TAX INCENTIVES TO ENCOURAGE HOUSING IN URBAN POVERTY AREAS

1851-2

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETIETH CONGRESS

FIRST SESSION

ON

S. 2100

A BILL TO ENCOURAGE AND ASSIST PRIVATE ENTERPRISE TO PROVIDE ADEQUATE HOUSING IN URBAN POVERTY AREAS FOR LOW-INCOME AND LOWER MIDDLE INCOME PERSONS

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TAX INCENTIVES TO ENCOURAGE HOUSING IN URBAN POVERTY AREAS

THURSDAY, SEPTEMBER 14, 1967

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10:40 a.m. in room 2221, New Senate Office Building, Senator Russell B. Long (chairman) presiding.

Present: Senators Long, Smathers, Talmadge, Harris, Williams, Carlson, Curtis, and Dirksen.

The CHAIRMAN. This hearing was called to hear witnesses on S. 2100, a bill to encourage and assist private enterprise to provide adequate housing in urban poverty areas for low-income and lower middle-income persons, introduced by Senator Kennedy of New York, Senator Smathers, Senator Pearson, and Senator Ribicoff.

(The bill, S. 2100, and the committee press release announcing these hearings, follow:)

90TH CONGRESS
1ST SESSION

S. 2100 *

IN THE SENATE OF THE UNITED STATES

JULY 13, 1967

Mr. KENNEDY of New York (for himself, Mr. SMATHERS, Mr. PEARSON, and Mr. RIBICOFF) introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To encourage and assist private enterprise to provide adequate housing in urban poverty areas for low-income and lower middle income persons.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That this Act may be cited as the "Urban Housing Develop-
4 ment Act of 1967".

5 DECLARATION OF PURPOSE

6 SEC. 2. It is the purpose of this Act to assist private
7 enterprise in providing new and substantially rehabilitated
8 housing in urban poverty areas in order to enhance the living
9 conditions of such areas, and to meet an immediate and

*S. 2100, amended, to reflect changes suggested by Senator Robert F. Kennedy, appears at p. 421.

1 pressing need for decent, safe, and sanitary housing for low-
2 income and lower middle income persons at rentals which
3 they can afford.

4 DEFINITIONS

5 SEC. 3. As used in this Act—

6 (1) The term "Secretary" (for purposes of title I and
7 title II) means the Secretary of Housing and Urban Devel-
8 opment.

9 (2) The term "urban poverty area" means an area,
10 within a standard metropolitan statistical area containing a
11 population of at least two hundred and fifty thousand, which
12 the Bureau of the Census has determined, at the request of,
13 and under procedures approved by, the Office of Economic
14 Opportunity, to be a poverty area, subject to such modifica-
15 tions, exceptions, or additions as the Secretary, in consulta-
16 tion with the Director of the Office of Economic Opportunity,
17 may determine to be appropriate for the purposes of this Act.

18 (3) The term "city" means any municipality, county,
19 parish, or other political subdivision of a State having general
20 governmental powers.

21 (4) The term "certified project" means a housing proj-
22 ect, which may consist of one or more buildings, with respect
23 to which an unrevoked certificate of eligibility has been issued
24 by the Secretary under section 101 of this Act.

1 (5) The term "certified operation period" means with
2 regard to a certified project—
3 (A) in the case of a project financed in part by a
4 mortgage insured under section 235 of the National
5 Housing Act, the term of such mortgage, or
6 (B) in the case of a project not financed in part by a
7 mortgage insured under section 235 of the National
8 Housing Act, fifty years from the date of completion of
9 construction or rehabilitation of the project which is
10 certified under section 101 of this Act.
11 (6) The term "net return" means with respect to any
12 fiscal year, the net operating income of a certified project,
13 before any deductions for depreciation, interest, United States
14 income tax, and State or local income or franchise taxes com-
15 puted with reference to net income, but less the amount of the
16 amortization payment (including both the amount thereof
17 attributable to interest and the amount thereof attributable to
18 retirement of principal) payable on a mortgage on the project
19 insured under section 235 of the National Housing Act.
20 (7) The term "home management corporation" means
21 a public or private nonprofit corporation or association which
22 is organized under State or local law by the residents of one
23 or more certified projects in an urban poverty area for the
24 purpose of managing and performing maintenance tasks on

1 each project, for developing and carrying out programs for
2 improving the physical, economic, and social conditions pre-
3 vailing in the urban poverty area where such project is con-
4 structed, and ultimately for purchasing such project to take
5 ownership either in the name of the corporation or in the
6 name of each resident of such project.

7 (8) The term "holder" means any individual, firm, or
8 corporation possessing an unrevoked certificate of eligibility
9 issued by the Secretary under section 101 of this Act.

10 (9) The term "initial equity" means, with respect to
11 the holder of a certified project, the difference between the
12 total cost of the project to the holder as determined under
13 section 235(d)(3) of the National Housing Act and the
14 principal amount of any mortgage on the project, insured
15 under section 235 of the National Housing Act, at the par-
16 ticular time in question.

17 (10) The term "occupancy charge" means the rental
18 or other payment made by the occupants of dwelling units
19 in a certified project to any holder of such project including
20 a home management corporation composed of such occupants.

21 TITLE I—ELIGIBILITY FOR ASSISTANCE

22 CERTIFICATES OF ELIGIBILITY

23 SEC. 101. (a) The Secretary shall issue a certificate of
24 eligibility to any applicant desiring to provide housing in an
25 urban poverty area for low-income and lower middle-income
26 persons, if—

1 (1) the governing body of the city in which the
2 project is to be located has given written notice to the
3 Secretary that it wishes to participate in the program
4 authorized by this Act, and has given written assurances
5 (deemed satisfactory to the Secretary) that local real
6 estate taxes levied against any project, during any year
7 in the certified operation period, will not exceed 5 per
8 centum of the occupancy charge for the project during
9 such period;
10 (2) the Secretary, after consultation with such
11 governing body or an agency or instrumentality of such
12 city designated by such body, and after consultation
13 with the residents of such urban poverty area deter-
14 mines that such project will contribute to the overall
15 economic and social welfare of the area and will be
16 coordinated with all other governmental programs for
17 community development;
18 (3) the Secretary determines that the applicant
19 meets such requirements with respect to business and
20 financial responsibility as he may prescribe; and
21 (4) the applicant agrees, in such form and manner
22 as the Secretary may prescribe—
23 (A) to provide at least one hundred dwelling
24 units of housing (through new construction or the
25 substantial rehabilitation of existing structures) in

1 conformity with standards prescribed by the Secre-
2 tary under subsection (d) within such period of
3 time, and at such site within an urban poverty area,
4 as may be specified or agreed to by the approving
5 agency under paragraph (2);
6 (B) to provide at least as many dwelling units
7 of housing (through new construction or the sub-
8 stantial rehabilitation of existing structures) as are
9 eliminated in the course of such construction or sub-
10 stantial rehabilitation;
11 (C) to hold and manage the certified project
12 in accordance with the provisions of this Act, and
13 any regulations issued pursuant thereto;
14 (D) to establish, during the certified operation
15 period, occupancy charges for dwelling units in the
16 project which are not in excess of the levels pre-
17 scribed by the Secretary pursuant to section 102;
18 (E) to lease, during the certified operation
19 period, dwelling units in the project to eligible indi-
20 viduals and families in accordance with regulations
21 prescribed by the Secretary under section 103;
22 (F) to utilize, during the certified operation
23 period, the services of a home management corpora-
24 tion whenever such services are available; and
25 (G) to sell, transfer, or otherwise dispose of the

1 certified project only to the holder of a certificate of
2 eligibility issued pursuant to subsection (b), during
3 the certified operation period: *Provided*, That any
4 home management corporation established for the
5 certified project shall have a first option to purchase
6 such project from the applicant at any time after the
7 expiration of four-fifths of the applicant's minimum
8 holding period at a price which exceeds the princi-
9 pal amount of any insured mortgage on the project
10 under section 235 of the National Housing Act by
11 no more than the holder's initial equity in the project
12 and subject to such other terms and conditions as
13 may be specified by the Secretary.
14 (5) the Secretary determines that the cost of the
15 project, estimated operating costs of the project, and
16 other factors relating thereto, will permit the establish-
17 ment of occupancy charges, under the standards set
18 forth in section 102, which will not be in excess of those
19 suitable for low-income or lower middle income individ-
20 uals and families. The Secretary shall issue, from time to
21 time, bulletins setting forth maximum occupancy charge
22 levels suitable for low-income or lower middle income
23 individuals and families in various urban poverty areas
24 throughout the country; and
25 (6) the Secretary determines that the approving

1 agency under paragraph (2), or such other agency or
2 instrumentality as the governing body of the city may
3 designate, will carry out an adequate relocation program,
4 in accordance with section 105, for any persons displaced
5 from their homes or business establishments by the
6 project.

7 (b) The Secretary shall issue a certificate of eligibility
8 for benefits under this Act to any applicant who is or will
9 be the successor in interest to the ownership of any project
10 with respect to which a certificate was issued under subsection
11 (a), if—

12 (1) the Secretary determines that the applicant
13 meets such requirements with respect to business and
14 financial responsibility as he may prescribe; and

15 (2) the applicant agrees to conform to the require-
16 ments of subsection (a) (4).

17 (c) The Secretary shall terminate a certificate of eligi-
18 bility issued to any holder under this section whenever he
19 determines after a hearing that such holder has failed, after
20 due notice and a reasonable opportunity to correct the failure
21 has been given, to carry out its agreement under subsection
22 (a) (4) or (b) (2).

23 (d) Any certified project with respect to which a cer-
24 tificate of eligibility is issued under this section shall conform
25 to such standards of design, construction, and operation as

1 the Secretary shall by regulation require. Such regulations
2 shall—
3 (1) giving due effect to any action taken by the
4 locality in which such project is located, insure that the
5 project is so designed, constructed, and operated as to
6 provide decent, safe, and sanitary dwellings in estheti-
7 cally pleasing structures, and
8 (2) establish maximum cost limitations for the
9 project and for dwelling units in the project having
10 regard for—
11 (A) the provisions of subsection (a) (4),
12 (B) the size and nature of the unit,
13 (C) whether the unit is provided by new con-
14 struction or substantial rehabilitation, and
15 (D) building costs in the particular locality.
16 (e) The Secretary shall keep interested and participat-
17 ing Federal, State, and local agencies fully apprised of any
18 action taken by him under this section.
19 (f) The Secretary may by regulation require the holder
20 of a certificate of eligibility issued under this section to file
21 such reports from time to time as he may deem necessary in
22 order to carry out his functions under this title.
23 (g) No certificate of eligibility shall be issued under
24 this section, unless application therefore is received by the

1 Secretary prior to the expiration of fifteen years after the
2 date of enactment of this Act.

3 OCCUPANCY CHARGES FOR DWELLING UNITS IN CERTIFIED
4 PROJECTS

5 SEC. 102. (a) The maximum occupancy charges for
6 dwelling units in any certified project shall be fixed in
7 accordance with schedules to be submitted by the holder
8 to the Secretary, from time to time, and approved by the
9 Secretary. In approving any such schedule for any such
10 project, the Secretary shall be guided by the following
11 criteria.

12 (1) The gross occupancy charges for a certified
13 project shall be established at a level which (assuming
14 a vacancy factor of not more than 7 per centum of
15 the available dwelling units in the project), would be
16 sufficient to produce for a holder having the minimum
17 initial equity in the project, a net return equal to 3 per
18 centum of such equity in each fiscal year of the holder
19 commencing or ending during the certified operation
20 period. The fact that a holder has a greater equity in
21 a certified project than the minimum required equity
22 shall not affect the gross occupancy charge of the
23 project.

24 (2) The occupancy charge for each dwelling unit
25 shall bear its reasonable and proportionate share (having

1 regard to the type and size of the accommodations
2 provided) of the gross occupancy charge for the project.
3 (b) The Secretary may, at the request of the owner of
4 a certified project or upon his own initiative, authorize or
5 require such changes or modifications in any occupancy
6 charge schedule, approved for such project under subsection
7 (a), as he determines to be necessary (1) to allow for
8 maintenance costs or a vacancy factor above or below those
9 upon which such schedule was previously predicated and
10 approved, or (2) to insure compliance with the require-
11 ments set forth in subsection (a) of section 101 (a) (4).
12 (c) The Secretary is authorized, upon such terms and
13 conditions as he shall by regulation prescribe, to make com-
14 mitments to insure, and to insure, the owner of a certified
15 project against a negative annual net return from such
16 project in a particular fiscal year. For the purposes of this
17 subsection there is hereby created an Equity Insurance Fund
18 which shall be used by the Secretary as a revolving fund
19 with respect to insurance provided hereunder, and there is
20 authorized to be appropriated (1) the sum of $10,000,000
21 to provide initial capital for such fund, and (2) such addi-
22 tional sums as may from time to time be required, in the
23 event the balance in such fund becomes less than $5,000,000,
24 to restore such balance to an amount equal to $10,000,000.
25 For insurance granted under this subsection the Secretary

1 shall fix and collect a premium charge in such amount as
2 he determines to be necessary to maintain the fund on a
3 sound basis: *Provided,* That any charges so established shall
4 be reduced during any period in which the balance in such
5 fund exceeds $11,000,000: *Provided further,* That no sums
6 shall be paid from such fund to the owner of a certified
7 project who willfully causes his annual net return from his
8 investment to fall below 0 per centum.

9 ELIGIBILITY REQUIREMENTS FOR OBTAINING OCCUPANCY
10 IN CERTIFIED PROJECTS

11 SEC. 103. The Secretary shall prescribe regulations with
12 respect to the eligibility of individuals and families for occu-
13 pancy in a certified project. In prescribing such regulations,
14 the Secretary shall be guided by the following criteria:

15 (1) No person shall be ineligible for occupancy in
16 the project because of race, creed, color, or national
17 origin.

18 (2) A first priority shall be granted to individuals
19 and families who were displaced from their homes as a
20 result of property acquisitions made in connection with
21 the establishment of such project or an industrial or
22 commercial facility under the provisions of the Urban
23 Employment Opportunities Development Act of 1967.

24 (3) Except as provided in paragraph (2), no indi-
25 vidual or family shall be eligible to obtain occupancy in

1 a dwelling unit of the project if the annual occupancy
2 charge established and approved for such unit is less
3 than 18 per centum of the adjusted gross annual income
4 (as defined in section 62 of the Internal Revenue Code)
5 of such individual or family: *Provided*, That the Secre-
6 tary may waive the foregoing requirement whenever he
7 determines that there are no prospective tenants avail-
8 able for such dwelling unit, at the established occupancy
9 charge rate, who are eligible individuals and families.

10 ELIGIBILITY REQUIREMENTS FOR MAINTAINING OCCU-
11 PANCY IN CERTIFIED PROJECTS

12 SEC. 104. (a) No individual or family shall be required
13 to move from a certified project as a result of an increase in
14 his or its annual income: *Provided*, That if, for any calendar
15 year, the annual occupancy charge for the dwelling unit
16 occupied by an individual or family is less than 15 per
17 centum of his or its adjusted gross income for such year,
18 such individual or family shall be required to pay to the
19 holder of the project, such amount in addition to his or its
20 regular payments, in such installments and at such times as
21 may be required under regulations to be prescribed by the
22 Secretary, as will result in a total occupancy charge to such
23 individual or family equal to 18 per centum of the adjusted
24 gross income of such individual or family for such year. Any
25 such additional amounts received by the owner of the project

1 shall be used to make payments to the Secretary for deposit
2 in the Tax Abatement Fund, established under section 106,
3 to reduce the costs to the Federal Government of making
4 grants under such section.

5 (b) The Secretary may by regulation require each in-
6 dividual or family occupying a unit in a certified project to
7 file such income statements from time to time as he may deem
8 necessary in order to carry out his functions under this
9 section.

10 RELOCATION ASSISTANCE

11 SEC. 105. (a) In determining whether, for the purposes
12 of section 101 (a) (5), an adequate relocation program exists
13 in any city to assist in the relocation of persons, businesses,
14 and nonprofit organizations displaced as the result of property
15 acquisitions made in connection with a certified project, the
16 Secretary shall be guided by the following criteria:

17 (1) Any persons so displaced shall be assured under
18 the program of obtaining decent, safe, and sanitary hous-
19 ing at rentals which they can afford and at locations
20 which are reasonably accessible to their places of em-
21 ployment.

22 (2) As part of the program, the services of a home
23 management corporation shall be utilized to provide mov-
24 ing and resettlement assistance to persons so displaced:
25 *Provided*, That if such services are not available a local

1 group of residents of the area in which the project will be
2 situated will receive training and compensation, in ac-
3 cordance with regulations prescribed by the Secretary, in
4 providing moving and resettlement assistance to persons
5 so displaced.
6 (3) (A) There will be paid to any person or family
7 so displaced—
8 (i) a moving expense allowance, determined
9 according to a schedule approved by the Secretary,
10 not to exceed $200;
11 (ii) a dislocation allowance equal to the amount
12 under (i) or $100, whichever is the lesser;
13 (iii) an additional payment of $300, if such
14 person or family purchases a dwelling for the pur-
15 pose of residence within one year from the date of
16 actual displacement, and the dwelling so purchased
17 is situated upon real estate in which such person or
18 family acquires a fee title or a life estate, or which is
19 held under a ninety-nine-year lease or other type of
20 long-term lease equivalent to fee ownership.
21 (B) In addition to the amounts payable under sub-
22 paragraph (A), there will be paid to any family, any
23 individual (not a member of a family) who is sixty-two
24 years of age or over, or any individual (not a member
25 of a family) who is handicapped within the meaning of

1 section 202 of the Housing Act of 1959, monthly pay-
2 ments over a period not to exceed twenty-four months
3 in an amount not to exceed $500 in the first twelve
4 months and $500 in the second twelve months to
5 assist such family or individual to secure a decent,
6 safe, and sanitary dwelling. Subject to the limitation
7 imposed by the preceding sentence, the additional pay-
8 ments shall be an amount which, when added to 20
9 per centum of the annual income of such family or in-
10 dividual at the time of displacement, equals the average
11 annual rental required for such a decent, safe, and
12 sanitary dwelling of modest standards adequate in size
13 to accommodate such family or individual in areas not
14 generally less desirable in regard to public utilities and
15 public and commercial facilities: *Provided*, That such
16 payments shall be made only to a family or individual
17 who is unable to secure a dwelling unit in a low-rent
18 housing project assisted under the United States Housing
19 Act of 1937, or under a State or local program having
20 the same general purposes as the Federal program under
21 such Act, or a dwelling unit assisted under section 101
22 of the Housing and Urban Development Act of 1965.
23 (4) There will be paid to any business concern or
24 nonprofit organization so displaced—
25 (A) its reasonable and necessary moving ex-

1 penses and any actual direct losses of property
2 (except goodwill or profit) for which reimburse-
3 ment or compensation is not otherwise made; and
4 (B) an additional $2,500 in the case of a pri-
5 vate business concern with average annual net earn-
6 ings of less than $10,000 per year, if such concern
7 is not part of a larger enterprise having establish-
8 ments other than the one with respect to which the
9 displacement occurred.
10 (b) The Secretary is authorized to enter into contracts
11 to make, and to make grants to any city carrying out an
12 approved relocation program under this section, or to any
13 agency or instrumentality of such city designated by the gov-
14 erning body thereof, to defray that part of the cost of carry-
15 ing out such program which is required under paragraphs
16 (2), (3), and (4) of subsection (a).
17 (c) There are authorized to be appropriated such sums
18 as may be necessary to carry out the purposes of this section.
19 Any sums so appropriated shall remain available until
20 expended.
21 GRANTS TO CITIES PROVIDING TAX BENEFITS WITH RESPECT
22 TO CERTIFIED PROJECTS
23 SEC. 106. (a) The Secretary is authorized to enter into
24 contracts to make, and to make, annual grants to cities par-

1 ticipating in the program authorized by this Act. The amount
2 of any such grant shall not exceed a sum equal to—
3 (1) 50 per centum of the amount by which the tax
4 revenues received or receivable by such city during any
5 year were reduced by reason of any tax benefits granted
6 by such city, pursuant to section 101 (a) (1), to one or
7 more certified projects, and
8 (2) an amount equal to any contribution paid or
9 payable to such city by a State to defray any part of
10 the loss of tax revenues incurred or incurrable by such
11 city during such year as the result of such tax benefit:
12 *Provided*, That in no case shall the amount of any such
13 grant exceed 75 per centum of the amount by which the
14 tax revenues received or receivable by any such city
15 during any year were reduced by reason of such tax
16 benefit.
17 (b) For the purpose of this section, there is hereby
18 created a Tax Abatement Fund which shall be used by the
19 Secretary for grants hereunder. Such funds shall consist of
20 (1) the sum of $30,000,000 to be appropriated by the Con-
21 gress to provide initial capital to such fund, (2) such addi-
22 tional sums as may be appropriated thereto by the Congress
23 in the event the balance in such fund becomes less than $20,-
24 000,000 to restore such balance to an amount equal to $30,-

1 000,000, and (3) such sums as may be deposited therein by
2 the Secretary from receipts under section 104 (a) (2).

3 ASSISTANCE FOR HOME MANAGEMENT CORPORATIONS

4 SEC. 107. (a) The Secretary, in consultation with the
5 Director of the Office of Economic Opportunity, is authorized
6 to undertake such activities as he determines to be appro-
7 priate to assist the residents of urban poverty areas to orga-
8 nize and make use of home management corporations. Such
9 activities may include grants to defray reasonable and neces-
10 sary expenses incident to the organization of such corpora-
11 tions. Such activities may also include the issuance of model
12 forms of management agreements which may be entered into
13 between holders and such corporations.

14 (b) For the purposes of this section, there is hereby
15 created a Home Management Assistance Fund, and there is
16 authorized to be appropriated (1) the sum of $5,000,000 to
17 provide initial capital for such fund, and (2) such addi-
18 tional sums as may from time to time be required to make all
19 necessary grants to home management corporations. Any
20 sum so appropriated shall remain available until expended.

21 (c) After its organization, a home management corpora-
22 tion shall receive funds from the Home Management Fund
23 and from any other Federal agency only if the Secretary, in
24 consultation with the Director of the Office of Economic

1 Opportunity, determines that the members of such corpora-
2 tion are contributing sufficient time and funds to insure that
3 the corporation is operating efficiently and effectively.

4 ADMINISTRATION

5 SEC. 108. The provisions of this title shall be admin-
6 istered by the Secretary through a Low-Income Housing
7 Administration to be established by the Secretary in the
8 Department of Housing and Urban Development.

9 PENALTIES

10 SEC. 109. Whoever, in any report or income statement
11 required to be filed under this title, or any regulation issued
12 pursuant thereto, knowingly makes a false statement of a
13 material fact, shall be fined not more than $ or
14 imprisoned not more than , or both.

15 TITLE II—HOUSING ACTS AMENDMENTS

16 MORTGAGE INSURANCE

17 SEC. 201. Title II of the National Housing Act is
18 amended by adding at the end thereof a new section as
19 follows:

20 "MORTGAGE INSURANCE FOR URBAN HOUSING

21 "SEC. 235. (a) This section is designed to assist private
22 industry to provide housing in urban poverty areas for low-
23 income and lower middle income persons in furtherance of
24 the purposes of, and under a program authorized by, the
25 Urban Housing and Development Act of 1967.

