumstances, a sufficient amount of construction work of other types as its equivalent. Pay-as-you-go under such circumstances would work a serious hardship on taxpayers in one year to be followed by unusually light taxes in years thereafter. In view of these facts, the Committee on State and Local Taxation and Expenditures of the Chamber of Commerce of the United States advocated the adherence to the pay-as-you-go principle for capital expenditures of a recurring nature, and the issuance of bonds to finance non-recurring expenditures. This would appear to be an advisable practice. A governmental organization, therefore, should follow the pay-as-you-go method so far as possible, for ordinarily regular capital improvements, but for extraordinary expenditures, the issuance of bonds is the preferable method of financing.<sup>14</sup>

**Debt Retirement.** It is advisable that public indebtedness be retired as rapidly as is possible, consistent with the current needs

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<sup>14</sup> See *Capital Expenditures*, a report of the Committee on State and Local Taxation and Expenditures of the Chamber of Commerce of the United States.



of the city and the ability of the taxpayers to pay. As long as the debt is outstanding, interest charges must be paid, and rapid retirement of the debt saves money at this point.

There are instances on record of cities paying for bridges and buildings long after the improvements themselves have become obsolete or have been replaced, due either to the issuance of bonds running for unduly long terms, or to an insufficiency in providing sinking funds to retire the debts when due, with the result that the bond issues must be refunded.

To facilitate prompt debt retirement serial bonds are advantageous. In the long run, there is not a great deal of difference in the net cost to the municipality, under theoretically perfect administration, as between serial bonds and sinking-fund bonds. Sinking funds, however, are liable to mismanagement and there has been in the past a sufficient number of such cases to make it desirable for cities to issue serial bonds upon which a certain amount of debt is retired each year.

In no case, furthermore, should the term of bonds exceed the life of the improvement for which they are issued.

In the interest of prompt debt retirement, it may be advisable, in cases where debts are unduly heavy, to require that a certain percentage of revenue be devoted to this purpose. In some cases, 25 per cent might not even suffice. In cases where the debt is of manageable proportions, as high an amount as this may be unnecessary.

### **SPECIAL ASSESSMENT PROCEDURE**

Limitation on the levy of special assessments could properly be discussed at this point, but in view of the discussion of this topic in other sections of the report, no mention of it will be made here.

### **LONG TERM FINANCIAL PLANNING**

There has now been described a series of restrictions and practices, the object of which is to safeguard the interest of the taxpayer against excessive demands on the part of government. Are they absolute preventives of extravagance or financial abuse? Are they guarantees as to sound financial procedure? Probably not. Experience of certain communities in various parts of the United States where real estate values have been over-inflated in recent

years, only to be followed by collapses of such booms, would indicate that no restrictive measures can be absolute safeguards or guarantees of municipal solvency or of reasonable taxation. That these restrictions would appear to be desirable is evident. It must be distinctly understood, however, that they are not a sure cure. There is no legal substitute for common sense.

One procedure, however, when coupled with the foregoing limitations, will probably be as effective a preventive against municipal financial shortsightedness as can be found. This is long-term financial planning.

A city, like a private individual or a business corporation, must plan for the future. It cannot go from day to day, or year to year, on a hand-to-mouth basis. It must look ahead, try to foresee its future development, and work out its plans accordingly.

A number of American cities plan from five to ten years ahead, revising their plans annually as new conditions arise. Such plans outline the public improvements that it will be necessary for the city to construct, and the other expenditures it will be necessary for it to make each year, for a definite period of years ahead. These plans are carefully worked out, being based upon population growth, the existing needs and facilities of the city, and the probable needs of the future in the light of determined conditions. A plan of this sort saves money. It prevents haphazard construction and guards against such errors as building million-dollar municipal bathing pools when the crying need is for better sewers and more street repaving. By adjusting proposed construction to the ability of the taxpayers to pay, and by coordinating all types of municipal expenditures, money is saved and extravagance is avoided.<sup>15</sup>

The existence of a well-balanced plan of this sort is one of the surest safeguards against inordinate and improvident construction of improvements.

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<sup>15</sup> See Rightor, C. E., *The Preparation of a Long-Term Financial Program*, New York, Municipal Administration Service, 1927 (pamphlet).

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