1 "(b) The Secretary is authorized, upon application by
2 the mortgagee, (1) to insure in accordance with the pro-
3 visions of this section any mortgage (including advances dur-
4 ing construction) which is executed by a mortgagor to whom
5 has been issued, under section 101 of the Urban Housing
6 Development Act of 1967, an unrevoked certificate of eligi-
7 bility, and which is otherwise eligible for insurance as herein
8 provided; and (2) upon such terms and conditions as the
9 Secretary may prescribe, to make commitments for the in-
10 surance of such mortgages prior to their execution or dis-
11 bursement thereon.
12 "(c) As used in this section (except as otherwise herein
13 provided), the terms 'mortgage', 'mortgagee', 'mortgagor',
14 and 'maturity date' shall have the same meaning as in sec-
15 tion 201 of this Act.
16 "(d) To be eligible for insurance under this section, a
17 mortgage shall—
18 "(1) have been made to and be held by a mort-
19 gagee approved by the Secretary as responsible and able
20 to service the mortgage properly;
21 "(2) not exceed in principal amount $,
22 "(3) not exceed 80 per centum of the total cost of
23 the project when the proposed new construction or sub-
24 stantial rehabilitation is completed. For purposes of this
25 paragraph, the total cost of a certified project shall be

1 the sum of (A) the mortgagor's adjusted basis for the
2 project (including both the land and the buildings) for
3 Federal income tax purposes, at the time that the new
4 construction, or substantial rehabilitation, certified under
5 section 101 of the Urban Housing Development Act of
6 1967, is completed, and (B) the amount of carrying
7 charges allocable to the certified project, which were
8 incurred during such construction or rehabilitation thereof
9 and deducted by the mortgagor under section 266 of the
10 Internal Revenue Code. Subject to regulations to be pre-
11 scribed by the Secretary, there may be included in the
12 total cost of the project, a net profit for the builder (who,
13 for this purpose, shall include all parties related to the
14 builder under section 267 of the Internal Revenue
15 Code), of up to, but not more than, 10 per centum of
16 the total cost of the project less such profit;
17 "(4) bear interest (exclusive of premium charges
18 for insurance and service charge, if any) at not to
19 exceed 2 per centum per annum on the amount of the
20 principal obligation outstanding at any time; and contain
21 such terms and provisions with respect to the application
22 of the mortgagor's periodic payment to amortization of
23 the principal of the mortgage, insurance, repairs, altera-

1 tions, payment of taxes, default reserves, delinquency
2 charges, foreclosure proceedings, anticipation of maturity,
3 and such other matters as the Secretary may prescribe;
4 and

5 "(5) provide for complete amortization by periodic
6 payments within such terms, but not to exceed fifty
7 years, as the Secretary may prescribe.

8 "(e) A project covered by a mortgage insured under
9 the provisions of this section shall comply with the require-
10 ments of the Urban Housing Development Act of 1967, and
11 regulations prescribed thereunder, and for such purpose the
12 Secretary may make such contracts with, and acquire for
13 not to exceed $100 such stock or interest in the mortgagor,
14 as he deems necessary to render effective any such require-
15 ments. Such stock or interest shall be paid for out of the
16 General Insurance Fund and shall be redeemed by the mort-
17 gagor at par upon the termination of all obligations of the
18 Secretary under the insurance.

19 "(f) Notwithstanding any provision of this Act, the
20 Secretary may, whenever he determines that such action is
21 necessary or desirable in furtherance of the purposes of this
22 section, insure a mortgage under this section with no premium
23 charge, with a reduced premium charge, or with a premium

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1 charge for such period or periods during the time the insur-
2 ance is in effect, as the Secretary may determine, and there
3 is authorized to be appropriated such amounts as may be
4 necessary to reimburse the General Insurance Fund for any
5 net losses in connection with such insurance.

6 "(g) The mortgagee shall be entitled to receive the
7 benefits of insurance issued under this section as provided
8 in section 207 (g) of this Act with respect to mortgage in-
9 sured under such section 207, and the provisions of subsec-
10 tions (h), (i), (j), (k), and (l) of such section 207 shall
11 be applicable to mortgages insured under this section."

12 COST CERTIFICATION

13 SEC. 202. Section 227 (a) of the National Housing
14 Act is amended by striking out "or (viii) under section 234
15 (d)" and inserting in lieu thereof "(viii) under section 234
16 (d), or (ix) under section 235".

17 PURCHASES BY FEDERAL NATIONAL MORTGAGE
18 ASSOCIATION

19 SEC. 203. Section 305 of the National Housing Act is
20 amended by adding at the end thereof a new subsection as
21 follows:

22 "(j) Notwithstanding any other provision of this Act,
23 the Association is authorized to make commitments to pur-

1 chase and to purchase, service, or sell, any mortgage insured
2 under section 235 of this Act, subject to the following limi-
3 tations:
4 "(1) The total amount of such purchases and com-
5 mitments outstanding at any one time shall not exceed
6 $500,000,000, which amount shall be increased by
7 $500,000,000 on July 1 in each of the years 1968,
8 1969, 1970, 1971, and 1972.
9 "(2) Not more than 20 per centum of the total
10 amount of such purchases and commitments outstanding
11 at any one time shall relate to mortgages secured by
12 properties situated in any one city."
13 CERTIFIED PROJECTS IN URBAN RENEWAL AREAS
14 SEC. 204. Section 107(a) of the Housing Act of 1949 is
15 amended—
16 (1) by striking out "or (2)" and inserting "(2)";
17 (2) by adding after "Act," the following: "or (3)
18 a purchaser having an unrevoked certificate of eligibility
19 issued under section 101 of the Urban Housing Develop-
20 ment Act of 1967,"; and
21 (3) by inserting "low or" before "moderate
22 income".

1 TITLE III—INTERNAL REVENUE CODE
2 AMENDMENTS

3 TAX TREATMENT OF CERTIFIED PROJECTS

4 SEC. 301. (a) Subpart A of part IV of subchapter A of
5 chapter 1 of the Internal Revenue Code of 1954 (relating to
6 credits allowable) is amended by renumbering section 40 as
7 42, and by inserting the following new section:

8 "SEC. 41. INVESTMENT IN CERTAIN HOUSING PROJECTS
9 IN URBAN POVERTY AREAS.

10 "(a) GENERAL RULE.—There shall be allowed, as a
11 credit against the tax imposed by this chapter, the amount
12 determined under section 1392.

13 "(b) REGULATIONS.—The Secretary or his delegate
14 shall prescribe such regulations as may be necessary to carry
15 out the purposes of this section and section 1392."

16 (b) Subchapter S of chapter 1 of the Internal Revenue
17 Code of 1954 (relating to the taxable status of small business
18 corporations) is amended by inserting after section 1378 the
19 following new section:

20 "SEC. 1379. ISURED INDEBTEDNESS OF SMALL BUSI-
21 NESS CORPORATION.

22 "(a) INSURED LOAN.—In the case of an electing small
23 business corporation which has been granted an insured loan
24 (as defined in subsection (c)) or which has purchased a

1 section 1391 property (as defined in subsection 1391 (3))
2 subject to an insured loan (as defined in subsection (c))—
3 "(1) the insured loan shall be deemed to have been
4 made by the lender to the shareholders of such corpora-
5 tion, in proportion to their holdings of stock at the time
6 that the loan is made,
7 "(2) the proceeds of the insured loan shall be
8 deemed to have been loaned by such shareholders to the
9 electing corporation, on the same terms as those of the
10 insured loan, and
11 "(3) payments by the corporation on the insured
12 loan shall be treated as payments on the loan deemed
13 made to the corporation by its shareholders under sub-
14 section (b) herewith, which are, in turn, paid by the
15 shareholders on the insured loan.
16 "(b) SALE OF STOCK.—A sale or exchange of shares
17 of stock in an electing small business corporation, in propor-
18 tion to which an allocation of an insured loan was at any time
19 made under subsection (a) (1) shall be deemed—
20 "(1) to include a sale or exchange of the unpaid
21 portion, if any, of the loan to the corporation which was
22 deemed made by the holder of such stock under subsec-
23 tion (a) (2), and
24 "(2) to have been made subject to the portion of

1 the insured loan deemed owing by the holder of such
2 stock under subsection (a) (1).
3 "(c) DEFINITIONS.—For purposes of this section the
4 term 'insured loan' means a loan made to an electing small
5 business corporation which is insured under section 235 of
6 the National Housing Act."
7 (c) Chapter 1 of the Internal Revenue Code of 1954
8 (relating to normal taxes and surtaxes) is amended by add-
9 ing at the end thereof the following new subchapter:

10 **"Subchapter U—Tax Treatment of Certain Hous-**
11 **ing Projects in Urban Poverty Areas**

"Sec. 1391. Definitions.
"Sec. 1392. Investment credit.
"Sec. 1393. Depreciation of section 1391 buildings.
"Sec. 1394. Restoration of basis.
"Sec. 1395. Dispositions before end of minimum holding period.
"Sec. 1396. Nonrecognition of gain on certain dispositions of section 1391 property.

12 **"SEC. 1391. DEFINITIONS.**
13 "For purposes of this subchapter—
14 "(1) SECTION 1391 CERTIFICATE.—The term
15 'section 1391 certificate' means a certificate of eligibility
16 issued by the Secretary of Housing and Urban De-
17 velopment—
18 "(A) under section 101(a) of the Urban
19 Housing Development Act of 1967, authorizing the
20 grant of certain income tax and other incentives

1 to a person constructing, or substantially rehabili-
2 tating, a certified project, or

3 "(B) under section 101 (b) of such Act, au-
4 thorizing certain income tax and other incentives
5 to a person who is a successor in interest to such
6 a project.

7 "(2) SECTION 1391 BUILDING.—The term 'section
8 1391 building' means any building which has been con-
9 structed, or substantially rehabilitated, pursuant to a
10 section 1391 certificate. The term includes—

11 "(A) the structure of the building and all
12 components of such building constituting section
13 1250 property (as defined in subsection 1250 (c)),
14 and

15 "(B) elevators and escalators in the building
16 but no other equipment used in the operation of
17 the building which constitutes section 1245 property
18 (as defined in subsection 1245 (a) (3)).

19 "(3) SECTION 1391 PROPERTY.—The term 'section
20 1391 property' means real property consisting of—

21 "(A) a section 1391 building, and

22 "(B) the land on which any such section 1391
23 building is located.

24 For purposes of this subsection, the land on which a sec-

1 tion 1391 building is located shall include reasonable
2 grounds for the building, encompassing gardens, play-
3 grounds, and other facilities. In a case in which such
4 grounds constitute less than all of a tract of land owned
5 by the taxpayer (whether or not any other building not
6 constituting a section 1391 building is located on such a
7 tract), an apportionment of the total tract as between
8 the section 1391 property and other property, shall be
9 made pursuant to regulations to be prescribed by the
10 Secretary or his delegate.
11 "(4) SECTION 1391 CORPORATION.—The term
12 'section 1391 corporation' means a corporation which is
13 holding one or more section 1391 properties.
14 "(5) EQUITY INVESTMENT.—The term 'equity
15 investment' means—
16 "(A) with respect to the first holder of a sec-
17 tion 1391 property, the amount by which (i) the
18 holder's adjusted basis for such property at the time
19 of the completion of the construction or substantial
20 rehabilitation undertaken pursuant to the section
21 1391 certificate exceeds (ii) the initial principal
22 amount of any mortgage on such property which is
23 insured under the provisions of section 235 of the
24 National Housing Act, and
25 "(B) with respect to a subsequent holder of a

1 section 1391 property, the amount by which (i)
2 such holder's adjusted basis for such property at the
3 time of acquisition exceeds (ii) the unpaid principal
4 amount of any mortgage insured under the provisions
5 of section 235 of the National Housing Act to which
6 the property is subject at the time of its acquisition.
7 "(6) EQUITY INVESTMENT PERCENTAGE.—The
8 term 'equity investment percentage' means, with respect
9 to the holder of a section 1391 property, the ratio of—
10 "(A) the holder's equity investment in such
11 property, over
12 "(B) the holder's adjusted basis for such prop-
13 erty at the applicable time specified in subsection
14 (5).
15 "(7) MAXIMUM HOLDING PERIOD.—The term
16 'maximum holding period' means with respect to a sec-
17 tion 1391 property the lesser of (A) the useful life of
18 the section 1391 building, constituting part of such prop-
19 erty, as determined under section 1393 (whether or not
20 an election with respect to such building has been made
21 under such section), or, (B) the useful life of such
22 building for purposes of section 167, determined without
23 regard to section 1393.
24 "(8) MINIMUM HOLDING PERIOD.—The term 'min-

1 imum holding period' means with respect to a section
2 1391 property—
3 "(A) in the case of the first holder thereof 10
4 years, or
5 "(B) in the case of a subsequent holder of such
6 property, 10 years or, if lower, the useful life of the
7 section 1391 building constituting part of such prop-
8 erty for purposes of section 167 but determined
9 without regard to section 1393.
10 "(9) QUALIFIED EXPENDITURES.—The term 'qual-
11 ified expenditures' means, with respect to any taxable
12 year—
13 "(A) as to a taxpayer who, during the taxable
14 year, completed the construction or substantial reha-
15 bilitation of a section 1391 building, pursuant to a
16 section 1391 certificate, the adjusted basis of the
17 section 1391 property of which such building con-
18 stitutes a part, at the time of the completion of such
19 construction or substantial rehabilitation, and
20 "(B) as to a taxpayer who purchases a section
21 1391 property during the taxable year, as a subse-
22 quent holder thereof, the basis of such property at
23 the time of purchase.
24 "(10) FIRST HOLDER.—The term 'first holder'

1 means with respect to any section 1391 building, or sec-
2 tion 1391 property, the person to whom a section 1391
3 certificate is issued authorizing the construction or sub-
4 stantial rehabilitation of a section 1391 building as part
5 of such property.

6 "(11) SUBSEQUENT HOLDER.—The term 'subse-
7 quent holder' means, with respect to any section 1391
8 property, a person to whom a section 1391 certificate
9 has been issued with respect to such property under sec-
10 tion 101 (b) of the Urban Housing Development Act
11 of 1967, but only if—

12 "(A) such person acquires such property by
13 purchase (as defined in section 179 (d) (2)) from
14 a person who, at the time of the purchase, was a first
15 holder or subsequent holder of the property,

16 "(B) the acquisition is made after the end of
17 the minimum holding period applicable to such prop-
18 erty in the hands of such first or subsequent holder.

19 **"SEC. 1392. INVESTMENT CREDIT.**

20 "(a) DETERMINATION OF AMOUNT.—

21 "(1) GENERAL RULE.—The amount of the credit
22 allowed by section 41 for the taxable year with respect
23 to any section 1391 property (as defined in subsection
24 1391 (3)) shall be the following percentage of the quali-

1 fied expenditures (as defined in subsection 1391 (7))
2 made by the taxpayer during the taxable year with
3 respect to such property:

"If the taxpayer's equity investment percentage (as defined in subsection 1391(5)) is—	In the case of the first holder of any section 1391 property (as defined in subsection 1391(10)), the credit shall be—	In the case of a subsequent holder of such property (as defined in subsection 1391 (11)), the credit shall be—
20 percent or more but less than 25 percent	3 percent	2 percent.
25 percent or more but less than 30 percent	5 percent	3 percent.
30 percent or more but less than 35 percent	6.5 percent	4 percent.
35 percent or more but less than 40 percent	8 percent	5 percent.
40 percent or more but less than 45 percent	9.5 percent	7.5 percent.
45 percent or more but less than 50 percent	11 percent	10 percent.
50 percent or more but less than 55 percent	12 percent	12 percent.
55 percent or more but less than 60 percent	13 percent	13 percent.
60 percent or more but less than 65 percent	14 percent	14 percent.
65 percent or more but less than 70 percent	15 percent	15 percent.
70 percent or more but less than 75 percent	16 percent	16 percent.
75 percent or more but less than 80 percent	17 percent	17 percent.
80 percent or more but less than 85 percent	18 percent	18 percent.
85 percent or more but less than 90 percent	19 percent	19 percent.
90 percent or more but less than 95 percent	20 percent	20 percent.
95 percent or more but less than 100 percent	21 percent	21 percent.
100 percent	22 percent	22 percent.

4 "(2) LIMITATION.—Notwithstanding paragraph
5 (1), the credit allowed by section 41 for the taxable
6 year shall not exceed the taxpayer's liability for tax
7 for the taxable year.
8 "(3) LIABILITY FOR TAX.—For purposes of this
9 section, the liability for tax for the taxable year shall be
10 the tax imposed by this chapter for such year, reduced
11 by the sum of the credits allowable under—
12 "(A) section 33 (relating to foreign tax
13 credit),
14 "(B) section 35 (relating to partially tax-ex-
15 empt interest),
16 "(C) section 37 (relating to retirement in-
17 come), and

1 "(D) section 38 (relating to investment in cer-
2 tain depreciable property).
3 For purposes of this paragraph, any tax imposed for
4 the taxable year by section 531 (relating to accumu-
5 lated earnings tax), section 541 (relating to personal
6 holding company tax), or section 1378 (relating to tax
7 on certain capital gains of subchapter S corporations),
8 and any additional tax imposed for the taxable year by
9 section 1351(d)(1) (relating to recoveries of foreign
10 expropriation losses), shall not be considered tax im-
11 posed by this chapter for such year.
12 "(b) CARRYBACK AND CARRYOVER OF UNUSED
13 CREDITS.—
14 "(1) ALLOWANCE OF CREDIT.—If the amount of
15 the credit determined under subsection (a)(1) for any
16 taxable year exceeds the limitation provided by subsec-
17 tion (a)(2) for such taxable year (hereafter in this
18 subsection referred to as the 'unused credit year'), such
19 excess shall be—
20 "(A) a section 41 credit carryback to each of
21 the 3 taxable years preceding the unused credit
22 year, and
23 "(B) a section 41 credit carryover to each of
24 the 7 taxable years following the unused credit year,

1 and shall be added to the amount allowable as a credit
2 by section 41 for such years, except that such excess
3 may be a carryback only to a taxable year ending after
4 the date of the enactment of the Urban Housing De-
5 velopment Act of 1967. The entire amount of the
6 unused credit for an unused credit year shall be carried
7 to the earliest of the 10 taxable years to which (by
8 reason of subparagraphs (A) and (B)), such credit
9 may be carried and then to each of the other 9 taxable
10 years to the extent that, because of the limitation con-
11 tained in paragraph (2), such unused credit may not be
12 added for a prior taxable year to which such unused
13 credit may be carried.
14 "(2) LIMITATION.—The amount of the unused
15 credit which may be added under paragraph (1) for
16 any preceding or succeeding taxable year shall not ex-
17 ceed the amount by which the limitation provided by
18 subsection (a) (2) for such taxable year exceeds the
19 sum of—
20 "(A) the credit allowable under subsection
21 (a) (1) for such taxable year, and
22 "(B) the amounts which, by reason of this
23 subsection, are added to the amount allowable for
24 such taxable year and attributable to taxable years
25 preceding the unused credit year.

1 "(c) SUBCHAPTER S CORPORATIONS.—In the case of
2 an electing small business corporation (as defined in section
3 1371)—
4 "(1) the qualified expenditures for each taxable
5 year shall be apportioned pro rata among the persons
6 who are shareholders of such corporation on the last day
7 of such taxable year, and
8 "(2) any person to whom any expenditures have
9 been apportioned under paragraph (1) shall be treated
10 (for purposes of this subchapter) as the taxpayer with
11 respect to such expenditures, and such expenditures shall
12 not (by reason of such apportionment) lose their char-
13 acter as qualified expenditures.
14 "(d) ESTATES AND TRUSTS.—In the case of an estate
15 or trust—
16 "(1) the qualified expenditures for any taxable year
17 shall be apportioned between the estate or trust and the
18 beneficiaries on the basis of the income of the estate or
19 trust allocable to each, and
20 "(2) any beneficiary to whom any expenditures
21 have been apportioned under paragraph (1) shall be
22 treated (for purposes of this subchapter) as the taxpayer
23 with respect to such expenditures, and such expenditures
24 shall not (by reason of such apportionment) lose their
25 character as qualified expenditures.

1 "(c) Cross References.—

"(1) For the effect of a disposition of section 1391 property before the end of the minimum holding period applicable to a certified housing project, see section 1395.
"(2) For application of this subchapter to certain acquiring corporations, see section 381(c)(24).

2 "SEC. 1393. DEPRECIATION OF SECTION 1391 BUILDINGS.

3 "(a) Election by Taxpayer.—If an election is made
4 under this subsection with respect to a section 1391 building
5 (as defined in subsection 1391(2))—
6 "(1) expenditures paid or accrued in the course of
7 the construction, or substantial rehabilitation of such
8 building, pursuant to a section 1391 certificate (as de-
9 fined in subsection 1391(1)), for the demolition of
10 existing structures and for site improvement, which
11 would, apart from this subsection, be added to the tax-
12 payer's basis for the land, shall instead be added to the
13 taxpayer's basis for the section 1391 building;
14 "(2) the useful life of such section 1391 building,
15 for purposes of section 167 shall be the number of years
16 determined under subsection (b); and
17 "(3) for purposes of section 167, such building shall
18 be treated as having no salvage value.
19 An election under this subsection with respect to any prop-
20 erty shall be made at such time and in such manner as the
21 Secretary or his delegate prescribes by regulations. Any such

1 election may be revoked only with the consent of the Secre-
2 tary or his delegate.

3 "(b) USEFUL LIFE.—For purposes of subsection (a)—

"If the taxpayer's equity investment percentage (as defined in subsection 1391([illegible])) is—	If the taxpayer is the first holder (as defined in subsection 1391(10)) with respect to the section 1391 building, the useful life of the building shall be the following percentage of its useful life determined without regard to this subsection—	If the taxpayer is a subsequent holder (as defined in subsection 1391(11)) with respect to the section 1391 building, the useful life of the building shall be the following percentage of its useful life determined without regard to this subsection—
20 percent or more but less than 25 percent	40 percent	50 percent.
25 percent or more but less than 30 percent	36 percent	46 percent.
30 percent or more but less than 35 percent	32 percent	43 percent.
35 percent or more but less than 40 percent	28 percent	40 percent.
40 percent or more but less than 45 percent	25 percent	35 percent.
45 percent or more but less than 50 percent	22 percent	30 percent.
50 percent or more	20 percent	25 percent.

4 For purposes of applying this subsection, the useful life of a
5 section 1391 building apart from the application of the per-
6 centages specified in this subsection shall not be deemed less
7 than the term, or remaining term, of any mortgage on the
8 building insured under section 235 of the National Housing
9 Act.

10 "(c) METHOD OF DEPRECIATION.—If an election is
11 made under subsection (a) with respect to any section 1391
12 building, the methods of depreciation specified in subsection
13 167(c) may be used only if the taxpayer's equity invest-
14 ment percentage is in excess of 50 percent.

15 "(d) LIMITATION.—Paragraph (1)(A) shall not
16 apply to any section 1391 building if the useful life of such
17 building to the taxpayer for purposes of section 167 (deter-
18 mined without regard to this subsection) is less than 10

1 years. The useful life of any section 1391 building shall not,
2 by reason of an election under this subsection, be less than
3 10 years.

4 "(e) CROSS REFERENCE.—

"For the effect of any early disposition of a section 1391 building with respect to which an election is made under subsection (a), see section 1395.

5 **"SEC. 1394. RESTORATION OF BASIS.**

6 "(a) ELECTION.—Under regulations prescribed by the
7 Secretary or his delegate, if a holder of a section 1391 prop-
8 erty (as defined in subsection 1391 (3)) holds such property
9 for the maximum holding period applicable thereto (as
10 defined in subsection 1391 (7)), and at the end of such
11 period certifies to the Secretary or his delegate that he will
12 continue to hold such property in conformity with the re-
13 quirements of section 101 of the Urban Housing Develop-
14 ment Act of 1967, such holder shall, for purposes of this
15 chapter (except as provided in subsection (b)), be treated
16 as having sold and purchased such property, on the first day
17 after the end of such maximum holding period, for an amount
18 equal to the sum of:

19 "(1) his equity investment in such property (as
20 defined in subsection 1391 (5)) less the amount of any
21 credits allowed to such holder under section 41 with
22 respect to such property; and

23 "(2) the unpaid principal amount of any mortgage

1 insured under section 235 of the National Housing Act
2 to which such property is subject on the date of such
3 purchase.
4 "(b) TREATMENT AS SUBSEQUENT HOLDER.—A tax-
5 payer who makes an election under subsection (a) hereof
6 shall be treated as of the date of the purchase under such
7 election as a subsequent holder of the section 1391 property
8 for all purposes under this chapter, except that such taxpayer
9 shall not be entitled to any credit on such purchase under
10 section 1392.
11 "SEC. 1395. DISPOSITIONS BEFORE END OF MINIMUM
12 HOLDING PERIOD.
13 "(a) DISPOSITIONS OF SECTION 1391 PROPERTY.—If
14 any section 1391 property (as defined in subsection 1391
15 (3)) is disposed of before the end of the minimum holding
16 period applicable to such property (as defined in subsection
17 1391 (8)) except in a disposition subject to section 1396
18 (c)—
19 "(1) in applying section 1250 (relating to gain
20 from disposition of certain depreciable realty) to such
21 disposition—
22 "(A) the applicable percentage shall be 100
23 percent, and
24 "(B) the term 'additional depreciation' in sub-
25 section 1250(a)(1)(A) shall mean (in lieu of the

1 meaning set forth in subsection 1250(b)(1)) the
2 depreciation adjustments with respect to such prop-
3 erty, to the extent they exceed the sum of—
4 "(i) the amount of the depreciation ad-
5 justments which would have resulted if such
6 adjustments had been determined for each tax-
7 able year, under the straight-line method of
8 depreciation, but without regard to section
9 1393, and
10 "(ii) any amounts eliminated from addi-
11 tional depreciation under paragraph (b)(5).
12 "(2) the tax under this chapter for the taxable year
13 in which the disposition occurs shall be increased by an
14 amount equal to the credits allowed under section 41 for
15 prior taxable years which are attributable to such prop-
16 erty, and any carrybacks and carryovers under section
17 1392(b) shall be adjusted: *Provided*, That this para-
18 graph shall not apply to any disposition upon which gain
19 otherwise subject to section 1250(a) is not recognized
20 in whole or in part by virtue of any of the provisions of
21 section 1250(c).
22 For purposes of this subsection, if the section 1391 certificate
23 (as defined in subsection 1391(1)), issued with respect
24 to any section 1391 property, is terminated by the Secre-
25 tary of Housing and Urban Development under section 101

1 (c) of the Urban Housing Development Act of 1967, or if
2 any property otherwise ceases to qualify as section 1391
3 property with respect to the taxpayer, such property shall
4 be treated as having been disposed of on the day on which
5 such termination becomes effective or such cessation occurs.
6 "(b) DISPOSITION OF STOCK.—
7 "(1) GENERAL RULE.—If stock in a section 1391
8 corporation (as defined in subsection 1391 (4)) is dis-
9 posed of before the end of the minimum holding period
10 applicable to any section 1391 property held by the
11 corporation issuing such stock, gain on such disposition
12 which is not subject to the provision of section 341 (a),
13 shall be considered as gain from the sale or exchange
14 of property which is not a capital asset, to the extent
15 of the amount determined under paragraph (2).
16 "(2) AMOUNT OF ORDINARY INCOME.—The
17 amount of gain subject to paragraph (1) shall be the
18 amount allocable to the stock sold (as determined by
19 the regulations to be prescribed by the Secretary or his
20 delegate), of the aggregate gain subject to section
21 1250 (a) that would have been realized by the section
22 1391 corporation, if at the time of such disposition of
23 stock, the corporation sold, at a price equal to its fair
24 market value, each section 1391 property (as defined in
25 subsection 1391 (3)) which it had not, at such time,

1 held for its minimum holding period. In applying para-
2 graph (1) to a sale or exchange under section 302,
3 303, or 346, any gain subject to subsection (a) realized
4 by the section 1391 corporation on such sale or ex-
5 change shall not be included in the potential income
6 of the corporation subject to section 1250, referred to
7 in the preceding sentence.
8 "(3) MINORITY SHAREHOLDERS.—Paragraph (1)
9 of this subsection shall not apply if—
10 "(A) at no time during the 5 years preced-
11 ing the sale or exchange, the taxpayer owned di-
12 rectly or indirectly over 10 percent of either the
13 common stock or the voting stock of the section 1391
14 corporation, or
15 "(B) at the time of the sale or exchange, the
16 aggregate fair market value of the section 1391
17 properties held by the section 1391 corporation, less
18 the liabilities to which such properties are subject or
19 which are otherwise related thereto, represented less
20 than 10 percent of the fair market value of such cor-
21 poration's assets less the amount of all its liabilities.
22 "(4) EXCEPTED TRANSFERS.—
23 "(A) Paragraph (1) shall not apply to a dis-
24 position upon death or by gift.
25 "(B) Paragraph (1) shall not apply to a sale

1 or exchange of stock in complete liquidation of the
2 corporation under section 331.
3 "(C) If the basis of stock in a section 1391
4 corporation in the hands of a transferee is deter-
5 mined by reference to its basis in the hands of the
6 transferor thereof in a disposition otherwise subject
7 to paragraph (1), by reason of the application of
8 section 332, 351, 361, 371 (a), 721, or 731, the
9 amount of gain taken into account by the transferor
10 on such disposition under paragraph (1) of this
11 subsection shall not exceed the amount of gain rec-
12 ognized on the disposition, determined without ref-
13 erence to this section.
14 "(5) ELIMINATION FROM ADDITIONAL DEPRECIA-
15 TION.—The amount of gain recognized under paragraph
16 (1) on a sale or exchange of stock in a section 1391
17 corporation shall, as of the date of such sale or exchange,
18 be eliminated from the additional depreciation as to the
19 section 1391 properties held by such corporation under
20 subparagraph 1391 (a) (1) (B) (ii).
21 **"SEC. 1396. NONRECOGNITION OF GAIN ON CERTAIN DIS-**
22 **POSITIONS OF SECTION 1391 PROPERTY.**
23 "(a) NONRECOGNITION OF GAIN.—Upon a sale or ex-
24 change of section 1391 property (as defined in subsection

1 1391(3)), gain shall not be recognized to the extent set
2 forth in subsection (b), (c), or (e).
3 "(b) QUALIFIED REINVESTMENT.—
4 "(1) GENERAL RULE.—If section 1391 property
5 is sold or exchanged at any time after the end of the
6 minimum holding period applicable to such property (as
7 defined in subsection 1391(8)), no gain shall be recog-
8 nized if, within 1 year after the date of such sale or
9 exchange, or within such longer period of time as may
10 be authorized by the Secretary or his delegate, upon an
11 application of the taxpayer showing reasonable grounds
12 for an extension, the taxpayer makes a qualified reinvest-
13 ment (as defined in paragraph (2)) of an amount not
14 less than:
15 "(A) the amount realized on such sale or ex-
16 change, over
17 "(B) the amount of any mortgage on such
18 property insured under section 235 of the National
19 Housing Act (as of the date of such sale or ex-
20 change).
21 "(2) AMOUNT OF QUALIFIED REINVESTMENT.—
22 For purposes of this subsection, a qualified reinvestment
23 shall mean:
24 "(A) an expenditure paid or accrued by the
25 taxpayer which will constitute part of a qualified

1 expenditure (as defined in subsection 1391 (9)), or
2 "(B) any other expenditure paid or accrued by
3 the taxpayer for the construction or substantial re-
4 habilitation of housing, the rental levels of which
5 insure that they will be suitable for occupancy by
6 low-income or lower middle income families or indi-
7 viduals. The types of expenditures which shall con-
8 stitute qualified reinvestments under subparagraph
9 (B) shall be specified in regulations to be prescribed
10 by the Secretary of Housing and Urban Develop-
11 ment.
12 "(c) DISPOSITION TO HOME MANAGEMENT CORPORA-
13 TION.—If section 1391 property is sold or exchanged at
14 any time after the end of four-fifths of the minimum holding
15 period applicable to such property, no gain shall be recog-
16 nized if such sale or exchange is made to a home manage-
17 ment corporation (as defined in section 3 (7) of the Urban
18 Housing Development Act of 1967).
19 "(d) DISPOSITIONS AFTER END OF MAXIMUM HOLD-
20 ING PERIOD.—
21 "(1) GENERAL RULE.—If section 1391 property is
22 sold or exchanged at any time after the end of the maxi-
23 mum holding period applicable to such property (as
24 defined in subsection 1391 (7)) and subsection (b) or
25 (c) do not apply to such sale or exchange, then the gain

1 to be recognized on such sale or exchange shall not ex-
2 ceed an amount determined under paragraph (2).
3 "(2) AMOUNT OF ORDINARY INCOME.—The
4 amount of gain to be recognized in a sale or exchange
5 described in paragraph (1) shall not be greater than
6 the excess of:
7 "(A) the amount realized on such sale or ex-
8 change, over
9 "(B) the amount of any mortgage on such
10 property insured under section 235 of the National
11 Housing Act, as of the date of such sale or exchange.
12 "(e) CHARACTERIZATION OF GAIN.—If section 1391
13 property is sold or exchanged after the expiration of the
14 minimum holding period applicable to such property, any
15 gain realized on such sale or exchange shall be treated as
16 gain on the sale or exchange of property described in sub-
17 section 1231(b)."
18 TECHNICAL, CONFORMING, AND CLERICAL AMENDMENTS
19 SEC. 302. (a) The table of subchapters for chapter 1
20 of the Internal Revenue Code of 1954 is amended by adding
21 at the end thereof the following new item:

"SUBCHAPTER U. Tax treatment of certain housing projects in urban poverty areas."

1 (b) The table of sections for subpart A of part IV of
2 subchapter A of chapter 1 of such Code is amended by
3 inserting the following:

"Sec. 41. Investment in certain housing projects in urban poverty areas."

4 (c) Section 167(j) of such Code is amended to read
5 as follows:

6 "(j) CROSS REFERENCES.—

"(1) For additional rules applicable to depreciation of improvements in the case of mines, oil and gas wells, other natural deposits, and timber, see section 611.

"(2) For additional rules applicable to depreciation of section 1391 property, see section 1393."

7 (d) Section 381(c) of such Code is amended by adding
8 at the end thereof the following new paragraph:

9 "(24) CREDIT UNDER SECTION 41 FOR INVEST-
10 MENT IN CERTAIN HOUSING PROJECTS IN URBAN
11 POVERTY AREAS.—The acquiring corporation shall take
12 into account (to the extent proper to carry out the pur-
13 poses of this section and section 41, and under such regu-
14 lations as may be prescribed by the Secretary or his
15 delegate) the items required to be taken into account for
16 purposes of section 41 in respect to the distributor or
17 transferor corporation."

1 (e) Section 1250 of such Code is amended by adding
2 at the end thereof the following new subsection:
3 "(i) CERTIFIED HOUSING PROJECT.—For special rules
4 for applying this section in the case of real property com-
5 prising section 1391 property, see section 1395."
6 (f) Subsection 1250(d) is amended by adding at the
7 end thereof the following new paragraph:
8 "(9) TRANSFER TO HOME MANAGEMENT CORPO-
9 RATION.—Subsection (a) shall not apply to a disposition
10 of section 1391 property (as defined in subsection 1391
11 (3)) which is subject to subsection 1396(c)."
12 (g) Section 1371 of such Code is amended by adding
13 at the end thereof the following new subsection:
14 "(e) CORPORATE SHAREHOLDERS.—Subparagraph (a)
15 (2) of this section shall not apply to a corporation during
16 any taxable year in which over 90 percent of its gross re-
17 ceipts constitute rental or other income realized in the opera-
18 tion of section 1391 property and/or the proceeds of sales
19 or exchanges of such property."
20 (h) Section 1372(e)(5) of such Code is amended by
21 inserting after "rents" the following: "(other than rents
22 from section 1391 property)".
23 (i) The table of sections for subchapter S of chapter 1

1 of such Code is amended by adding at the end thereof the

2 following new item:

"Sec. 1379. Indebtedness to shareholders of small business corporation holding section 1391 property."

3 EFFECTIVE DATE

4 SEC. 303. The amendments made by this title shall

5 apply to taxable years ending after the date of the enactment

6 of this Act.

[Press release, Committee on Finance, United States Senate, Aug. 11, 1967]

RUSSELL B. LONG (D. LA.), CHAIRMAN, COMMITTEE ON FINANCE, ANNOUNCES HEARINGS ON TAX INCENTIVES TO ENCOURAGE HOUSING CONSTRUCTION IN POVERTY AREAS

Chairman Russell B. Long today announced that the Committee on Finance would hold three days of hearings on legislation to encourage and assist private enterprise to provide adequate housing in urban poverty areas. The Chairman stated that spokesmen from the Treasury Department and from the Department of Housing and Urban Development would be lead-off witnesses.

The Hearing would begin at 10 a.m., on Thursday, September 14 and would continue *through* Saturday, September 16, in Room 2221, New Senate Office Bldg.

Legislation presently before the Committee on Finance dealing with this subject is embodied in S. 2100, introduced by Senators Smathers, Ribicoff, Kennedy (NY) and Pearson. Among the Federal tax incentives included in this bill are (1) tax credits ranging from 2% to 22% of the expenditures involved, depending upon the proportion of the owners equity in the building to the debt involved; (2) accelerated depreciation based on shorter useful lives for the building where the owner has a substantial equity; and (3) an allowance for amortization of the costs incurred in demolishing existing structures to make way for the new housing.

In addition to these Federal tax benefits, S. 2100 would authorize Federal grants to cities (a) in the nature of reimbursements for a portion of revenues lost to the city because of tax benefits it may grant with respect to such housings, and (b) to match State contributions to the city for the same purpose.

Persons desiring to be heard on this important matter should submit requests to Tom Vail, Chief Counsel, Committee on Finance, not later than Friday, September 8. In order to facilitate the hearing, those with similar interests should designate a single spokesman to present their testimony. As soon as the hearing schedule is fixed, witnesses will be advised of their time of appearance, and a full witness list will be announced.

Witnesses who are scheduled to appear are urged to make their statements as brief as possible to conserve the time of the Committee. In order to further conserve time, the Committee will be pleased to receive from any interested person a written statement for inclusion in the printed record of the hearings in lieu of a personal appearance. These statements will be given the same full consideration as though they had been delivered orally. Chairman Long urged that those persons who desire to contribute written statements to submit them to Tom Vail, Chief Counsel, no later than Saturday, September 16.

All statements should include a summary sheet and subject heading and should be submitted to the Committee the day before the witness is to testify.

The CHAIRMAN. One of the sponsors, along with Senator Kennedy, is the ranking member of this committee, Senator Smathers. He might want to say a word or two about the bill as we open hearings on it.

Senator SMATHERS. First, I would like to thank the chairman for his willingness to call the committee together to hear what I think is a very significant and important proposal in a field which we need to give more attention and more action if we are to bring about better conditions in our Nation's cities.

I hope we will have as many Senators as possible to hear the remarks of the author of the bill, Senator Kennedy, and those who are sponsoring it with him—the Senator from Kansas, the Senator from Connecticut, and others.

As I say, I think it is a monumentally important piece of legislation.

If the sickening living conditions of the ghetto dweller were in part responsible for the strife of the summer of 1967, and if we do not want to see this strife repeated, with its wanton destruction and looting, then we must do something to rid the cities of their intolerable living conditions.

The problem of inadequate housing for the poor has long been with us. Unfortunately, not enough has been done about it. The Federal Government 30 years ago acted to provide public housing for low-income groups. Yet over those 30 years only 639,000 public housing units have been completed, and four-fifths of these were built in communities that cannot be classified as poverty-stricken urban centers.

The remedy to poor housing through direct Government assistance has been tried and it has been found wanting. As yet, a workable alternative to public housing for low-income groups has not been found.

Private developers have not wished to engage in low-income housing construction because there has been little, if any, profit in it. Quite naturally, the American businessman expects the maximum profit—at least a fair profit—from his investments. Unfortunately, by itself, building private housing for the poor offers no such profit.

S. 2100 attempts to make investments in low-income housing more attractive to the businessman than it is today. It would do this by making construction loans available under terms which cannot be matched today.

To a builder willing to build multiple, low-income dwelling units in urban areas, 50-year mortgages would be available at an interest cost of 2 percent, with the Government subsidizing the approximate 2-percent interest difference between the 4-percent rate at which the Government would borrow to obtain the mortgage funds and the 2-percent rate at which the mortgage money would be lent to the builder.

While the low-interest mortgage money is a genuine incentive to a builder, the incentive in S. 2100 that would really make the program attractive to the businessman are the tax benefits which are intended to encourage greater participation by the businessman in this low-income urban housing investment.

Since this is the tax-writing committee in the Senate, it is appropriate that the bill be before us and that we discuss its tax provisions. The principal tax incentives provided by the bill to developers of low-income urban housing are, first, the tax credits, and second, the reduced depreciable life of these properties.

The bill before us provides as a credit against the income tax of an individual or corporation investing in low-income, urban housing a percentage of the investment. The credit which the taxpayer can take rises with the taxpayer's equity investment in the project.

Thus, a credit against income tax of 3 percent of the investment is available to the person who has a minimum 20-percent equity in the cost of the housing; but the credit can be as high as 30 percent for the person who pays the entire project cost.

Second, the useful lives of the low-income urban housing to be constructed under this bill are reduced for depreciation purposes. Thus, the cost of the project can be deducted in large amounts over fewer years than is ordinarily possible, providing the taxpayer with a larger reduction in taxable income in those years of depreciation.

In S. 2100, depreciation on a building with a normal, useful life of 50 years may be taken over a period of 20 years by an investor who puts up 20 percent of the cost of construction. The period of deprecia-

tion is reduced to 7 years for the investor whose equity capital pays the entire cost of the urban housing construction.

The basis upon which depreciation is taken is to include site improvement and demolition costs. And for purposes of depreciation, the building is to be treated as having no salvage value, permitting depreciation of the entire cost of the building.

There are additional tax provisions in the proposal before us today which will be developed as the hearing proceeds.

As a coauthor of S. 2100, I believe it offers the right kind of incentives in the right amounts. I believe it offers a responsible solution to the housing needs of the poor that direct Government intervention has been unable to provide despite 30 years of trial.

This hearing gives us an opportunity to view the housing needs of the poor in perspective and to weigh the features of S. 2100 against those needs. I am confident the bill will withstand the test of analysis.

Our first witness this morning is the Honorable Robert F. Kennedy, Senator from the State of New York, and principal author of the bill before us.

Senator Kennedy, we are delighted that you can be with us. Would you please take the stand and begin your statement?

Senator CARLSON. Mr. Chairman, before the distinguished Senator proceeds, may I state that at 11 o'clock this morning we have the first meeting of the conferees on the foreign aid bill. We will meet in the Senate committee room. When I walk out, I hope the distinguished Senator will understand I am going to a committee meeting. It is the first meeting for the conference between the House and Senate.

STATEMENT OF HON. ROBERT F. KENNEDY, A U.S. SENATOR FROM THE STATE OF NEW YORK

Senator KENNEDY. Mr. Chairman, I have a statement from the junior Senator from Kansas who had expected to testify before the committee. He left his statement with me. He asks that it be placed in the record.

(Senator Pearson's statement appears at p. 114.)

The CHAIRMAN. During these hearings, Senator Kennedy, I may have to go to the floor. I hope you will pardon me if I do. I hope to hear your statement. If so, I will leave you in the sympathetic hands of Senator Smathers.

Senator KENNEDY. I would like to be in your sympathetic hands as well. I would also like to express my appreciation to the chairman and to the members of the committee for calling this hearing, and hearing testimony today, Friday, and Saturday.

I very much appreciate the opportunity to testify before this committee on S. 2100. In the course of your work on the Internal Revenue Code, you have dealt with literally hundreds of widely varying questions of social policy. You have decided that tax incentives were appropriate and necessary to encourage such diverse activities as the construction of grain facilities, the purchase of heavy machinery, the development of rural farmlands, and the growth of Puerto Rico.

S. 2100 would have this committee make a similar decision about low-income housing—a decision which the committee's experience has justly

qualified it to make, for the committee's work on social security and welfare has brought it in direct contact with the problem of the poor.

Moreover, it has considered housing and other construction problems several times within recent years. For example, its decision to grant accelerated depreciation for construction has helped maintain a booming investment market for office buildings and high- and middle-income housing units.

Now this committee has an opportunity to enlarge that market. S. 2100 would stimulate investment in low-income housing within the poverty areas of our major cities. Its companion, S. 2088, would encourage industrial development in the same areas.

This has been the fourth summer of widespread and serious civil disorder in the great urban centers of our country. It is the fourth summer in which the frustration and anger born out of poverty and nurtured on lack of opportunity have shattered the peace and tranquillity of our society. And in this fourth summer, we have seen the most serious upheavals, the most widespread looting, and the most vicious and senseless acts of violence.

Today, the easy temptation—the tendency of all too many—is to think that force and troops, firearms, and tear gas are the answer to strife between Americans. For too many, the simple course of ordering obedience to law and of prohibiting riots is the solution to the crisis of our cities.

But force and violence and prohibitive decrees cannot and must not be our only responses to the tragic problems before us. Punishment is not prevention; denunciation will not provide opportunity. If we are not again to reap violence and disorder—if we are to overcome the demagogs who preach hate and destruction—then we must renew our efforts to end the grinding poverty that breeds first fury and frustration—and then riots and recrimination.

We must bring light to this dark world which the poor now inhabit. For the child, for the unemployed young men, for all those who live in the urban ghetto, we must make life something more than continuing frustration and degradation.

It is no longer enough to point to a landmark Elementary and Secondary Education Act when we know that seven out of 10 children in poverty areas will not graduate from high school—and that if they do, there is no better than an even chance that they will have acquired the equivalent of an eighth grade education.

It will not suffice to point to the achievements of medicare and medicaid when we know that in our urban ghettos infant mortality rates are twice the national average, and mental retardation is seven times the community average.

We can take little pride in 30 years of low-income housing programs when our statistics show that 43 percent of all housing in the inner city is substandard, unhealthly, and dilapidated.

Most important, we cannot rest on a record which lists the Manpower Development and Training Act, the Area Redevelopment Act, the Economic Development Act, and the Economic Opportunity Act when we know that unemployment remains the curse of the poor. There can be little sense of accomplishment when we realize that in a typical big-city poverty area, only about 45 percent of the adult men have

full-time employment which pays more than $60 a week. A bare majority of these men have full-time work at any rate of pay. Less than three out of five have any work at all. The fact is that the people of the ghetto live today with an unemployment rate far worse than the rest of the Nation knew during the great depression.

The time has come when we must begin a meaningful dialog between the two Americas—a dialog between honest men which will inevitably reveal the misery and degradation of the one and liberate the fundamental decency of the other. This dialog will require more than words and more than sentiments of brotherhood. We must demonstrate good faith with swift and forceful action.

But if these efforts are to be meaningful, if they are to have significance, then they can no longer be limited to programs which are run by the Federal Government and financed by direct appropriations, programs which are run out of Washington and implemented by Government agencies. For even the strongest advocates of increased Federal efforts in education, health, and housing—and I number myself in these ranks—must admit that they are not enough.

To rely exclusively, even primarily, on Government efforts is to ignore private enterprise, the shaping force in American life and politics. Private industry has built our cities and industries, it has created jobs for over 60 million Americans now at work. But it has not yet rebuilt the centers of poverty, nor put their people to work, for there has been no adequate inducement to do so.

Now we must find the right mechanism for involving private enterprise in this great remaining task. We must find the key to unlocking the initiative and resources of the private sector—the key to making it profitable for investors to put their funds to work in this Nation's poverty areas.

The bill S. 2100 that Senator Smathers and I introduced, in which we were joined by Senators Pearson and Ribicoff, provides such a mechanism. It is designed to encourage a partnership of private enterprise and Government in one area of need—in the swift and efficient production of low-income housing. It establishes a new approach to lowering the cost of housing, while providing reasonable and competitive profits on investment—primarily through a system of tax incentives.

Before turning to a description of S. 2100's provisions, let me stress that this bill—and its companion measure S. 2088—offers only one type of mechanism for permitting private enterprise to attack the problems of our urban ghettos. Certainly there are other ways—some of which may be equally as effective—for achieving the objective we seek.

But the hour is late for our urban centers; the time for extended studies and drawn-out hearings has passed. As Prof. George Sternlieb has written:

> The gap between the norm and the typical living conditions of poor urbanites is perhaps wider today than it was 20 years ago.

In my judgment, unless some other cohesive and workable proposal appears more feasible, we should utilize the tax incentive approach which is incorporated in these measures. For in the field of housing, S. 2100 offers an infinitely expandable mechanism, with minimal costs, to create the low-income dwelling units so badly needed in the major cities of this Nation.

This bill has 11 basic features. I have also developed a number of amendments to it since it was introduced, and I will describe many of those as well.

First, the bill encompasses not only the building of new units, but encourages the rehabilitation of existing structures.

Second, cities will have primary control over their programs. Satisfactory consultation must be had with city officials—as well as local residents—before a certificate can be obtained from the Department of Housing and Urban Development. Under this procedure, the city can determine the order and pace of reconstruction for its poverty areas, and deal with resettlement in an orderly fashion.

Third, the benefits of the bill are limited to the construction of low-income housing within urban poverty areas, demarcated on maps prepared by the Bureau of the Census for the Office of Economic Opportunity.

Fourth, the bill establishes a new Low-Income Housing Administration within the Department of Housing and Urban Development. Assignment of this program to the Federal Housing Administration would be neither appropriate nor effective. FHA's primary interest is in the construction of single-family homes for middle-income families. But the presonnel and procedures developed to deal with the suburbs are not well suited to the rapid processing of applications for the construction of multiple-dwelling units for low-income families.

Fifth, an applicant receiving local approval and certification from HUD can obtain mortgage insurance for a loan of up to 80 percent of the project's cost, to be amortized over a period of 50 years at a 2 percent rate of interest. In return for receiving the low-interest loan and other benefits, the applicant must agree to meet basic standards of design, construction, and maintenance, and to build or rehabilitate at least 100 units whose rentals will be determined by the Department of Housing and Urban Development.

The investing entity must also agree to accept a direct base return on its equity of approximately 3 percent. Finally, it must rent to low-income persons, and continue as owner of the project for a minimum period of 10 years.

Sixth, in order to induce groups of individuals and corporations to pool their resources for the rebuilding of urban poverty areas, the bill amends subchapter S of the Internal Revenue Code. Under the amendments, corporations having individual or corporate shareholders can be formed to construct low-income housing projects and treat the income thus derived as though they were partnerships. These corporations can then pass the rental income received and the tax losses through to their shareholders without an intervening corporate income tax.

Seventh, the bill provides for adequate payments to aid the resettlement of all those persons or businesses forced to move due to the construction or rehabilitation of low-income housing.

Eighth, the bill creates a Home Management Fund and provides for the formation of home management corporations. The Fund, with an initial appropriation of $5 billion, will supply financial assistance and expertise for organizing the buildings' tenants into management corporations. These bodies will then work with the projects' owners, performing management and maintenance functions within the buildings for appropriate fees.

It is expected that the role of the management corporation in the project itself will grow from maintenance assistance to ownership. The bill, therefore, provides inducements for the owner to sell the building to his tenants. Thus, the management corporations can provide a gradual transition from ordinary renting to cooperative or condominium ownership, avoiding at the outset the complex and difficult legal and financial problems of ownership of multiple dwellings.

Ninth, the bill provides for the establishment of a property tax abatement fund whose ultimate effect will be to lower tenant rentals in projects built under this program.

Tenth, the bill establishes an integrated system of tax and other incentives designed to encourage individuals and corporations to invest in the construction of certified low-income housing projects. The initial owner of the project would receive a tax credit scaled to his equity investment, from a 3-percent credit for an investment of 20 percent to what I now propose should be a 30-percent credit against a 100-percent equity investment. The credit is taken on the entire cost of the project.

The initial owner is also afforded accelerated depreciation on a sliding scale depending on the amount of his equity investment. With a 20-percent equity investment, the owner can depreciate the project over a period of 20 years. With a 100-percent equity investment, the progressive scale that I am now proposing would permit a 7-year depreciation period.

Included within the depreciable base—not capitalized as land costs—are all demolition and site improvement costs. In depreciating the project, the initial owner need not make an allowance for the project's salvage value.

The initial owner is assigned a minimum and a maximum required holding period. The minimum period for all initial owners is equal to 10 years or the assigned depreciation period, whichever is less, and a sale before the end of that period—except to a home management corporation—leads to a return of all tax benefits to the Government.

A sale to the tenants is completely tax free if it is made after the owner has held the project for at least 2 years. If the sale to a private buyer occurs after the minimum period, the owner can either pay a limited capital gains tax on his profits, or reinvest the cash proceeds—free of tax—in another low-income housing project. In other words, Mr. Chairman, the bill aims at forcing the owner to hold the project for at least 7 to 10 years, which gives some stability to the project. The only exception is if he sells to the tenants' council—the people that live in the building, and they take over the ownership. He can make this sale after 2 years and if he does he pays no capital gains tax.

The point is that it gives stability if he holds it himself; but if he disposes of it he has to dispose of it to the people who live in the project so that they then become the owners of their own housing, which we think is very advisable and very helpful. It is a way to go into home-ownership and go into it in a careful way that really makes some sense.

If the sale to the private buyer occurs after the minimum period, the owner can either pay a limited capital gains tax on his profits or re-invest the cash proceeds, free of tax, in the construction or rehabilita-

tion of another low-income housing project. In other words, if he sells to the tenants, he pays no capital gains tax, or if he uses the money he gains from the sale of the project and reinvests it back in the ghetto or in this low-income area, he doesn't have to pay a tax.

Again, it is an incentive to reinvest the money and to have the money build on itself, so that there are additional buildings constructed. That is the point of allowing the forgiveness.

Senator CURTIS. May I ask a brief question?

On the reinvestment, does it have to be in new construction?

Senator KENNEDY. No; either rehabilitation or new construction.

Senator CURTIS. How about existing structures?

Senator KENNEDY. Yes; in the area. As long as he invests in a low-income area and will rebuild the housing, that is all that is necessary.

If he builds more low-income housing, then no taxable gain is recognized on any of the reinvested sale proceeds—just as an individual taxpayer who sells his house to buy another need not recognize any gain on the sale of his first house.

If he does not reinvest the proceeds, he pays a capital gains tax only on a portion of his profit. In effect, the builder is relieved of capital gains payments on the difference between his proceeds and the remaining mortgage, which is calculated as if he has an initial mortgage of 80 percent of the total cost.

The maximum required holding period is also scaled to benefit the high-equity investor. The maximum required holding period is equal to the useful life of the project for depreciation purposes—approximately 20 years for the owner with 20 percent in equity; 7 years for the 100 percent equity investor.

I think you are familiar with the fact that he has to invest at least 20 percent, but he can invest up to 100 percent. The depreciation period if he invests only the 20 percent is 20 years, and if he invests the whole 100 percent he has a depreciation period of only 7 years.

So there is a substantial tax advantage for him to put additional equity in the investment. The latter figure is new. We used to have, as you remember, 10 years and we have lowered it to 7 years. It is provided in one of the amendments I have developed.

If at the end of the maximum required holding period an owner decides to continue operating the building, he is given a restored basis and permitted to redepreciate the building as if he had purchased it from himself but at a constantly decilining price. In most cases, stability of ownership is desirable and this bill takes the relevant steps to encourage that stability.

All subsequent buyers—other than the tenants' home management corporation—are granted credits and accelerated depreciation periods. They are also assigned maximum and minimum required holding periods.

Finally, an insurance fund with an initial appropriation of $10 million is established. The fund, while charging a reasonable premium from all participating owners, guarantees that if in any year the direct return on an investment in a project falls from the permitted 3 percent below zero percent, there will be a reimbursement for cash losses.

In the 2 months that have passed since this bill and its companion measure to encourage the construction of industrial and commercial

facilities were introduced, I have solicited the views of mayors, businessmen, and community leaders. I have received comments and recommendations from hundreds of interested Americans. And, of course, these bills have had the benefit of careful and painstaking scrutiny from many competent men iwthin various departments and agencies which comprise our Federal Government. From these analyses, I have compiled a list of the most substantial suggestions and criticisms. All have been weighed carefully. Some have been adopted and I am now prepared to offer them as amendments. The remainder I have attempted to answer to my own satisfaction and I hope to the satisfaction of this committee.

Some of the witnesses who will appear before this committee have some very useful suggestions. I have not had time to incorporate them. Mr. Rouse, for instance, who is going to testify today, has some concern about some aspects of the bill, and I think these are very legitimate concerns. He has some suggestions.

Mr. Ford, who is going to submit a statement to the committee, also has some suggestions which he thinks will make the bill more attractive and more effective. I think some of his ideas also make some sense. I haven't incorporated all of them. I am not opposed to some of them. I would hope that they would be considered by the committee because I think many of them improve the bill and improve its companion measure.

Let me turn now to those suggestions which concern the Urban Housing Development Act, since that is the proposal which is before the committee today.

First, it is argued that the housing units which will be produced under this bill will bear rental charges that are too high to justify the incentives granted.

In my testimony before the Banking and Currency Committee a few weeks ago, I referred to a range of $73 to $99 a month as typical rents for units built under this proposal.

It is contended that these rents are too high for most of those who live in our urban poverty areas. But let us remember that they are from $25 to $50 a month less costly than the rents charged for comparable units similar in size and construction cost built under the major program that we now have for moderate-income housing—221 (d)(3).

In other words, I don't think this program is perfect, but I think these are provisions that are much better than any provisions that are presently on the books. I think that fact should be considered in any criticism that might be made that this bill is not applicable, or that these rents cannot be paid by every person who lives in the ghetto area.

Moreover, the rents which I mentioned when I introduced this bill are not statutorily fixed charges. When I cited these possible rentals I was relating them to housing units costing anywhere from $10,000 to $15,000 to construct and carrying monthly maintenance costs of from $40 to $50.

It is clear that in some large cities, dwelling units can be successfully rehabilitated for only $6,500 or $7,500; in these and in other cities, maintenance charges may be only $20 or $25 a month. Under these

circumstances, housing units may rent not for $70 or $80 but for only $45 to $50 a month.

Finally, as Secretary Weaver and many other urban scholars have told this Congress time and again, hundreds of thousands of urban poverty area residents are currently paying rentals of $100 and $110 a month for tiny dilapidated and deteriorating housing units. These are the millions of Americans who cannot qualify for public housing, but who earn too little to compete for decent living facilities on the open market.

It is these people who must now be aided in their efforts to obtain safe, clean, well-constructed housing, in which they and their children can live comfortably with a sense of pride and self-respect.

These people can benefit from S. 2100. They deserve assistance from Congress in their endeavors to find the "adequate shelter" which has been promised them for over three decades but which has been so long in coming.

Second, it is argued that the price which the taxpayers must pay to get private enterprise to build low-rent housing units under this program is too high.

Moreover, it is contended that the existing 221(d)(3) below market interest rate and rent supplement programs offer sufficiently high rates of return to interest private investors in the housing business.

After doing careful comparative cost analyses, which I shall submit to this committee with my testimony, I have reached the conclusion, and I think it will be supported by other testimony before this committee, that it would be far less expensive to produce low-rent dwelling units under S. 2100 than under a 221(d)(3) program even with an added rent supplement.

The cost to the taxpayer of a typical housing project built through 2-percent financing over 50 years under a coordinated system of tax incentives may be anywhere from $300,000 to over $1 million less during its lifetime than a comparable project built under existing programs. That would include a combined 221(d)(3) below market interest rate-rent supplement project.

Moreover, yields to the investor will be on the average of 5 to 10 percent higher under this bill than under 221(d)(3) with an added rent supplement. Consequently it will attract many of the investors who have traditionally avoided low-income Federal housing programs.

Finally, this bill does not have the disadvantages that would be involved in a large-scale extension of rent supplements. For this proposal is not a welfare approach; it avoids requiring low- and moderate-income people to rely on receiving Government help every month.

It avoids requiring the poor to live in housing units they cannot afford.

It avoids requiring landlords to rely on a monthly Government subsidy.

And it avoids forcing the Federal Government into a complicated and burdensome process of matching tenants and landlords.

Rather, S. 2100 is an effort to reduce rents to levels which the poor can afford to pay. At the same time it offers substantial profits to investors through a mechanism traditional in the real estate business—a mechanism which permits the investor, not the Federal Government,

to estimate yields and tax savings and to determine whether the investment is sound.

No new bureaucracy need be set up at the Federal level; no major new appropriations must be obtained from the Congress; no new forms and records must be submitted by private investors.

The program is virtually self-regulating once it has been put into effect. It is simple; it is clear; and it is understandable to all those who will participate in it.

Third, it is argued that inducing private enterprise to invest in urban poverty areas is not an appropriate use of the Internal Revenue Code. It is said that if this social purpose is sought through the mechanism of tax incentives, the code will be opened up to other exceptions until its primary function, raising revenue, is dissipated.

In general, I have supported the proposition that the Internal Revenue Code should strive for a uniform tax base and not offer a number of exceptions and tax-saving gimmicks. Preferential tax incentives should not be lightly given.

Nevertheless, I think we all must admit that from its inception, the code has been employed to attain worthwhile, and in some cases, not so worthwhile ends.

Now, in 1967, it is no simple matter to determine whether the code should be used for a new nonrevenue raising purpose. Nevertheless, there are some criteria that can help decide whether any particular suggested departure from a uniform tax base is justified.

Does it, as President Kennedy asked when he submitted the original investment credit proposal, "promote desirable social or economic objectives of overriding importance"?

Does it in fact compensate investors for additional risks and burdens rather than create a special privileged group?

Is it the simplest, most efficient means for attaining the desired goal?

In my judgment, tax incentives to induce housing construction, and industrial development as well, in urban poverty areas meet all of these criteria. Certainly they will promote "a desirable objective of overriding importance", the rebuilding of our urban ghettoes and the employment of our most disadvantaged citizens.

They are also fair. They insure nothing more than a reasonable rate of return to those who face the higher costs and increased security problems of investing in our urban slums; they do nothing more than compensate for greater than normal risks and greater than normal expenditures of time, effort, and resources.

Moreover, tax incentives are the most simple and efficient system for encouraging businessmen to begin the necessary task of restoring our urban centers—a task they are understandably uneasy about undertaking.

Such incentives can be introduced without establishing new bureaucratic and administrative procedures. They are understandable and acceptable to businessmen without being too costly. And they offer the certainty which investors need if they are to make new and risk-filled investments within our urban ghettoes.

Fourth, it is argued that even if all the incentives proposed by these bills are needed, they should not be granted in a prefixed package. Rather, they should be parceled out in different combinations and degrees to different investors.

In my judgment, this suggestion ignores not only the urgency and extent of our urban crisis, but the realities of business life and business attitudes about the Federal bureaucracy. Action—results—are needed now. We simply cannot take the time that would be involved in dealing with each investor as an individual and specific case.

We do not have the time to match every need with differing incentives. Our urban problems are too massive to be met by a narrow, circumscribed program. Unemployment rates of up to 40 percent and housing shortages in the millions will not be solved by a cumbersome process which carefully tailors its subsidies to satisfy each applicant's individual situation.

Moreover, our business leaders have never shown great interest in any program which necessitates constant conferences with, and observation by, Federal officials. They are far more attracted by a broad program which carefully lays out the rules of the game but not every specific play by the participants.

Fifth, it is argued that by building in the ghetto, we lock its residents in and turn our backs on the goal of integration. But open occupancy is not inconsistent with ghetto rehabilitation. For open occupancy laws are not enough. An escape hatch for those who both want to and can afford to move away from the ghetto is desirable. But what about those who either want to or have to stay where they are? What about those who would build their own community; those who would take pride in their own neighborhoods if they could?

Integration is a vital, an indispensable goal in an open society. But equally important, the vast majority of Negroes must be enabled to achieve basic financial and social security where they live now.

Indeed, a new generation of Negroes is striving to establish a sense of community as a people, to gain a measure of control over their own destiny as a people. Sensitivity to that aspiration is at the heart of S. 2100. And it is in no way inconsistent with a total commitment to an open society.

Our urban centers are ever more crowded, ever more segregated, ever more dangerous. We must come to grips with this overwhelming blight. We must rebuild these areas because that is what their residents need most. As the John F. Kraft organization found in its extensive survey of New York City's Harlem area; "There is one overriding problem—and it is housing. Eighty-four percent of those interviewed strongly endorsed a rebuilding program"—as compared to the 6 percent who were concerned over the issue of integration.

And they are right. For a truly open society depends in the long run on the achievement of full comparability of housing and full employment. Today's suburbs, after all, house the children and grandchildren of those whose confinement in the inner city ended only when they began earning enough to afford to move. Only when our center cities have been revitalized and made attractive to all, and when employment opportunities are truly equal, will we have a society where each man has the opportunity to choose whom he will call neighbor—a society in which open occupancy laws, have meaning for all.

Sixth, it is argued that the bill places too much emphasis on rental housing and does not offer sufficient possibilities for tenant owner-

ship. I believe there is some merit in this contention. I have therefore developed an amendment to meet this objection; but I would stress to the committee at the same time that undue reliance should not be placed on homeownerships as a panacea for all the problems of the slum.

Certainly, it does help provide a new sense of pride and participation in the community. But it is not an answer for the young man who lacks a decent job or a real education, or the opportunity to promise his chlidren a better life than he had.

And most important, homeownership is difficult in our large cities where people usually live in multiple dwellings. Mortgages with joint liability, common responsibility for common living areas, ownership bylaws, and the imposition of liens on nonpaying occupants are complex and troublesome matters. Defaults, foreclosures, and losses of equity investment can be overwhelming crisis for the residents of urban poverty areas who were once convinced of the value of homeownership.

Nevertheless, I think homeownership should be encouraged where it is feasible. I therefore propose that S. 2100 be amended to permit a private investor to sell the project to his tenants at the end of only 2 years with the approval of the Secretary of Housing and Urban Development. Included in this provision is a financing mechanism to encourage such sales.

The minimum 2-year period is to allow the tenants to form a stable residents' organization and carefully decide if they want to assume ownership of the project.

At the same time, a relatively short mandatory holding period has benefits both for the Federal Government and for the private investor. The more rapid the transfer to tenant ownership, the smaller the revenue loss. And because of the way the depreciation mechanism works, the swifter the sale, the higher the profit margin is to the private owner. In sort, a minimum holding period with a prescribed selling procedure may prove the most feasible possibility for transforming rental housing into homeownership in our major cities.

Seventh, although somewhat inconsistent with the homeownership argument, it is argued that potential investors under the bill will be deterred because it requires them to deal with their tenants through home management corporations.

But why in fact should a tenant organization disturb a private owner? As we are now beginning to learn, one of the most successful ways to avoid misunderstandings between landlord and tenants is to encourage tenant participation in the day-to-day operations of the building. The National Association of Housing & Redevelopment Officials has noted in discussing public housing:

> It seems doubtful that housing for low-income families can be kept in decent condition without the closest cooperation and participation of the tenants . . . Leadership (should) come from the joint efforts of the manager and tenants.

Moreover, since the landlord will benefit if the tenants purchase the project after a short period of time, it is to his advantage to help develop a management corporation and to stimulate the tenants' interest in buying the project.

Eighth, it is argued that the equity investment requirements are too high. It is also said that since progressivity of profits exists only up to

the 50 percent equity level, no businessmen will make a capital contribution above that percentage.

As to the first contention: it would be extremely easy for this committee to modify S. 2100 and allow a lower minimum equity or, for that matter, establish a fixed equity ratio in place of a sliding scale. But I believe neither of these changes should be made. I think they should be considered by the committee, but at the monent I would be opposed to them.

If Congress is to offer substantial profits to those who would invest in low- and moderate-income housing, then it should require higher than normal equity investments. And if this Congress—like any wartime Congress—is to work from the premise that only a limited pool of Federal mortgage money can be made available, then it should provide for scaled capital investment as a means for stretching our immediately available dollars a little bit further. In other words, under this program, Mr. Chairman, investors would not have to go to the Federal Government. They would make the money available themselves.

This bill puts an emphasis on that. It stresses the fact that the equity investment should be as high as possible. If we are going to do that, it seems to me we should make it more profitable to invest more equity.

As for the second contention, if it is the desire of Congress to achieve a profit scale that is progressive up to the 100-percent equity level, the result is relatively simple to attain. One of the amendments I have prepared would raise the maximum initial credit to 30 percent, reduce the minimum depreciation period to 7 years, and alter the capital gains recovery provisions.

In the original bill, we utilized a 22-percent credit with 10 years and this amendment would change these figures to 30 percent and 7 years. I would like that amendment to be considered by the committee.

If it is adopted, participation will increase in attractiveness as the equity contribution increases—all the way to a 100-percent level of contribution. And even with these modifications, it would still cost the Federal Government less to produce low rentals under this bill than it would cost under a combined 221(d)(3)—rent supplements program.

In brief, this bill is a flexible tool; it can be molded by this committee to produce those rates of return deemed necessary to insure the construction of sufficient low rental housing.

Ninth, it is contended that the tax abatement provisions will be of little value in States whose constitutions require uniformity of property taxation or limit the extent of any possible abatement. To meet this objection, I have prepared an amendment providing that in States where an outright abatement is impossible, lower taxes can be achieved by direct subsidy to the project owner, either from both the Federal and State governments or from the Federal Government alone.

Tenth, it is argued that S. 2100 fails to avoid the relocation problems which urban renewal caused. It is said that each effort at new construction or rehabilitation will lead to massive resettlement problems for the community's residents. I disagree. The bill requires the com-

munity to be consulted on project location. With the help of local groups, the rebuilding process can take place efficiently and without undue displacement. The densities of most slum areas are not so great as to preclude staggered construction, and the technology of private enterprise is not so backward that temporary housing cannot be made available for those whose dwelling units must be renovated.

Mr. Chairman, S. 2100 is in a sense a modest proposal. For no claim is made that it will by itself revitalize the ghetto. It offers no magic formula to thrust open all the doors that keep the poor from sharing in the affluent society.

It is a limited proposal—a new mechanism to induce private enterprise to play a major role in rebuilding our cities. It is a proposal which, along with its companion bill, S. 2088, is designed to meet the most pressing problems of America's poor—substandard housing and staggering unemployment rates.

And in this regard, Mr. Chairman, let me turn briefly to S. 2088, which, although not the subject of these hearings, is also before the committee.

S. 2088, which Senator Pearson and I introduced, and which has rereceived bipartisan support in both Houses of Congress, seeks to encourage private enterprise to create new job opportunities for unemployed and low-income persons. It is a bill designed to deal with an unemployment problem that is getting more serious by the day. As the Department of Labor states in its 1967 manpower report, "Economic and social conditions are getting worse, not better in slum areas."

At this time, I would like only to offer two amendments to S. 2088 for the consideration of this committee.

First, after a good deal of study, I have concluded that the most economically disadvantaged rural counties should be included in the proposal. Therefore, I would suggest that we permit the Secretary of Commerce to designate a number of rural counties, equal in number to those cities in which qualifying urban poverty areas are located, and to determine how many jobs are needed in each county. These counties should be selected on the basis of such criteria as per capita income, outmigration, rate of unemployment and underemployment and current economic development as well as potential for growth as an industrial or commercial area. To insure that a disproportionate number of these rural poverty areas are not selected in two or three States, I would also add a ceiling on the number which can be designated in any particular State. In certifying a particular plant or facility, the Secretary of Commerce would also have to determine if the area needed such a facility and if the plant would create a sufficient number of jobs to justify the incentives granted. But to maintain at least some inducement for industry to locate in our cities, I would limit the tax incentives for firms locating in these rural areas to credits and increased depreciation deductions. The excess salary deductions—which are clearly a risk equalize—should apply only to those plants establishing facilities in urban poverty areas. I believe these incentives will encourage investment in economically disadvantaged rural areas without producing a continued flight of industry from our large cities.

Second, I would suggest a reduction in the number of jobs which must be created at any qualifying industrial facility from 50 to 20.

The lower figure would still protect against operations whose impact on the unemployment problem is too small to justify the benefits granted. But it will significantly increase the number of firms which might qualify under the act, and will produce more substantial results in both urban and rural poverty areas.

Mr. Chairman, the time has come when Congress must decide whether it wishes to involve private enterprise in the struggle to remove the blight of poverty from the face of our Nation.

We must take the necessary steps—now—to induce potential investors to place surplus funds in poverty area enterprises. That it will take Federal encouragement in the form of tax incentives and subsidies should be no deterrent.

For as a great American poet once told us:

> New times demand new measures * * *; the world advances and in time outgrows the laws that in our fathers' day were best.

Mr. Chairman, I request that my full statement be made a part of the record and that the various amendments which I suggested to S. 2088 and S. 2100 along with a cost analysis of S. 2100 be made a part of the hearing record. (See below.)

Finally, I ask permission to include in the record certain statements and letters I have received from municipal officials, business executives, and civic leaders. (See appendix.)

Senator SMATHERS (presiding). Without objection, all of that will be made a part of the record.

PREPARED STATEMENT OF SENATOR ROBERT F. KENNEDY

Mr. Chairman and Members of the Committee, I very much appreciate the opportunity to testify before this Committee as its first witness on S. 2100. This Committee's jurisdiction gives it an expertise as broad as the range of problems faced by this Nation. In the course of its work on the Internal Revenue Code it has dealt with literally hundreds of widely varying questions of social policy. It has decided that tax incentives were appropriate and necessary to encourage such diverse activities as the construction of grain facilities, the purchase of heavy machinery, the development of rural farm lands, and the growth of Puerto Rico.

S. 2100 would have this Committee make a similar decision about low-income housing—a decision which the Committee's experience has justly qualified it to make. For the Committee's work on social security and welfare has brought it in direct contact with the problem of the poor. Moreover, it has considered housing and other construction problems several times within recent years. For example, its decision to grant accelerated depreciation for construction has helped maintain a booming investment market for office buildings and high and middle-income housing units. Now this Committee has an opportunity to enlarge that market. S. 2100 would stimulate investment in low-income housing within the poverty areas of our major cities. Its companion, S. 2088, would encourage industrial development in the same areas.

This has been the fourth summer of widespread and serious civil disorder in the great urban centers of our country. It is the fourth summer in which the frustration and anger born out of povety and nurtured on lack of opportunity have shattered the peace and tranquility of our society. And in this fourth summer, we have seen the most serious upheavals, the most widespread looting, and the most vicious and senseless acts of violence.

Today, the easy temptation—the tendency of all too many—is to think that force and troops, firearms, and tear gas are the answer to strife between Americans. For too many, the simple course of ordering obedience to law and of prohibiting riots is the solution to the crisis of our cities.

But force and violence and prohibitive decrees cannot and must not be our only responses to the tragic problems before us. Punishment is not prevention;

denunciation will not provide opportunity. If we are not again to reap violence and disorder—if we are to overcome the demagogues who preach hate and destruction—then we must renew our efforts to end the grinding poverty that breeds first fury and frustration—and then riots and recrimination.

We must bring light to this dark world which the poor now inhabit. For the child, for the unemployed young men, for all those who live in the urban ghetto, we must make life something more than continuing frustration and degradation.

It is no longer enough to point to a landmark Elementary and Secondary Education Act when we know that 7 out of 10 children in poverty areas will not graduate from high school—and that if they do, there is no better than an even chance they will have acquired the equivalent of an 8th grade education.

It will not suffice to point to the achievements of Medicare and Medicaid when we know that in our urban ghettoes infant mortality rates are twice the national average, and mental retardation is seven times the community average.

We can take little pride in 30 years of low-income housing programs when our statistics show that 43 percent of all housing in the inner city is substandard, unhealthy and dilapidated.

Most important, we cannot rest on a record which lists the Manpower Development and Training Act, the Area Redevelopment Act, the Economic Development Act and the Economic Opportunity Act when we know that unemployment remains the curse of the poor. There can be little sense of accomplishment when we realize that in a typical big-city poverty area, only about 45% of the adult men have full-time employment which pays more than $60 a week. A bare majority of these men have full time work at any rate of pay. Less than three out of five have any work at all. The fact is that the people of the ghetto live today with an unemployment rate far worse than the rest of the nation knew during the Great Depression.

The time has come when we must begin a meaningful dialogue between the two Americas—a diologue between honest men which will inevitably reveal the misery and degradation of the one and liberate the fundamental decency of the other. This dialogue will require more than words and more than sentiments of brotherhood. We must demonstrate good faith with swift and forceful action.

But if these efforts are to be meaningful, if they are to have significance, then they can no longer be limited to programs which are run by the Federal government and financed by direct appropriations, programs which are run out of Washington and implemented by government agencies. For even the strongest advocate of increased Federal efforts in education, health, and housing—and I number myself in these ranks—must admit that they are not enough.

To rely exclusively, even primarily, on Government efforts is to ignore private enterprise, the shaping force in American life and politics. Private industry has built our cities and industries, it has created jobs for over 60 million Americans now at work. But it has not yet rebuilt the centers of poverty, nor put their people to work for there has been no adequate inducement to do so.

Now we must find the right mechanism for involving private enterprise in this great remaining task. We must find the key to unlocking the initiative and resources of the private sector—the key to making it profitable for investors to put their funds to work in this Nation's poverty areas.

The Bill (S. 2100) that Senator Smathers and I introduced, in which we were joined by Senators Pearson and Ribicoff, provides such a mechanism. It is designed to encourage a partnership of private enterprise and government in one area of need—in the swift and efficient production of low-income housing. It establishes a new approach to lowering the cost of housing, while providing reasonable and competitive profits on investment—primarily through a system of tax incentives.

Before turning to a description of S. 2100's provisions, let me stress that this bill—and its companion measure S. 2088—offers only one type of mechanism for permitting private enterprise to attack the problems of our urban ghettoes. Certainly there are other ways—some of which may be equally as effective—for achieving the objective we seek.

But the hour is late for our urban centers; the time for extended studies and drawn-out hearings has passed. As Professor George Sternlieb has written: "The gap between the norm and the typical living conditions of poor urbanites is perhaps wider today than it was twenty years ago." In my judgment, unless some other cohesive and workable proposal appears more feasible we should utilize

the tax incentive approach which is incorporated in these measures. For, in the field of housing, S. 2100 offers an infinitely expandable mechanism, with minimal costs, to create the low-income dwelling units so badly needed in the major cities of this nation.

This bill has eleven basic features. I have developed a number of amendments to it since it was introduced, and I will describe many of those as well.

First. The bill encompasses not only the building of new units, but encourages the rehabilitation of existing structures.

Second. Cities will have primary control over their programs; satisfactory consultation must be had with city officials—as well as local residents—before a certificate can be obtained from the Department of Housing and Urban Development. Under this procedure, the city can determine the order and pace of reconstruction for its poverty areas, and deal with resettlement in an orderly fashion.

Third. The benefits of the bill are limited to the construction of low-income housing within urban poverty areas, demarcated on maps prepared by the Bureau of the Census for the Office of Economic Opportunity.

Fourth. The bill establishes a new Low-Income Housing Administration within the Department of Housing and Urban Development. Assignment of this program to the Federal Housing Administration would be neither appropriate nor effective. FHA's primary interest is in the construction of single-family homes for middle-income families. But the personnel and procedures developed to deal with the suburbs are not well suited to the rapid processing of applications for the construction of multiple-dwelling units for low-income families.

Fifth. An applicant receiving local approval and certification from HUD can obtain mortgage insurance for a loan of up to 80 percent of the project's cost, to be amortized over a period of 50 years at a 2 percent rate of interest. In return for receiving the low-interest loan and other benefits, the applicant must agree to meet basic standards of design, construction, and maintenance, and to build or rehabilitate at least 100 units whose rentals will be determined by the Department of Housing and Urban Development. The investing entity must also agree to accept a direct base return on his equity of approximately 3 percent. Finally, it must rent to low-income persons, and continue as owner of the project for a minimum period of ten years.

Sixth. In order to induce groups of individuals and corporations to pool their resources for the rebuilding of urban poverty areas, the bill amends Subchapter S of the Internal Revenue Code. Under the amendments, corporations having individual or corporate shareholders can be formed to construct low-income housing projects and treat the income thus derived as though they were partnerships. These corporations can then pass the rental income received and the tax losses through to their shareholders without an intervening corporate income tax.

Seventh. The bill provides for adequate payments to aid the resettlement of all those persons or businesses forced to move due to the construction or rehabilitation of low-income housing.

Eighth. The bill creates a Home Management Fund and provides for the formation of Home Management Corporations. The Fund, with an initial appropriation of $5 million, will supply financial assistance and expertise for organizing the buildings' tenants into management corporations. These bodies will then work with the project's owners, performing management and maintenance functions within the buildings for appropriate fees.

It is expected that the role of the management corporation in the project itself will grow from maintenance assistance to ownership. The bill therefore provides inducements for the owner to sell the building to his tenants. Thus the management corporations can provide a gradual transition from ordinary renting to cooperative or condominium ownership, avoiding at the outset the complex and difficult legal and financial problems of ownership of multiple dwellings.

Ninth. The bill provides for the establishment of a Property Tax Abatement Fund whose ultimate effect will be to lower tenant rentals in projects built under this program.

Tenth. The bill establishes an integrated system of tax and other incentives designed to encourage individuals and corporations to invest in the contruction of certified low-income housing projects. The initial owner of the project would receive a tax credit scaled to his equity investment, from a 3 percent credit for an investment of 20 percent, to what I now propose should be a 30 percent credit against a 100 percent equity investment. The credit is taken on the entire cost of the project.

The initial owner is also afforded accelerated depreciation on a sliding scale depending on the amount of his equity investment. With a 20 percent equity investment, the owner can depreciate the project over a period of 20 years. With a 100 percent equity investment, the progressive scale that I am now proposing would permit a 7-year depreciation period. Included within the depreciable base—not capitalized as land costs—are all demolition and site improvement costs. In depreciating the project, the initial owner need not make an allowance for the project's salvage value.

The initial owner is assigned a minimum and a maximum required holding period. The minimum period for all initial owners is equal to 10 years or the assigned depreciation period, whichever is less, and a sale before the end of that period—except to a home management corporation—leads to a return of all tax benefits to the Government. A sale to the tenants is completely tax free if it is made after the owner has held the project for at least two years. If the sale to a private buyer occurs after the minimum period, the owner can either pay a limited capital gains tax on his profits, the owner can either pay a limited capital gains tax on his profits, or reinvest the cash proceeds—free of tax—in another low-income housing project. If he builds more low-income housing, then no taxable gain is recognized on any of the reinvested sale proceeds—just as an individual taxpayer, who sells his house to buy another, need not recognize any gain on the sale of his first house. If he does not reinvest the proceeds, he pays a capital gains tax only on a portion of his profit. In effect the builder is relieved of capital gains payments on the difference between his proceeds and the remaining mortgage, which is calculated as if he has an initial mortgage of 80 percent of the total cost.

The maximum required holding period is also scaled to benefit the high equity investor. The maximum required holding period is equal to the useful life of the project for depreciation purposes; approximately 20 years for the owner with 20 percent in equity, 7 years for the 100 percent equity investor. The latter figure is new, and is provided in one of the amendments I have developed. If at the end of the maximum required holding period, an owner decides to continue operating the building, he is given a restored basis and permitted to redepreciate the building as if he had purchased it from himself. In most cases., stability of ownership is desirable and this bill takes relevant steps to encourage that stability.

All subsequent buyers—other than the tenants home management corporation—are granted credits and accelerated depreciation periods; they are also assigned maximum and minimum required holding periods.

Finally, an insurance fund with an initial appropriation of $10 million is established. The fund, while charging a reasonable premium from all participating owners, guarantees that if in any year, the direct return on an investment in a project falls from the permitted 3 percent below 0 percent, there will be a reimbursement for cash losses.

In the two months that have passed since this bill and its companion measure to encourage the construction of industrial and commercial facilities were introduced, I have solicited the views of mayors, businessmen and community leaders. I have received comments and recommendations from hundreds of interested Americans. And, of course, these bills have had the benefit of careful and painstaking scrutiny from many competent men within various departments and agencies which comprise our Federal Government. From these analyses I have compiled a list of the most substantial suggestions and criticisms: all have been weighed carefully; some have been adopted and I am now prepared to offer them as amendments; the remainder, I have attempted to answer to my own satisfaction and I hope to the satisfaction of this Committee.

Let me turn now to those suggestions which concern the Urban Housing Development Act, since that is the proopsal which is before te Committee today.

First, it is argued that the housing units which will be produced under this bill will bar rental charges that are too high to justify the incentives granted.

In my testimony before the Banking and Currency Committee a few weeks ago, I referred to a range of $73 to $99 a month as typical rents for units built under this proposal. It is contended that these rents are too high for most of those who live in our urban poverty areas. But let us remember that they are from $25 to $50 a month less costly than the rents charged for comparable units—similar in size and construction cost—built under the major program that we now have for moderate-income housing—221(d)(3).

Moreover, the rents which I mentioned when I introduced this bill are not statutorily fixed charges. When I cited these possible rentals I was relating them to housing units costing anywhere from $10,000 to $15,000 to construct and carrying monthly maintenance costs of from $40 to $50. It is clear that in some large cities, dwelling units can be successfully rehabilitated for only $6500 or $7500; in these and in other cities, maintenance charges may be to only $20 or $25 a month. Under these circumstances, housing units may rent not for $70 or $80 but for only $45 to $50 a month.

Finally, as Secretary Weaver and many other urban scholars have told this Congress time and again, hundreds of thousands of urban poverty area residents are currently paying rentals of $100 and $110 a month for tiny dilapidated and deteriorating housing units. These are the millions of Americans who cannot qualify for public housing, but who earn too little to compete for decent living facilities on the open market. It is these people who must now be aided in their efforts to obtain safe, clean, well-constructed housing, in which they and their children can live comfortably with a sense of pride and self-respect. These people can benefit from S. 2100. They deserve assistance from Congress in their endeavors to find the "adequate shelter" which has been promised them for over three decades but which has been so long in coming.

Second, it is argued that the price which the taxpayers must pay to get private enterprise to build low rent housing units under this program is too high. Moreover, it is contended that the existing 221(d)(3) below market interest rate and rent supplement programs offer sufficiently high rates of return to interest private investors in the housing business. After careful comparative cost analyses—which I shall submit to this Committee with my testimony—I have reached the conclusion that it would be far less expensive to produce low rent dwelling units under S. 2100 than under a 221(d)(3) program even with an added rent supplement. The cost to the taxpayer of a typical housing project built through 2 percent financing over 50 years under a coordinated system of tax incentives may be anywhere from $300,000 to over $1,000,000 less during its lifetime than a comparable project built under existing programs. Moreover. yields to the investor will be on the average of 5 to 10 percent higher under this bill than under 221(d)(3) with an added rent supplement. Consequently it will attract many of the investors who have traditionally avoided low-income Federal housing programs.

Finally, this bill does not have the disadvantages that would be involved in a large-scale extension of rent supplements. For this proposal is not a welfare approach: it avoids requiring low and moderate income people to rely on receiving government help every month. It avoids requiring the poor to live in housing units they cannot afford. It avoids requiring landlords to rely on a monthly government subsidy. And it avoids forcing the Federal Government into a complicated and burdensome process of matching tenants and landlords.

Rather, S. 2100 is an effort to reduce rents to levels which the poor can afford to pay. At the same time it offers substantial profits to investors through a mechanism traditional in the real estate business—a mechanism which permits the investor, not the Federal government, to estimate yields and tax savings and to determine whether the investment is sound. No new bureaucracy need be set up at the Federal level; no major new appropriations must be obtained from the Congress; no new forms and records must be submitted by private investors. The program is virtually self-regulating once it has been put into effect. It is simple; it is clear; and it is understandable to all those who will participate in it.

Third, it is argued that inducing private enterprise to invest in urban poverty areas is not an appropriate use of the Internal Revenue Code. It is said that if this social purpose is sought through the mechanism of tax incentives, the Code will be opened up to other exceptions until its primary function—raising revenue—is dissipated.

In general, I have supported the proposition that the Internal Revenue Code should strive for a uniform tax base and not offer a number of exceptions and tax-saving gimmicks. Preferential tax incentives should not be lightly given. Nevertheless, I think we all must admit that from its inception, the Code has been employed to attain worthwhile—and in some cases not so worthwhile ends.

Now—in 1967—it is no simple matter to determine whether the Code should be used for a new non-revenue raising purpose. Nevertheless, there are some criteria that can help decide whether any particular suggested departure from a uniform tax base is justified.

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Does it, as President Kennedy asked when he submitted the original investment credit proposal, "promote desirable social or economic objectives of overriding importance?"

Does it in fact compensate investors for additional risks and burdens rather than create a special privileged group?

Is it the simplest, most efficient means for attaining the desired goal?

In my judgment, tax incentives to induce housing construction—and industrial development as well—in urban poverty areas meet all of these criteria. Certainly they will promote "a desirable objective of overriding importance"—the rebuilding of our urban ghettoes and the employment of our most disadvantaged citizens. They are also fair. They insure nothing more than a reasonable rate of return to those who face the higher costs and increased security problems of investing in our urban slums; they do nothing more than compensate for greater than normal risks and greater than normal expenditures of time, effort, and resources. Moreover, tax incentives are the most simple and efficient system for encouraging businessmen to under-take the necessary task of restoring our urban centers—a task they are understandably uneasy about undertaking. Such incentives can be introduced without establishing new bureaucratic and administrative procedures. They are understandable and acceptable to businessmen without being too costly. And they offer the certainty which investors need if they are to make new and risk-filled investments within our urban ghettoes.

Fourth, it is argued that even if all the incentives proposed by these bills are needed, they should not be granted in a pre-fixed package. Rather they should be parceled out in different combinations and degrees to different investors. In my judgment, this suggestion ignores not only the urgency and extent of our urban crisis, but the realities of business life and business attitudes about the Federal bureaucracy. Action—results—are needed now. We simply cannot take the time that would be involved in dealing with each investor as an individual case. We do not have the time to match every need with differing incentives. Our urban problems are too massive to be met by a narrow, circumscribed program. Unemployment rates of up to 40 percent and housing shortages in the millions will not be solved by a cumbersome process which carefully tailors its subsidies to satisfy each applicant's individual situation. Moreover, our business leaders have never shown great interest in any program which necessitates constant conferences with, and observation by, Federal officials. They are far more attracted by a broad program which carefully lays out the rules of the game but not every specific play by the participants.

Fifth, it is argued that by building in the ghetto, we lock its residents in and turn our backs on the goal of integration. But open occupancy is not inconsistent with ghetto rehabilitation. For open occupancy laws are not enough. An escape hatch for those who both want to and can afford to move away from the ghetto is desirable. But what about those who either want to and have to stay where they are? What about those who would build their own community, those who would take pride in their own neighborhoods if they could?

Integration is a vital, an indispensable goal in an open society. But equally important, the vast majority of Negroes must be enabled to achieve basic financial and social security where they live now. Indeed, a new generation of Negroes is striving to establish a sense of community as a people, to gain a measure of control over their own destiny as a people. Sensitivity to that aspiration is at the heart of S. 2100. And it is in no way inconsistent with a total commitment to an open society.

Our urban centers are ever more crowded, ever more segregated, ever more dangerous. We must come to grips with this overwhelming blight. We must rebuild these areas because that is what their residents need most. As the John F. Kraft organization found in its extensive survey of New York City's Harlem area; "There is one overriding problem—and it is housing. Eighty-four percent of those interviewed strongly endorsed a rebuilding program"—as compared to the 6 percent who were concerned over the issue of integration. And they are right.

For a truly open society depends in the long run on the achievement of full comparability of housing and full employment. Today's suburbs, after all, house the children and grandchildren of those whose confinement in the inner city ended only when they began earning enough to afford to move. Only when our center cities have been revitalized and made attractive to all, and when em-

ployment opportunities are truly equal, will we have a society where each man has the opportunity to choose whom he will call neighbor—a society in which open occupancy laws, have meaning for all.

Sixth, it is argued that the bill places too much emphasis on rental housing and does not offer sufficient possibilities for tenant ownership. I believe there is some merit in this contention. I have developed an amendment to meet this objection; but I would stress to the Committee at the same time that undue reliance should not be placed on home ownership as a panacea for all the problems of the slum. Certainly, it does help provide a new sense of pride and participation in the community. But it is not an answer for the young man who lacks a decent job or a real education, or the opportunity to promise his children a better life. And most important, home ownership is difficult in our large cities where people usually live in multiple dwellings. Mortgages with joint liability, common responsibility for common living areas, ownership by-laws, and the imposition of liens on non-paying occupants are complex and troublesome matters. Defaults, foreclosures, and losses if equity investment can be overwhelming crises for the residents of urban poverty areas who were once convinced of the value of home ownership.

Nevertheless, I think home ownership should be encouraged where it is feasible. I therefore propose that S. 2100 be amended to permit a private investor to sell the project to his tenants at the end of only two years with the approval of the Secretary of Housing and Urban Development. Included in this provision is a financing mechanism to encourage such sales.

The minimum two-year period is to allow the tenants to form a stable residents' organization and carefully decide if they want to assume ownership of the project. At the same time, a relatively short mandatory holding period has benefits both for the Federal Government and for the private investor. The more rapid the transfer to tenant ownership, the smaller the revenue loss. And because of the way depreciation works the swifter the sale, the higher the profit margin is to the private owner. In short, a minimum holding period with a prescribed selling procedure may prove the most feasible possibility for transforming rental housing into home ownership in our major cities.

Seventh, somewhat inconsistent with the home ownership argument, it is argued that potential investors under the bill will be deterred because it requires them to deal with their tenants through home management corporations. But why in fact should a tenant organization disturb a private owner? As we are now beginning to learn, one of the most successful ways to avoid misunderstandings between landlord and tenants is to encourage tenant participation in the day-to-day operations of the building. As the National Association of Housing and Redevelopment Officials has noted in discussing public housing: "It seems doubtful that housing for low-income families can be kept in decent condition without the closest cooperation and participation of the tenants . . . Leadership (should) come from the joint efforts of the manager and tenants." Moreover, since the landlord will benefit if the tenants purchase the project after a short period of time, it is to his advantage to help develop a management corporation and to stimulate the tenants' interest in buying the project.

Eighth, it is argued that the equity investment requirements are too high. It is also said that since progressivity of profits exists only up to 50 percent equity level, no businessmen will make a capital contribution above that percentage. As to the first contention: it would be extremely easy for this Committee to modify S. 2100 and allow a lower minimum equity or, for that matter, establish a fixed equity ratio in place of a sliding scale. But I believe neither of these changes should be made. If Congress is to offer substantial profits to those who would invest in low and moderate income housing, then it should require higher than normal equity investments. And if this Congress—like any wartime Congress—is to work from the premise that only a limited pool of Federal mortgage money can be made available, then it should provide for scaled capital investment as a means for stretching our immediately available dollars a little bit further.

As for the second contention, if it is the desire of Congress to achieve a profits scale that is progressive up to the 100 percent equity level, the result is relatively simple to attain. One of the amendments I have prepared would raise the maximum initial credit to 30 percent, reduces the minimum depreciation period to 7 years, and alter the capital gains recovery provisions. If this amendment is adopted, participation will increase in attractiveness as the equity contribution

increases—all the way to a 100 percent level of contribution. And even with these modifications, it would still cost the Federal government less to produce low rentals under this bill than it would cost under a combined 221(d)(3) rent supplements program. In brief, this bill is a flexible tool; it can be molded by this Committee to produce those rates of return deemed necessary to ensure the construction of sufficient low rental housing.

Ninth, it is contended that the tax abatement provisions will be of little value in States whose Constitutions require uniformity of property taxation or limit the extent of any possible abatement. To meet this objection, I have prepared an amendment providing that in States where an outright abatement is impossible, lower taxes can be achieved by direct subsidy to the project owner, either from both the Federal and State Governments or from the Federal Government alone.

Tenth, it is argued that S. 2100 fails to avoid the relocation problems which urban renewal caused. It is said that each effort at new construction or rehabilitation will lead to massive resettlement problems for the community's residents. I disagree. The bill requires the community to be consulted on project location. With the help of local groups, the rebuilding process can take place efficiently and without undue displacement. The densities of most slum areas are not so great as to preclude staggered construction, and the technology of private enterprise is not so backward that temporary housing cannot be made available for those whose dwelling units must be renovated.

Mr. Chairman, S. 2100 is in a sense a modest proposal. For no claim is made that it will by itself revitalize the ghetto. It offers no magic formula to thrust open all the doors that keep the poor from sharing in the affluent society. It is a limited proposal—a new mechanism to induce private enterprise to play a major role in rebuilding our cities. It is a proposal which, along with its companion bill, S. 2088, is designed to meet the most pressing problems of America's poor—substandard housing and staggering unemployment rates.

And in this regard, Mr. Chairman, let me turn briefly to S. 2088, which, although not the subject of these hearings, is also before the Committee. S. 2088, which Senator Pearson and I introduced, and which has received bipartisan support in both Houses of Congress, seeks to encourage private enterprise to create new job opportunities for unemployed and low-income persons. It is a bill designed to deal with an unemployment problem that is getting more serious by the day.

As the Department of Labor states in its 1967 Manpower report, "Economic and social conditions are getting worse, not better in slum areas."

At this time, I would like only to offer two amendments to S. 2088 for the consideration of this Committee.

First, after a good deal of study, I have concluded that the most economically disadvantaged rural counties should be included in the proposal. Therefore, I would suggest that we permit the Secretary of Commerce to designate a number of rural counties, equal in number to those cities in which qualifying urban poverty areas are located, and to determine how many jobs are needed in each county. These counties should be selected on the basis of such criteria as per capita income, out-migration, rate of unemployment and under-employment and current economic development as well as potential for growth as an industrial or commercial area. To ensure that a disproportionate number of these rural poverty areas are not selected in two or three States, I would also add a ceiling on the number which can be designated in any particular State. In certifying a particular plant or facility, the Secretary of Commerce would also have to determine if the area needed such a facility and if the plant would create a sufficient number of jobs to justify the incentives granted.

I believe these incentives will encourage investment in economically disadvantaged rural areas without producing a continued flight of industry from our large cities.

Second, I would suggest a reduction in the number of jobs which must be created at any qualifying industrial facility from fifty to twenty. The lower figure would still protect against operations whose impact on the unemployment problem is too small to justify the benefits granted. But it will substantially increase the number of firms which might qualify under the Act, and will produce more substantial results in both urban and rural poverty areas.

Mr. Chairman, the time has come when Congress must decide whether it wishes significantly to involve private enterprise in the struggle to remove the

blight of poverty from the face of our nation. We must take the necessary steps—now—to induce potential investors to place surplus funds in poverty area enterprises. That it will take Federal encouragement in the form of tax incentives and subsidies should be no deterrent. For as a great American poet once told us: "New times demand new measures . . .; the world advances and in time outgrows the laws that in our fathers' day were best."

SUGGESTED AMENDMENT TO S. 2100

Page 3, lines 4, 7 & 19, add (d) after 235

Page 3, line 23, or more certified projects in an urban poverty area, and of which such residents are the sole members for the

Page 4, line 15, add (d) after 235

Page 5, Sec. 101(a)(1) should now read, (1) the governing body of the city in which the project is to be primarily located and which, under local law, has the primary authority to act in regard to the construction or substantial rehabilitation of such project, has given written notice to the Secretary that it wishes to participate in the program authorized by this Act;

Page 5, add a new Sec. 101(a)(2)

(2) the city and when necessary, the State in which the project is to be located, have

(A) given written assurances, deemed satisfactory to the Secretary, that the aggregate of State and city real estate taxes and assessments levied against any project, during any year in the certified operation period (less any direct subsidies given by the State and city to the project, including but not limited to any reductions in land cost) will not exceed 5 percentum of the occupancy charges of the project during such period; or

(B) submitted a written opinion of the highest legal officer of the State that the furnishing of such assurances is barred, or barred to the extent not furnished, by a provision in the Constitution of such State in force on July 13, 1967;

(succeeding numbers (2) through (6) become (3) through (7)

Page7, line 5, delete the word "first"

Page 7, line 7, expiration of two years of the applicant's minimum holding period. Such option shall be exercised only upon the affirmative vote of two-thirds of the members of the home management corporation and, during the first seven years of such corporation's existence shall require the approval of the Secretary. The Secretary shall, in cases where his approval for an exercise of such option is required, grant such approval only if the home management corporation demonstrates to his satisfaction that it is capable of managing the building on an efficient and financially sound basis. Such option shall be a right to purchase the project for a price equal to the excess of:

(i) the aggregate qualified expenditures (as defined in section 1391(9) of the Internal Revenue Code) of the first holder thereof (as defined in section 1391 (10) of the Internal Revenue Code) over

(ii) the aggregate amount of depreciation deductions that would have been allowable to such holder under section 167 of the Internal Revenue Code if he had held the project through the date of exercise of the option and depreciation deductions were computed under the straight line method of depreciation over a useful life of 50 years. A purchase pursuant to any such aption shall be subject to such other terms and conditions as may be specified by the Secretary; (continue with line 14, number (5)

Page 8, line 16 ments of subsection (a)(5).

Page 8, line 22, (a)(5) or (b)(2).

Page 9, line 11 (A) the provisions of subsection (a) (5),

Page 10, line 15, take-out the comma after "project"

Page 10, line 16, add a comma after the word "produce"

Page 10, add a new paragraph (2) following line 23 (2) The gross occupancy charges for a certified project held by a home management corporation may include any additional amount needed to cover the payments on any mortgage placed on such project by the home management corporation to finance the purchase of such project: *Provided,* That such charges will not be increased to a level in excess of 105% of that otherwise permissible under paragraph (1).

Page 10, line 24, Paragraph (2) becomes (3)

Page 11, line 11, ments set forth in section 101(a)(5).

Page 13, line 3, than 18 per centum of the average annual adjusted gross income

Page 13, line 5, of such individual or the adults in such family taken in the aggregate, over a period to be specified by the Secretary: *Provided,* That the Secre-

Page 13, lines 14 through 24,
his or its income: Provided, That if, the annual occupancy charge for the dwelling unit occupied by the individual or family is less than 15 per centum of such individual's average annual adjusted gross income, or the aggregate average adjusted gross income of the adults in such family, in such period as may be specified by the Secretary, such individual or family shall prospectively be required to pay to the holder of the project, an annual occupancy charge equal to 18 per centum of the average adjusted gross income of such individual, or the aggregate average adjusted gross income of the adults of such family, in such period as the Secretary specified. Any

Page 14, line 7,
file such copies of income tax returns or other income statements from time to time as he may deem

Page 14, line 12,
of section 101 (a) (6), an adequate relocation program exists

Page 14, line 22 through line 25,
(2) As part of the program, a local
(continue with page 15)

Page 15, line 2,
situated may receive training and compensation, in ac-

Page 16, lines 9 and 10,
percentum of the average adjusted gross income of such individual or the average aggregate adjusted gross income of the adults in such family, over a period to be specified by the Secretary, equals the average

Page 17, line 5,
vate business concern with average annual taxable income, over a period to be specified by the Secretary,

Page 17, line 7,
is not part of a larger enterprise (as defined under regulations to be prescribed by the Secretary) having establish-

Page 17, line 24,
contracts to make, and to make, annual grants to States and cities par-

Page 18, line 3, substitute new paragraph (1) and (2) and add new subsections (b), (c), and (d)

(1) to a State or city, 50 per centum of the amount by which the real estate tax revenues and assessments received or receivable by such State or city in any taxable year were reduced by reason of assurances granted under section 101 (a) (2), plus

(2) to a city, an amount equal to any contribution paid or payable to such city by a State to defray any part of the reduction of tax revenues incurred or incurrable by such city during such year as the result of such assurances: Provided, That in no case shall the amount payable under this paragraph exceed 25 per centum of the amount by which the tax revenues receivable by any such city during any year were reduced by reason of such assurances.

(b) In any case in which assurances under section 101 (a) (2) were not furnished, or were furnished only in part, the Secretary is authorized to enter into contracts to make, and to make, annual grants to the holder of a certified project in such city equal to fifty per centum of the excess of—

(1) the amount of State and city real estate taxes and assessments paid or payable by such holder for each year, after subtracting any reductions in such taxes as a result of any assurances, over

(2) 5 per centum of the occupancy charges for such year.

(c) For purposes of subsections (a) and (b), a reduction in tax revenues shall include any subsidies given by a State or city to, or for, a certified project for the purpose of reducing the local real estate tax assessments pursuant to assurances granted under section 101 (a) (2).

(d) No payments shall be made under subsections (a) or (b) with respect to State or city real estate taxes and assessments which constitute a higher percentage of the occupancy charges of a certified project than the percentage which such taxes and assessments bear to the gross rental income of conventional apartment houses in the same city.

Page 18, line 17, (b) becomes (e)

Page 19, line 2,
the Secretary from receipts under section 104 (a).
Page 19, line 2,
forms of constitutions for home management corporations and of model forms of management agreements which may be entered into
Page 20, after line 3, add new Sec. 108

OWNERSHIP SUBSIDY FOR HOME MANAGEMENT CORPORATIONS

Sec. 108 (a) A home management corporation which, pursuant to section 101 (a)(5)(G) has exercised its option to purchase a certified project shall be entitled to receive as a subsidy, for each of its fiscal years ending after the exercise of such option, but within the certified operation period, the amount needed to meet the payments on any mortgage placed on such project by such corporation to finance the purchase of such project, but only to the extent such amount cannot be obtained by such corporation through gross occupancy charges because of the limitation on such charges provided in section 102(a)(2).

(b) For purposes of this section, there is hereby created a Home Management Purchase Fund, and there is authorized to be appropriated (1) the sum of $5,000,000 to provide initial capital for such fund, and (2) such additional sums as may from time to time be required to make all necessary subsidy payments to home management corporations pursuant to subsection (a). Any sum so appropriated shall remain available until expended.

Page 20, line 5 and line 10, Sec. 108 and Sec. 109 become Sec. 109 and Sec. 110
Page 20, line 23,
income and lower middle income persons, and to assist home management corporations to purchase housing, in furtherance of
Page 21, line 2, take out the comma after the word "mortgagee"
Page 21, lines 4 through 8,
ing construction) which meets the requirements of subsection (d) or (e) of this section, and which is otherwise eligible for insurance as herein provided; and (2) upon such terms and conditions as the
Page 21, line 16 and line 17,
"(d) A mortgage shall be eligible for insurance under this section if it shall—
Page 21, lines 18 through 20, add new "(1),
have been executed by a mortgagor to whom has been issued, under section 101 (a) of the Urban Housing Development Act of 1967, an unrevoked certificate of eligibility;
(succeeding numbers "(1) through "(5) become "(2) through "(6)
Page 22, line 9, after the word "mortgagor" add "but which could have been capitalized by the mortgagor"
Page 23, lines 6 and 7,
payments, upon such terms as the Secretary may prescribe, over a period of fifty years.
Page 23, after line 7, add new "(e) and "(1) through "(6).
"(e) A mortgage shall be eligible for insurance under this section if it shall—

"(1) have been executed by a home management corporation which has purchased a certified project,

"(2) have been made to, and be held by, a mortgagee approved by the Secretary as responsible and able to service the mortgage properly;

"(3) not exceed in principal amount $——;

"(4) not exceed in principal amount the excess, if any, of:

"(A) the price at which the home management corporation purchased the property, over

"(B) the sum of:

"(i) the amount of any mortgage insured under section 235(d) of the National Housing Act to which such project is subject at the time of the purchase by the home management corporation, plus

"(ii) an amount equal to the number of units in such project multiplied by $100.

"(5) bear interest (exclusive of premium charges for insurance and service charge, if any) at a rate not to exceed 6 per centum per annum on the amount of the principal obligation outstanding at any time; and contain such terms and provisions with respect to the application of the mortgagor's periodic payment to amortization of the principal of the mortgage, insurance, repairs, alterations,

payment of taxes, default reserves, delinquency charges, foreclosure proceedings, anticipation of maturity, and such other matters as the Secretary may prescribe; and

"(6) provide for complete amortization by periodic payments upon such terms as the Secretary may prescribe, over a period of fifty years less the period which has elapsed since the completion of construction or substantial rehabilitation of such project pursuant to a certificate granted under section 101 (a) of the Urban Housing Development Act of 1967.
(succeeding letters "(e), "(f), and "(g) become "(f), "(g) and "(h)

Page 26, line 5,
mitments outstanding at any one time as to mortgages subject to section 235 (d) shall not exceed

Page 25, line 11,
at any one time, after the issuance of purchases and commitments totaling at least $———, shall relate to mortgages secured by

Page 26, line 20, correct the spelling of the word "INSURED"
Page 27, line 14, change the word herewith to hereof
Page 27, line 19, add a comma after (1)
Page 28, line 5, add (d) after 235
Page 29, line 13, take out "sub" in "subsection 1250 (c))
Line 29, line 18, take out "sub" in "Subsection 1245 (a) (3)
Page 30, line 23, add (d), after section 235
Page 31, line 5, add (d) after section 235
Page 31, line 11,
property, to

Page 31, line 21, take out the comma after the word "or"
Page 32, lines 2 through 9
1391 property the lesser of (A) ten years, (B) the useful life of the section 1391 building, constitutng part of such property, as determined under section 1393 (whether or not an election with respect to such building has been made under such section), or (C) the useful life of such section 1391 building for purposes of section 167, determined without regard to section 1393.

Page 33, line 23, take out "sub" in the word "subsection"
Page 34, line 1.
fied expenditures (as defined in section 1391 (9))

Page 34, line 2,
made by the taxpayer with

Page 34, change figures in middle and right-hand columns of chart

left-hand column	(middle column)	(right-hand column)
Less than 20% none	3 percent	2 percent
	5 "	3 "
	6.5 "	4 "
	8 "	5 "
	9.5 "	6 "
	10 "	7 "
	11 "	8 "
	12 "	9 "
	14 "	10 "
	16 "	11 "
	18 "	12 "
	20 "	13 "
	22 "	15 "
	24 "	17 "
	26 "	19 "
	28 "	21 "
	30 "	23 "

Page 34, immediately following chart, add
A subsequent holder shall receive a credit under this paragraph with respect to any section 1391 property only if he acquires such property within 40 years after the completion of construction or substantial rehabilitation of a section 1391 building thereon.

Page 39, line 5, take out "sub" in the word "subsection"
Page 39, line 9, take out "sub" in the word "subsection"
Page 38, line 15,
for purposes of section 167, shall be

Page 39, line 3 and chart "(b)" Useful Life.—(1) For purposes of subsection (a)—

"If the taxpayer's equity investment percentage (as defined in sec. 1391(6)) is—	If the taxpayer is the 1st holder (as defined in sec. 1391(10)) with respect to the sec. 1391 building, the useful life of the building shall be the following percentage of its useful life as determined under par. (2)—	If the taxpayer is a subsequent holder (as defined in sec. 1391(11)) with respect to the sec. 1391 building, the useful life of the building shall be the following percentage of its useful life as determined under par. (2), but in no case less than 10 years—
(1)	(2)	(3)
Less than 10 percent	None	75 percent.
10 percent or more but less than 20 percent	None	55 percent.
20 percent or more but less than 25 percent	40 percent	40 percent.
25 percent or more but less than 30 percent	36 percent	39 percent.
30 percent or more but less than 35 percent	32 percent	38 percent.
35 percent or more but less than 40 percent	28 percent	37 percent.
40 percent or more but less than 45 percent	25 percent	36 percent.
45 percent or more but less than 50 percent	22 percent	35 percent.
50 percent or more but less than 55 percent	20 percent	34 percent.
55 percent or more but less than 60 percent	19 percent	33 percent.
60 percent or more but less than 65 percent	18 percent	32 percent.
65 percent or more but less than 70 percent	17.5 percent	31 percent.
70 percent or more but less than 75 percent	17 percent	30 percent.
75 percent or more but less than 80 percent	16.5 percent	29 percent.
80 percent or more but less than 85 percent	16 percent	28 percent.
85 percent or more but less than 90 percent	15.5 percent	27 percent.
90 percent or more but less than 95 percent	15 percent	26 percent.
95 percent or more but less than 100 percent	14.5 percent	25 percent.
100 percent	14 percent	24 percent.

Page 39, following chart, "(2) For purposes of applying the percentages set forth in paragraph (1), the useful life of a section 1391 building shall be—

"(A) In the case of a first holder, 50 years, and

"(B) In the case of any subsequent holder, the remaining useful life of the section 1391 building at the time of its acquisition, assuming a useful life of 50 years in the hands of the first holder.

"(3) If the useful life determined under paragraph (1) includes a fraction of a year, such useful life shall be computed in years and months and any fraction of a month shall be rounded to the nearest month.

Page 39, take out lines 4 through 9.

Page 39, line 12, take out the "sub" in the word "subsection"

Page 39, line 13, 167 (c) may not be used.

Page 39, take out lines 14 through 18

Page 40, take out lines 1 through 3

Page 40, line 4, "(d) Cross Reference.—

Page 40, line 3, take out "sub" in the word "subsection"

Page 40, line 10, take out "sub" in the word "subsection"

Page 40, line 11, period, elects to

Page 40, line 18 to page 41, line 3, determined under subsection (b).

"(b) *Restoration Price.* The price at which a holder making an election under subsection (a) shall be treated as having sold and purchased the section 1391 property, shall be an amount equal to:

"(1) in the case of the first holder of such property, the price at which a home management corporation could have exercised its option to purchase such property, on the date of such sale and purchase, under section 101 (a) (5) of the Urban Housing Development Act of 1967; and

"(2) in the case of a subsequent holder of such property, the lesser of:

"(A) the option price for a home management corporation under section 101 (a) (5) of the Urban Housing Development Act of 1967, on the date of such sale and purchase, or

"(B) the excess, if any, of—

"(i) the aggregate qualified expenditures (as defined in section 1391 (9) of such holder, over

"(ii) the aggregate amount of depreciation deductions that would have been allowable to such holder under section 167 to the date of the purchase assuming depreciation deductions were computed under the straight line method of depreciation over the remaining useful life of the section 1391 building at the time of its acquisition by such holder, assuming a useful life of 50 years in the hands of the first holder.

Page 41, line 4, change "(b) to "(c)

Page 41, line 8, add after chapter "except that (1) such election shall not affect the taxpayer's status as a holder or subsequent holder for purposes of subsection (b), (2) such purchase shall not be a qualified reinvestment for the purpose of applying section 1396 (b) (1), (3) such taxpayer"

Page 41, line 14, take out the "sub" in the word "subsection"

Page 41, line 16, take out the "sub" in the word "subsection"

Page 41, line 17, the word "expect" shsould be "except"

Page 42, line 4, "(1) the depreciation ad-

Page 42, line 7, take out the comma after the word "year"

Page 42, line 23, take out the "sub" in the word "subsection"

Page 43, line 8, take out the "sub" in the word "subsection".

Page 43, line 20, take out the comma after the word "delegate"

Page 43, line 21, 1250(a) that would have been recognized by the section

Page 43, line 23 and 24, stock, the corporation sold, at a price determined under section 1349(b); each section 1391 property (as defined in

Page 45, line 15, TION.—The amount of gain subject to paragraph

Page 45, line 16, (1) on a disposition of stock in a section 1391

Page 45, line 17, corporation shall, as of the date of such disposition,

Page 45, line 20, subparagraph 1395(a)(1)(B)(i).

Page 45, line 23 and 24, "(a) NONRECOGNITION OF GAIN.—Upon a disposition of section 1301 property (as defined in section

Page 46, line 2, forth in subsection (b), (c), or (d).

Page 46, line 18, property insured under section 235(d) of the National

Page 47, line 1, change "subsection 1391(9)" to "section 1391(9)(A)"

Page 47, line 8, add the word "this" before the word "subparagraph"

Page 47, line 9, shall be specified in regulations to be prescribed

Page 47, line 14, any time after the expiration of two years of the taxpayer's holding

Page 47, lines 19, 22, and 23, change "maximum" to "minimum"

Page 47, line 24, take out the "sub" in the word "subsection" 1391

Page 48, line 2, ceed the amount determined under paragraph (2)

Page 48, line 3, "(2) AMOUNT OF GAIN.—The

Page 48, line 4, amount of gain to be recognized on a sale or exchange

Page 48, line 9 through 11, add a new "(B) "(B) the amount of the mortgage insured under section 235(d) of the National Housing Act that would have been on such property, as of the date of such sale or exchange, on the assumptions that:

(i) the equity investment percentage (as defined in section 1391(5)) of the first holder of the property (as defined in section 1391(10)) was 20%, and

(ii) all payments on such mortgage had been timely made through the date of such sale or exchange.

Page 48, line 15–16, gain or loss recognized on such sale or exchange shall be treated as gain or loss on the sale or exchange of property described in

Page 48, after line 17 add new Sec. 1397

"SEC. 1397. AUTHORITY OF PRESIDENT TO CHANGE RATES AND USEFUL LIFE

"(a) *Change by Executive.*—The President shall have the power at any time and from time to time to increase or decrease by Executive order any or all of the:

"(1) rates of credits specified in Sec. 1392 (a) (1),

"(2) the percentages utilized in computing useful lives under Sec. 1393 (b)(1) and,

"(3) the useful life specified in Sec. 1392(b)(2) as the basis for the application of the percentages specified in Sec. 1392(b)(1).

"(b) *Maximum Change.*—No increase or decrease in the rate, percentage, or useful life prescribed in an Executive order issued under subsection (a) shall cause such rate, percentage, or useful life to be higher than 115 percent or lower than 85 percent of the comparable rate, percentage, or useful life specified in Sec. 1392(a)(1), Sec. 1393(b)(1) or Sec. 1393(b)(2) on the date of enactment of the Urban Housing Development Act of 1967.

"(c) Different Property.—The power of the President under subsection (a), shall include, but not be limited to, the power to prescribe different rates of credit, percentages, and useful lives for different classes of Sec. 1391 property and for different areas of the country.

Page 49, after line 17 add a new (e)

(e) Section 501(c) of such Code is amended by adding at the end thereof, the following new paragraph:

"(18) A home management corporation as defined in section 3(7) of the Urban Housing Development Act of 1967.

Page 50, succeeding subsections (e) and (f) become (f) and (g)

Page 50, line 10, take out the "sub" in the word "subsection"

Page 50, line 11, take out the "sub" in the word "subsection"

Page 50, succeeding subsection (g), (h), and (i) become (h), (i), and (j)

Page 50, lines 17 through 19 ceipts are realized in the operation, sale, or exchange of section 1391 property."

Summary of Suggested Amendments to S. 2100

I. Local Real Estate Tax Abatement

A. S. 2100 provides that a certified project may be erected in a city only if assurances are furnished that local real estate taxes will be kept to not more than 5 percent of the occupancy charges of the project. The Federal government will then reimburse the city for 50 percent of the loss of tax revenues. If the State reimburses the city for any further portion of the loss the Federal government will match its contribution up to an additional 25 percent of the loss. This provision brings the Federal government's total contribution up to 75 percent of the abatement.

B. The suggested amendments to the bill reflect the following changes in these provisions:

1. When several local jurisdictions would otherwise impose real estate taxes on the certified project, or when such taxes are imposed by the State, assurances may be required from that State;

2. The assurances concerning the maintenance of real estate taxes at the 5 percent level need not be furnished in any case in which the State and/or city is barred from the giving of such assurances by a constitutional provision in effect on the date of introduction of the bill. In this type of case, the Federal government will reimburse the holder of a project directly for 50 percent of the excess of the real estate taxes paid over 5 percent of the occupancy charges for the project. Because of this limited 50 percent reimbursement, the rentals for such a project will be slightly higher than the rentals for a comparable project in the city in which the real estate taxes are held to 5 percent of occupancy charges.

C. In certain cases a State or city may be unable to reduce its real estate taxes directly, but may be able to make a direct subsidy to a project holder so as to reduce its net local tax burden. Any such direct subsidy will be treated as a reduction of the real estate taxes otherwise paid or payable by the particular project.

II. Sales to Home Management Corporations

The following changes were made in the provisions of the bill governing sales of certified projects to home management corporations.

A. A home management corporation is now given an absolute option to purchase the property instead of merely a first option prior to a sale to another party.

B. The HMC's option is useable at any time after the expiration of two years of a private owner's holding period, but may be exercised only with the approval of HUD in the first 7 years of the HMC's existence.

C. The option price to an HMC represents the initial cost of the property less the depreciation on the building computed under the straight line method over a 50 year life. Thus after the expiration of 50 years the price to the HMC would represent merely the initial cost of land.

D. The Department of Housing and Urban Development is given the power to promulgate model forms of constitutions and management contracts for HMC's. It is specifically provided however, that an HMC may exercise its option to purchase the project only upon the affirmative vote of ⅔ of its members.

E. In order to assist an HMC in becoming the owner of its property the FHA will insure a mortgage loan to an HMC which was procured to finance part of the purchase price. The maximum amount of a mortgage which may be so insured is the excess of: (1) The price paid by the HMC pursuant to its option, over (2) the sum of the existing insured mortgage, if any, on the project and a charge of $100 per apartment which is to be contributed by the tenants as equity capital toward the purchase.

F. An HMC may, in order to meet the payments on any mortgage it incurs in purchasing the project, raise the occupancy charges by 5% of the previously

existing level. If the increased charges are insufficient to finance the payment of all of the expenses of the HMC, including payments on its new mortgage, the HMC may receive a subsidy from a Federal Fund established to help finance such purchases. The bill provides an initial appropriation of $5 million for such a fund.

III. TENANT ELIGIBILITY AND RENT INCREASES

A. The amendments submitted give the Department of Housing and Urban Development the authority to promulgate regulations regarding the length of the period during which the income of an individual, or family, must fall within a required range, if such individual or family is to be eligible as a tenant in a qualified project.

B. S. 2100 provides that no individual, or family, residing in a certified project shall be required to move as a result of an increase in its income. However, if the charge for its rent becomes less than 18% of his or its adjusted gross income, the tenant is required to pay an additional occupancy charge equal to such difference. The amendments submitted in this regard are as follows:

1. In order to prevent rent changes as a result of a mere temporary fluctuation in the tenant's income, HUD is given the authority to promulgate reguations specifying the length of the period during which the tenant's income must increase, if his rent is also to be increased.

2. Any such increase in occupancy charges may be made only prospectively following the end of the stipulated period.

IV. MORTGAGE TERM

Under S. 2100 as introduced, the Department of HUD had the authority to insure mortgages on the certified project for any term up to 50 years. Under the proposed amendments, the mandatory term of any mortgage insured under proposed section 235 is 50 years.

V. TAX PROVISIONS

The following changes are made in the tax provisions of the bill:

A. The credit rates are changed. The previous range of credits for a first holder was from 3% to 22% whereas under the proposed amendments the range is from 3% to 30%.

The previous range of credits for a subsequent holder was from 2% to 22%. Under the proposed amendments the range is from 2% to 23%. The credits in the middle ranges of equity investment have, however, been reduced.

B. A subsequent holder will be eligible for the credits only if it acquires the property within 40 years after completion of the construction or substantial rehabilitation.

C. Under the bill as introduced, the useful life of a certified project apart from the percentage reduction established by section 1394 (the "base useful life") was left to determination in each case under existing law.

Under the proposed amendments the base useful life is specified as:

1. 50 years for the first holder, and
2. for any subsequent holder, 50 years less the period elapsing for any previous holders following the completion of the construction or substantial rehabilitation of the project.

D. The range of percentage reductions of useful life has also been changed. In the original bill the useful lives for a first holder were reduced to from 2% to 20% of the useful lives otherwise applicable, i.e., to depreciation periods of 20 years to 10 years. Under the amendments, the range is from 40% to 14% of the useful lives otherwise applicable. That is to depreciation periods of from 20 years to 7 years. In the original bill the depreciation period for a subsequent holder ranged from 50% to 25% of the useful life otherwise applicable. Under the amendments the range is from 75% to 24% of the useful life otherwise applicable. A subsequent holder's depreciation period may in no event be reduced under section 1394 below 10 years.

E. Under the original bill, upon a sale of a certified project by a holder—to someone other than a HMC—after the expiration of the holder's minimum holding period a full capital gains tax was payable. Upon a sale at the end of a holder's maximum holding period, the capital gains payable was to be recognized only to the extent that the sales price exceeded the insured mortgage.

Under the amendments submitted, if a holder sells after the expiration of his *minimum holding period* a gain is recognized only to the extent of the excess of:

1. the sales price over

2. the amount of the mortgage that would have been on the project if the first holder had made the minimum 20 percent equity investment. The holder's maximum holding period now has significance only under the restoration of basis provisions (see below).

F. Under section 1394, a holder of a certified project may, after the expiration of his maximum holding period, elect to continue to hold the property. As a result of such election he is treated as if he sold the property to himself. Under the proposed amendments, the price at which such sale is deemed made is defined as the lesser of:

1. The price at which the holder would have sold the property to a Home Management Corporation at the time, pursuant to the Home Management Corporation's option, or

2. In the case of a subsequent holder the excess of his actual cost to him for the property over the depreciation of the part of such costs allocable to the building. Such depreciation is to be computed on a straight line basis over a life equal to 50 years less the period lapsing between the completion of construction or substantial rehabilitation of the project and the holder's acquisition thereof. Under such an election, the holder is deemed to recognize gain as if he had sold to a stranger at such prices. He then receives a "step-up" in basis, for depreciation and other purposes, up to the amount of said price.

G. Section 1395 provides that in certain circumstances upon a sale of stock in a section 1391 corporation, a taxpayer will realize ordinary income to the extent of his proportionate share of the amount of ordinary income which would have been realized by the corporation if it had sold all of its section 1391 properties which it had not yet held for the minimum holding period. In certain instances—such as a sale to an HMC—no gain would be recognized by the corporation. Under the amendments submitted, no ordinary income will be realized upon a stock sale to the extent that ordinary income would have been realized by the corporation on the sale to the same buyer.

H. Under the amendments submitted, the President is given the authority to vary the credit rates and alter the useful life up or down within a 15 percent range. The President is given the authority to make variations within such range for different types of buildings and for different areas of the country. Such changes may be necessary to reflect differences in construction costs, operating income, and other factors.

Economic Analysis of the Urban Housing Development Act of 1967

1. PURPOSE OF BILL

The purpose of the Urban Housing Development Act is to promote the construction and rehabilitation of low rental housing by private enterprise. By encouraging large corporations to invest in such housing, the bill also is designed to induce private industry to begin achieving "that scale of operation, that integration of functions, and that mechanization of activities which will refute the charge that housing is the industry capitalism forgot." [1]

This memorandum explores the means by which the Urban Housing Development Act achieves these objectives and the resulting revenue costs to the Federal government. Comparisons are drawn between the revenue losses incurred under this bill with those incurred under a combined rent supplement—below market interest rate Section 221(d)(3) program—the most comparable housing program possible under existing law. [2]

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[1] Meyerson, Terrett, Wheaton, *Housing, People and Cities*, 344 (1962). The authors go on to state that "Because the building industry is made up of so many relatively small operating units, no one exerts the economic influence necessary to convert it into a more effective structure." Costs and rentals can only be reduced by "large, tight-knit, efficiently managed organizations" which can "eliminate most of the weak links in the long chain of actions that keep the majority of builders inefficient and insecure."

[2] Section 221(d)(3) authorizes the FHA to insure mortgage loans on rental and cooperative "low-interest rate" multiple dwelling housing. The interest rate on such loans is set by the FHA at a rate lower than the current market rate but not lower than the lesser of (a) 3% or (b) the average market yield on outstanding U.S. securities in a particular period. At the present time the rate is 3%. The term of a 21(d)(3) loan may be any period up to 40 years.

In the case of a building to be owned by a private profit corporation (as distinguished from a cooperative or a nonprofit corporation):

(a) the owner must be a "limited dividend corporation";
(b) the loan may not exceed 90% of the cost of the project; and
(c) the owner's rent charges may not exceed an amount which will produce with a 7% vacancy factor, a 6% yield on the owner's net equity investment.

A. Low Rentals

The "low rentals" objective is produced under the Urban Housing Development Act in the following manner:

1. The rentals for the apartments in a project built under this bill (a "certified project") are established at a level which allows (after payment of operating expenses, real estate taxes and debt service) a basic 8 percent yield on equity capital to the investor.

This return is to be compared with the yield of 6 percent included in the rentals of a section 221(d)(3) project.

2. The rentals of units in a certified project are also maintained at a modest level (below those feasible for a 221(d)(3) project) by reducing two of the basic expenses which rentals normally must cover, namely, real estate taxes and debt service.

Local real estate taxes paid by a 221(d)(3) project have normally amounted to at least 14 percent of rental income (net of such taxes)—a rate which increases in larger cities. By contrast, this bill provides that local authorities desiring to participate in the program, must—in the absence of an existing constitutional prohibition [3]—hold real estate taxes on the certified project to not more than 5 percent of rental income. The Federal government will then reimburse the local taxing entity for a maximum of 50 percent of the cost of this reduction. If the State reimburses a further 25 percent, the Federal government will bear the last 25 percent—thereby raising its total contribution to 75 percent of the abatement.[4]

The second expense controlled by the bill is debt service. Under the 221(d)(3) program, with a limited-profit sponsor, the debt service to be covered by rentals constitutes payments on a loan:

of 90 percent of the cost of the project,
payable over 40 years,
with 3 percent interest,

Under this bill, the debt service is on a loan,

of not more than 80 percent of the cost of the project,
payable over 50 years,
with 2 percent interest

The monthly debt service to be covered by rentals[5] under the Urban Housing Development Act is approximately 84 percent of that which must be covered with regard to a 221(d)(3) project.

As a result of these two factors, the rentals on units in a certified project will typically be only 75 percent of the rentals of a comparable project constructed under section 221(d)(3).

B. Builder's Yield

1. 221(d)(3) Project—The 6 percent yield from the rentals on a 221(d)(3) project would not suffice to interest investors in the program. There are, however, various other tax benefits under existing law which increase the yield of the owner of a 221(d)(3) project.

The owner of a 221(d)(3) project—or, for that matter the owners of many conventional apartment houses—will typically realize tax losses during the first seven or eight years of operation. This is the period during which accelerated depreciation deductions[6] substantially exceed the operating income of the building, including that portion of the income being used to amortize the mortgage. Tax losses in this period are magnified by the fact that the mortgage payments

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[3] The bill provides that in those States where an existing constitutional prohibition prevents a real estate tax abatement or a direct subsidy to produce a tax level of 5 percent, the Federal government will pay a subsidy directly to the owner of the project in order to reduce taxes by anywhere from 50 to 75 percent, of the charges, depending upon the locality's efforts in reducing the cost of the land.

[4] Since the buildings now located in urban poverty areas produce very limited tax revenues, it is estimated that this system of tax abatements will not in fact produce any loss in revenues to local governments. Even after an abatement, the result will normally be a revenue gain.

[5] The rental level on all projects built under this bill is computed as if the investor had made a minimum 20 percent equity investment even when the builder has in fact made a higher investment. The decline in the builder's debt service at higher levels of equity investment, permits the maintenance of a net return on equity which is slightly higher than 8 percent.

[6] The guideline life promulgated by the Treasury for apartment houses if 40 years. Under existing law, the first owner of any new apartment house may use the following accelerated methods of depreciation—the 200 percent declining balance method ("200 DB") and the sum of the years digits method. The owner of a used apartment house may use the 150 percent declining balance method ("150 percent DB") which is less rapid.

being made consist primarily of deductible interest rather than non-deductive principal amortization payments.

When the builder offsets these tax losses against his other income—thereby eliminating the potential tax thereon—he, in effect, realizes a further cash flow.[7] Indeed, by utilization of the 200DB method, the owner of a 221(d)(3) project may achieve, in the first 10 years of operations, an overall yield of about 8.19 percent. But even this return has proven insufficient to induce a substantial amount of building by private industry under section 221(d)(3).

From the eighth through approximately the tenth years, these tax benefits become negligible; by the end of about the eleventh year, the "tax shelter" aspect of the 221 project has been completely exhausted. At that point the constantly increasing mortgage amortization payments begin to exceed the declining depreciation deductions. Thus, the cash flow realized by the holder gradually becomes taxable, and his after tax yield declines below 6 percent.

In the case of a luxury apartment house or commercial building, the same problem of a declining tax shelter is offset by several other factors. First, the building may be fully occupied and in demand so that direct returns from rentals may have increased to 10 or even 20 percent of equity; the property has therefore become an attractive holding apart from tax benefits. Second, because of the increased yield, the owner may refinance the mortgage and thereby realize tax-free dollars to use for investment. Third, he may make a profitable sale of the building. Finally, if the original investment was intended only as a tax device and the property is not profitable, the owner may donate it to his charitable foundation—thereby securing a substantial tax deduction.

In the case of a 221(d)(3) project, the refinancing and profitable sale alternatives are not available in view of the deminimus 6 percent return from the property. Thus after about one-fourth its life expectancy the 221(d)(3) project has become an unprofitable and economically unsound part of the holder's portfolio.[8]

2. CERTIFIED PROJECT

In contrast, the tax incentives provided for in the Urban Housing Development Act are designed to increase the initial owner's rate of return on his net equity investment from the 8 percent realized from the rental income to a normal return of about 12–19%—a yield deemed necessary to promote the investment without being excessive. The bill also attempts to achieve a target yield of 10 percent for all subsequent buyers, other than a home management corporation.

This additional yield on the project arises from the following tax incentives provided for in the bill:

a. A tax credit based upon the owner's investment in the project;

b. A shorter depreciation period than is allowed by existing law; and

c. An inclusion in the project's depreciable base—as compared to its non-depreciable land costs—of the expenditures for demolition and site improvement.

The tax incentives proposed are patterned after provisions currently in our tax laws—such as the investment credit for machinery and equipment and the accelerated depreciation period for defense and grain facilities. This bill merely attempts to adapt these incentives to the socially desirable goal of producing low rental housing.

The size of the tax incentives is controlled by scaling them to the owner's equity investment. For example, a 3 percent credit and a 20-year depreciation period are granted to an owner making a 20 percent equity investment; the comparable figures for an investor financing the entire project by risk capital are 30 percent and 7 years.

This scaling of benefits to equity investment accomplishes three objectives. First it promotes the construction of low rental housing with the smallest possible drain on the Federal government's mortgage guaranty pool. Second it promotes the building of low rental housing even after the Federal mortgage funds appropriated in this bill are exhausted. Third it provides an incentive—especially

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[7] An excellent discussion of the tax shelter aspects of the building of conventional apartment houses appears in the *Secretary of the Treasury's Explanation of the President's 1963 Tax Message*, Hearings before the House Ways and Means Committee, p. 420 (1963). This report and other articles give examples of how such tax benefits have induced the construction of luxury apartment houses even when the actual rate of return expected in the early years from the building itself is minimal.

[8] The foregoing analysis may suggest at least one of the reasons why private enterprise has not shown great interest in the 221(d)(3) program.

for major corporations with available cash resources—to avoid the additional red tape involved in obtaining a substantial guaranteed loan.[9]

C. Relationship of Revenue Cost to Low Rentals and Yield

In comparing costs, yields and rentals of housing projects built under 221(d)(3) and under this proposed legislation, two relationships are of critical importance.

First, the added interest subsidy costs and real estate tax abatement payments incurred under this bill are reflected in lower rentals. Indeed the difference in rentals between the two programs is about twice the cost of achieving the difference. Both of these additional costs do not affect the owner's return but only reduce rentals.

Second, the tax incentives granted under this bill do not affect the rentals. Rather, they are merely the means for increasing the average yield for the initial investor in, and subsequent purchaser of, a certified project as compared with the return for the builder and holders of a 221(d)(3) project.

II. ELEMENTS OF REVENUE LOSS AND REVENUE RETURN

A revenue loss to the Federal government will be incurred on each certified project built under the Urban Housing Development Act. Computing the size and significance of that loss is not, however, an easy task, for numerous variables—such as the cost of Federal borrowing, the normal equity investment, the length of the initial owner's holding period and the probable purchaser from the initial owner—are involved in such computations and the interaction of these variables produce significantly different revenue results.

Moreover, any cost analysis must be viewed in the light of the basic fact that revenue increments produced by this bill—through the collection of taxes on new income generated by the construction—will occur during and shortly after the construction period, while, by contrast, the revenue costs will take place gradually over a 50 year period.

Cash immediately in hand can reproduce itself; as any businessman or banker will testify, there is economic value in having money at the present time even though a greater sum must be paid back over an extended period of time.

In general the revenue losses to the Federal government with regard to any certified project arise from the interest rate subsidy, the tax abatement payments, and the several tax incentives.

A. Interest Cost

An interest cost is incurred on each Federally insured mortgage used to finance a project. This cost represents the difference between the 2 percent interest rate at which the mortgage loan will be made and the interest rate at which the government is able to borrow the money.

Over the past two years, the Federal long-term borrowing rate has averaged approximately 4.5 percent; this rate has therefore been adopted for purposes of analysis. A 2.5 percent interest subsidy on a 50 year loan eventually amounts to 76 percent of the principal amount of the loan.[10] If the Federal borrowing rate were to go down to 4 percent—so that the subsidy would be only 2 percent—the subsidy would eventually amount to only 59 percent of the principal amount of the loan.

Thus, assuming a 4.5 percent borrowing rate, the 50 year interest subsidy on the full proposed $3 billion loan fund is about $2.28 billion. Of signifiance, however, is the fact that this cost is incurred, not in one lump sum, but over a 50 year period.

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[9] It is envisaged that a builder seeking a certification for tax benefits without a guaranteed mortgage or with a very small guaranteed mortgage should receive rapid approval as in the case of certifications for emergency defense facilities.

[10] The actual interest cost is computed in the following manner. It is assumed that the Department of Housing and Urban Development will lend $3.0 billion to qualifying builders. These loans will be subject to repayment in level monthly installments over a fifty year period with interest charges at the rate of 2 percent per annum. The installments to be received from HUD project owners in each year during this period will equal approximately $95.5 million. HUD is presumed to have borrowed this money from the Treasury at a 4.5 percent rate of interest. As each payment is received, HUD will apply the principal component against the principal of the amount it owes the Treasury, and the interest component against the interest it owes the Treasury. Since HUD has lent at 2 percent and is repaying at 4.5 percent, there will be a deficit in interest each month which will have to be made up by a direct appropriation. These interest deficits over a 50 year period will total $2.280 billion (76 percent of the amount loaned) or an average of about $43.6 million a year.

The interest subsidy on a 221(d)(3) loan (from 4.5 percent to 3 percent over 40 years) is only 34 percent of the principal amount of the mortgage. Section 221(d)(3) mortgage funds are generally 90 percent of project costs whereas mortgages under this bill are 80 percent *or less* of project costs. In short to produce the same amount of housing under the 221 (d)(3) program requires a minimum 10 percent increase in Federal borrowing. Moeover, if the fund established under this bill is used to supply mortgages of less than 80 percent of the cost of the project—which will occur in numerous cases—the same loan fund produces as well a still greater quantity of housing than would an identical sum of money under section 221 (d)(3).

B. Real Estate Tax Subsidy Cost

The bill also provides a real estate tax subsidy equal to between 50 percent and 75 percent of the difference between the city and State taxes otherwise payable (about 14 percent or more of gross rentals) and 5 percent of the gross rental income of a certified project.

Thus assuming the construction of 2500 projects of 120 units each,[11] the annual estimated Federal real estate subsidy may thus range from $13.875 to $20.00 million per year (50% to 75% of an $11,000 subsidy on 2500 buildings).

C. Costs and Rent Levels

Apart from tax incentives and flow back, the average annual cost of the bill should amount to approximately $60 to $66 million. This is computed as follows:

Interest subsidy ($2.3 billion divided by 50 yrs.)	46,000,000	
Real estate tax subsidy (2500 buildings at $5500 to $8300 yr.)	13,750,000—	20,625,000
Total	59,750,000—	66,625,000

With regard to a program of similar scope financed under section 221(d)(3) comparable annual cost would be only $28,687,500—which represents the average interest subsidy over 40 years on a loan fund of $3.375 billion.

It is estimated, however, that the annual aggregate of rental for units in each of the projects constructed under the Urban Housing Development Act bill would be $40,363 lower than the rentals in an identical project constituted under section 221(d)(3).[12] Thus to achieve under section 221(d)(3) the rentals achieved under this bill, the government would have to pay annual rent supplements of at least $110.91 million ($40,363 on 2,500 projects).

In summary, apart from the tax incentives, the Urban Housing Development Act costs $72.96 to $79.84 million per annum less than a program of similar size financed under 221(d)(3) coupled with rent supplements which would produce comparable rentals.[13]

D. Tax Costs

Attention is now turned to the tax costs which are designed to increase rates of return under the Urban Housing Development Act to satisfactory levels. These tax costs are as follows:

1. *Credit*

Tax credits are granted to the holder of each project and to subsequent purchasers. These credits, of course, reduce tax revenues dollar for dollar.

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[11] Treasury figures for unit cost and project size have been adopted. Under the Urban Housing Development Act, a fund of $3.750 billion ($3.0 billion in Federal mortgage money) and at least $750 million in private capital will build 2,500 projects of 120 units each. The comparable figures under 221(d)(3) are $3.375 billion in Federal mortgage money and $375 million in private capital.

[12] See p. 92 infra.

[13] The differential is computed as follows:

	Millions
221(d)(3) project	
Interest subsidy	$28.68
Rent supplements	110.91
Total cost	139.59
Urban Housing Development Act	
Interest and real estate tax subsidy	59.75 to 66.63
Total	79.84 to 72.96

85-199—67——7

2. Excess Depreciation

A cost for depreciation is incurred as the holder of each certified project applies the tax losses which arise each year from his continued ownership of the project against his other income.[14]

To the extent that the depreciation deductions shield the income of the project itself against taxes there is no revenue "loss" since, in the absence of the bill, the project would never have been built.

Depreciation deductions, of course, reduce the holder's cost for the project, and thus increase the amount of gain he will realize on a subsequent sale of project. Hence, to the extent that the holder of a certified project must pay a capital gains tax upon a sale, the excess depreciation tax cost is, in effect, "recouped" by the Federal government.

In three situations, payment of a capital gains tax upon sale is not required or is reduced by the Urban Housing Development Act.

(1) If the holder sells to a home management corporation (HMC) as early as two years after he assumes ownership, no capital gains tax is payable.

(2) If the holder sells after the expiration of his minimum holding period (10 years) and reinvests the proceeds in the construction of another low rental project, no capital gains tax is payable.

(3) If the holder sells after the end of his minimum holding period, the gain to be recognized for tax purposes is limited to the excess of—

(i) the sales proceeds, over

(ii) the amount of the insured mortgage that would have been on the property had the initial holder made the minimum 20 percent equity investment.

The capital gains taxes *not paid* in the above situations do *not* represent an "out of pocket" loss of revenue to the Federal government, since, in the absence of the Urban Housing Development Act, the projects would not have been built.

In short, the calculable revenue loss under this bill arises when the excess depreciation deductions on the project are applied against the holder's other income (which would otherwise have been subject to taxes). This revenue loss may be *reduced* by any capital gains tax that is paid on a sale of the certified project, rather than further increased by a capital gains forgiveness.

3. SUMMARY OF TAX COSTS

The amount of revenue loss resulting from the tax incentive provisions varies depending upon the amount of the holder's initial equity investment, the manner in which the holder disposes of the property, the time at which the disposition is made, and the choice of depreciation technique. The amount of loss on *any particular project* under various circumstances can be estimated and these calculations appear in a latter part of the memorandum. To obtain an overall cost figure, however, a computation has been made on the assumption that the Urban Housing Development Act will produce the construction of 2500 projects of 120 units each (a total of 300,000 units).

Under these circumstances, the 50 year tax revenue cost—if the projects are all built with 20 percent equity investments—may range anywhere from $297.5 million[15] to $1.4 billion[16] with the more likely estimate being closer to the $297.5 million figure.

If the projects are all built with a 100 percent equity investment the tax cost may range from $1.652[17] to $4.25 billion,[18] but would almost certainly be closer to the $1.652 figure. Moreover, those buildings constructed with a 100 percent equity investment would not bear any part of the $2.28 billion interest subsidy. The Federal mortgage fund would then be available to finance the construction of other housing projects.

E. The Flow Back

In any event, all or a substantial part of the Federal government's tax incentive revenue losses, on either a project constructed under the Urban Housing Development Act or under an enlarged 221(d)(3) program, should "flow back"

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[14] The annual tax loss, as to a particular project, is the excess of: (a) the depreciation deduction, over (b) the net operating income on the building, less, interest payments on the mortgage.

[15] $119,000 per building on 2500 buildings (see p. 13 infra).

[16] $560,000 per building on 2500 buildings (see p. 14 infra).

[17] $661,000 per building on 2500 buildings (see p. 16 infra).

[18] $1,700,000 per building on 2500 buildings (see p. 17 infra).

to it in the form of taxes on income which is generated by the construction of the buildings. Thus, for example, the government will collect additional income taxes on the salaries of laborers and other personnel employed in the construction of the buildings and on the profits obtained from the building materials supplied. It will also collect taxes on the income earned when laborers, management employees, and material suppliers engaged directly or indirectly in the construction of the projects spend their monies to purchase goods and services.[19]

It is estimated that for each dollar expended in the construction of the building, about $3.00 in income should be created throughout the economy (including the dollar itself). This additional income arises through the so-called "multiplier" effect.

Overall, it is estimated that approximately 13 percent of the $3.00 of income created by each dollar of expenditures on the certified project will return to the Federal Treasury in additional income tax revenues.[20] Thus even if the minimum 2500 buildings were built, the flow-back in revenues to the Federal Government would be $1.463 billion.[21]

It is critical to note that this "flow back" to the Treasury will occur during the period of construction of the building and within a year or two thereafter, and under normal circumstances will greatly exceed the only revenue losses during that period.[22]

III. OVERALL COST COMPUTATION UNDER URBAN HOUSING DEVELOPMENT ACT

If 2500 buildings with 80 percent financing are constructed under the Urban Housing Development Act, the minimum revenue loss, before the flow back, should be about $3.245 billion, computed as follows:

	Billions
Interest Subsidy	$2.280
Real Estate Tax Subsidy (max)	.667
Tax Reductions anywhere from .298 billion to $1.4 billion but likely to be close to	.298
Total	3.245

The revenue flow back in this case is $1.462 billion, leaving a net revenue cost of $1.782 billion ($35.6 million per year). If the maximum tax cost estimate of $1.4 billion is used instead of the minimum $.298 billion figure, the net cost comes to about $2.884 billion (about $57.6 million per year.)[23]

The gross revenue cost before the flow back, therefore, ranges from $3.2 billion to $4.3 billion, or from $64.1 million to $86.9 million per annum. This yearly cost is far less than the $139 million in rent supplements and interest subsidies needed to produce comparable rents under 221(d)(3). In addition, the annual tax costs for comparable 221(d)(3) projects will amount to at least an additional $2.5 million per annum.

If, by contrast, 5000 buildings were constructed, 2500 with 60 percent government financing and 2500 with no government financing, the aggregate revenue loss before the flow back would be about $5.560 billion computed as follows:

	Billions
Interest Subsidy	$2.280
Real Estate Tax Subsidy (max)	1.330
Tax reductions:	
80 percent Federal mortgage buildings anywhere from .298 billion to $1.330 billion (but likely to be closer to)	.298
Buildings without Federal mortgage (anywhere from $1.652 billion to $4.25 billion but likely to be closer to)	1.652
Total	5.560

[19] A further flow of revenues back to the government will come from taxes on the income of persons working in the maintenance and operations of the buildings. These revenues have not been included in the analysis.

[20] The foregoing "multiplier" analysis rests on the assumption that, in view of the unused productive capacity in the building industry and the amount of unused capital in the economy, the construction of the certified projects will lead to new employment and sales of materials, and will not merely "bid-up" the rates being paid for labor and services which might otherwise be used in the construction of other buildings.

[21] This total equals 13 percent of $11.25 billion (3×$3.75 billion).

[22] In short, no interest cost on revenues lost results to the government since it is earning interest on revenues which have flowed back, that are greater than any revenues which have been lost.

[23] Of this sum about $13.8 billion per year constitutes real estate tax subsidies.

In this case, however, the flow back in revenues is $2.926 billion [24] leaving a net revenue loss of about $2.634 billion (about $52.7 million per year).

IV. EXAMPLE

The above principles may best be illustrated by the following examples, all of which are based on a project consisting of 120 units costing $12,500 a unit.[25] The $1,500,000 aggregate cost of the project represents:

Land	$100,000
Demolition and site improvement	150,000
Building	1,250,000
Total	1,500,000

Rentals

The gross rental income of a project under the Urban Housing Development Act is designed to yield to an initial holder making a 20 percent equity investment a 3 percent yield ($9000) on his equity investment of $300,000.

The rental income and expenditures of such a certified project may be compared to the rental income and expenses of a comparable project under section 221(d)(3) as follows:

	Certified project		221 project	
	Per annum	Per unit per month	Per annum	Per unit
Gross rental income (assuming maximum occupancy and other adjustments)	$118,368	$82.20	$158,731	$110.23
7 percent vacancy factor	8,268	5.75	11,102	7.71
Annual gross rental income	[1] 110,100	76.45	147,629	102.52
Less:				
Operating expenses	57,600	40.00	57,600	40.00
Real estate tax [2]	5,500	3.82	23,040	16.00
Net operating income (taxable income before depreciation and interest)	47,000	32.63	66,989	46.52
Less mortgage payment (principal and interest)	38,000	26.38	57,989	40.27
Cash flow to holder	9,000	6.25	[3] 9,000	6.25

[1] The gross rental income figure will not vary even when the holder has invested a higher percentage of equity. Thus, in the case of a builder making a 50 percent equity investment, his mortgage payments will only be $23,700 per annum leaving him with a cash flow of $23,300 per annum (a little above a 3-percent return on his equity investment of $750,000).

[2] These taxes constitute 5 percent of gross rental income.

[3] This $9,000 figure represents a 6-percent return on the required 10 percent equity investment of $150,000.

The above table clearly shows why rentals are lower under the Urban Housing Development Act than under section 221(d)(3). These reduced charges are the result of lower payments of (a) real estate taxes and (b) debt service.

To achieve the same reduced rentals in a comparable project 221(d)(3), the Federal government would have to pay rent supplements of $40,363 per annum ($158,731–118,368), in addition to the interest subsidy involved in the section 221(d)(3) mortgage financing.

B. Real Estate Tax Subsidy

It is estimated that in the absence of the bill, local real estate taxes against such a project would amount to approximately 14 percent of gross rents or $16,571 per year.

The cost of reducing the local real estate tax expense to 5 percent of gross rents ($5,500) would thus be approximately $11,072 per year, of which the Federal government would bear 50–75 percent or $5,536 to $8,304 per year. This would amount to a cost of about $276,800 over the life of the project.

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[24] This sum represents twice the flow back in the above example.

[25] Detailed schedules underlying the computations summarized herein are annexed to this memorandum.

C. Interest Cost

The interest cost (assuming a 2.5% subsidy from 4.5% to 2%) will amount to 76% of the principal amount of the loan. Thus, it will vary from $912,000 ($18,250 per annum) in the case of a builder making a 20% equity investment to zero for the builder who finances the building completely through equity investment.

D. Multiplier

On the basis of a 3 to 1 multiplier the total income created through the construction of a project under either the Urban Housing Development Act or an expanded 221(d)(3) program would be about $4,500,000, of which about 13% or $585,000 would, within several years after the completion of construction, flow back to the government in tax revenues.

E. Tax Costs

1. Initial Holder Making a 20 Percent Equity Investment

a. Credit.—If the initial holder makes a minimum 20 percent equity investment, the initial tax credit granted is $45,000.

b. Depreciation Cost.—The application of the tax losses arsing from the project against the owner's other income results in tax savings to the owner, and revenue costs to the Federal government.

During the first ten years of the project's life, these tax savings and the investor's total yield are as follows:

Year	(1) Depreciation, (20 years, 150 percent D.B.)[1]	(2) Cash flow[2]	(3) Mortgage amortization	(4) Tax loss less 2 and 3	(5) Tax saving, 50 percent of (4)	(6) Builder, total Y (2) and (5)
1	$101,300	$9,000	$14,000	$78,300	$39,150	$48,150
2	93,700	9,000	14,400	70,300	35,150	44,150
3	86,600	9,000	14,700	62,900	31,450	40,450
4	80,100	9,000	15,000	56,100	28,050	37,050
5	74,100	9,000	15,300	49,800	24,900	33,900
6	68,600	9,000	15,600	44,000	22,000	31,000
7	63,000	9,000	15,900	38,100	19,050	28,050
8 (s/l)[3]	60,200	9,000	16,200	35,000	17,500	26,500
9 (s/l)[3]	60,200	9,000	16,600	34,600	17,300	26,500
10 (s/l)[3]	60,200	9,000	16,900	34,300	17,150	26,150
Total	748,000	90,000	154,600	503,400	251,700	341,700

[1] The depreciation is computed on a basis of $1,350,000 which, under the bill, includes demolition and site improvement costs of $150,000.

[2] The cash flow equals the net operating income of $47,000 less the mortgage payments of $38,000. The mortgage amortization (col. 3) equals the $38,000 mortgage payment less the interest component thereof.

[3] As under existing law, the builder switches to the straight-line method when this becomes profitable.

Of course, the shorter the holding period, the lower the revenue loss to the Federal government. This is, of course, due to the reduction in the number of years in which excess depreciation deductions are offset against the owner's other income.

In contrast, the investor's percentage yield increases as his holding period decreases. This result occurs because tax losses are at their highest in the early years of the holding period due to:

(1) the effect of declining balance depreciation, and

(2) the fact that the interest component of the mortgage payments (which is deductible) is at its highest.[23]

c. *Sale to HMC.*—A sale to a HMC may be made free of capital gains taxes after the end of the second year, (subject to HUD approval). Upon such a sale, the price is limited to the cost of the property less the depreciation deductions which would have been taken if the depreciation had been computed on a straight line basis over a 50 year period.

[23] The amount of the owner's final yield and the resulting revenue losses to the Federal government also depend upon the type of sale made, as hereinafter described.

The builder's yield, and the resulting revenue loss, assuming a sale to a HMC, may be summarized as follows:

Sale to HMC at end of year	Builder's yield (in percent) [1]	Revenue loss (including $45,000 credits)
2	19.12 (case 1)	$119,000
10	12.51 (case 2)	297,000
20	12.24 (case 3)	458,000

[1] The case numbers refer to computations in the annexed schedules.

In view of the high yield realizable upon an early sale, the initial owner has a significant incentive to prepare his tenants for purchasing the building through a HMC as quickly as possible. Such a sale is also advantageous for the Federal government, because at that point, the tenants receive no further tax incentives (although the interest and real estate tax subsidies continue). Indeed the total tax revenue losses in the above situation (which is likely to be the most common because of the favorable results to the private owner), constitute considerably less than the $585,000 gained in new tax revenues as a result of the construction of the project.[27] Moreover, even in the case of a sale to a HMC after 20 years, the total tax loss is only $458,000 and this cost is spread out over 20 years whereas the $585,000 in revenue flow back is received during, and shortly after, construction.

(d) *Sale to a Private Party at the End of the Maximum Holding Period.*—If the initial owner takes the less likely course of holding the property for his maximum holding period of 20 years, and then selling to a private party, the excess depreciation revenue loss is $413,000.[28]

Upon a private sale at the end of a maximum holding period, however, the owner must—unless he takes advantage of the reinvestment provision[29] pay a capital gains tax to the extent that the sale proceeds are received in cash above the mortgage.

The schedule of credits and depreciation period reductions for any private buyer has been structured to produce in most cases a 10 percent yield for such buyer if the purchase is made at a price equal to that at which a HMC has an option to purchase.

On the basis of such a sales price, the 20 percent investor's yield would be as follows:

Sale at end of year	Gross sales proceeds	Capital gains tax	Net sales proceeds	Percent of yield	Tax cost (amount shown above, less capital gain)
10	$185,000	[1] $46,000	$139,000	[2] 11.31	$251,000
20	104,000	[3] 26,000	88,000	[4] 12.14	432,000

[1] Since the sale is made after the end of the builder's minimum holding period, the capital gain is limited to $460,000, 25 percent of the excess of the $1,230,000 sales price.
[2] Case 4.
[3] This figure represents 25 percent of the cash proceeds of $104,000 received above the mortgage.
[4] Case 5.

In the case of the first buyer the credit may amount to approximately $26,000. For the first and subsequent buyers, the depreciation cost—net the recovery of capital gains taxes to the government should amount to only about $100,000.

[27] During the first two years after construction, the total revenue losses are a maximum of $173,000 computed as follows: real estate tax subsidy (2 years at maximum of $8,300 each); interest subsidy (2 years at $18,250); tax credit of $45,000; depreciation tax savings ($74,250). This is about thirty percent of the $585,000 revenue inflow on income generated by the construction.

[28] The initial owner's tax loss of $826,000 (which is assumed to result in a 50% tax benefit of $413,000) represents the excess of: (a) $1,850,000 in depreciation deductions, over (b) the aggregate income of $524,000.

[29] If, after the end of his minimum holding period, the builder sells the property and reinvests the cash proceeds (above the outstanding FHA insured mortgage in another low rental project), he is relieved of capital gains tax on the sale. Under this provision, the government secures two buildings for the cost of one. The total cost for both buildings in this situation will generally be comparable to the cost upon a tax free sale to a HMC after 10 years.

When these private turnovers are carried through for the entire fifty year period, the total tax credits and current tax reductions reach a limit of about $560,000. This figure should represent the maximum conceivable loss of tax revenues to the Federal government of any project constructed under the bill with a 20 percent equity investment. Even in this situation, however, the government's initial tax gain of $585,000—accruing in the period immediately following construction—exceeds the 50 year tax cost.

It is highly unlikely, however, that many buildings will remain in private hands throughout the full 50 year period—without at least one "roll-over" which would produce additional low-cost housing. It is even more likely that the builder will maximize his return by selling to a HMC as soon as it is possible for him to do so without incurring a penalty tax, that is, two years after construction with HUD approval. In this event, the revenue loss to the Federal government is substantially reduced.

3. INITIAL OWNER MAKING 50 PERCENT EQUITY INVESTMENT

The initial owner making a 50 percent equity investment $750,000) would be granted a tax credit of $165,000 (11% of $1,500,000).

The investor's yield and the Federal government's revenue loss resulting from depreciation deductions over the 10 years minimum and maximum holding period are as follows:

Year	Depreciation (50 percent D.B.—10 years)	Cash flow	Mortgage amortization	Tax losses	Tax saving	Return
1	$202,500	$23,300	$8,800	$170,400	$85,200	$108,500
2	172,130	23,300	9,000	139,830	69,915	93,215
3	146,310	23,300	9,200	113,810	56,905	80,205
4	124,360	23,300	9,400	91,660	45,830	69,130
5	117,450	23,300	9,600	84,550	42,275	65,575
6	117,450	23,300	9,800	84,350	42,175	65,475
7	117,450	23,300	10,000	83,950	42,075	65,375
8	117,450	23,300	10,200	83,950	41,975	65,275
9	117,450	23,300	10,400	83,750	41,875	65,175
10	117,450	23,300	10,600	83,550	41,775	65,075
Total	1,350,000	233,000	97,000	1,020,000	510,000	743,000

(a) *Sale to HMC.*—In the case of a sale to a HMC the investor's yield and the resulting revenue loss to the Federal government are as follows:

Sale at end of the year	Builder's yield	Revenue loss
2	[1] 23.34	$320,000
10	[2] 12.787	675,000

[1] Case 6.
[2] Case 7.

After such a sale to a HMC no further tax incentives are granted in regard to the building.

(b) *Sale to a private holder*

If such an investor makes a private sale after 10 years at the HMC price and does not reinvest the proceeds in more low income housing, a capital gains tax of approximately $46,000 will be payable. This represents 25 percent of the excess of:

(a) the $1,230,000 sales price over

(b) the $1,045,000 mortgage that would have been on the project at the time of sale if the builder had originally made the minimum 20% equity investment.

This tax would reduce the investor's yield to 12.249 percent (Case 8) and the Government's revenue loss to $629,000.

It will be noted that the cost in tax revenue at a 50 percent equity investment will exceed the comparable tax cost at 20 percent equity investment by any-

where from $200,000 to $378,000. However, the interest subsidy at 50% equity investment is approximately $343,000 lower than the interest subsidy at 20% equity investment (76% of a $450,000 loss of Federal mortgage). In short, under any circumstances, the increased costs to the Federal government for 50 percent equity investors is minimal. Moreover the number of houses which can be built for the same mortgage pool is increased by 25%.

3. INITIAL OWNER MAKING 100-PERCENT EQUITY INVESTMENT

In the case of an initial owner making a 100 percent equity investment, the tax credit granted would be approximately $400,000 (30% of $1,500,000) as opposed to the $45,000 credit granted to the builder making a 20 percent equity investment.

In this situation, however, there is no interest cost—as contrasted with the $912,000 interest cost incurred on an 80 percent federally insured mortgage.

The investor's yield and the Federal government's revenue loss resulting from depreciation deductions taken over the seven year minimum and maximum holding period are as follows:

Year	Depreciation (150 D.B.—7 years)	Cash flow	Amortization of mortgage	Tax loss	Tax saving	Total return
1	$289,400	$47,000	0	$242,400	$121,200	$168.20
2	227,300	47,000	0	180,300	90,150	137.15
3	178,500	47,000	0	131,500	65,750	112.75
4	163,700	47,000	0	116,700	58,350	105.35
5	163,700	47,000	0	116,700	58,350	105.35
6	163,700	47,000	0	116,700	58,350	105.35
7	163,700	47,000	0	116,700	58,350	105.35
Total	135,000	329,000	0	1,021,000	510,000	839.50

a. *Sale to HMC.*—In the case of a sale to a HMC, the owner's yield, and the resulting revenue loss to the Federal government are:

Sale at end of year	Builder's yield (percent)	Revenue loss
2	[1] 25.559	$661,000
7	[2] 13.132	960,000

[1] Case 9.
[2] Case 10.

Of course, after such a sale to a HMC, no further tax incentives are granted in regard to the building.

b. *A Sale to a Private Holder.*—Let us assume, on the other hand, that an investor financing the entire building by equity capital makes a private sale after 7 years, at the HMC option price, and does not reinvest the proceeds in more low-income housing. In such event, a capital gains tax of $54,000 will be paid, which represents 25% of the excess of:

(a) the $1,311,000 sales price, over

(b) the $1,095,000 mortgage that would have been on the project at the time of sale if the builder had originally made the minimum 20% equity investment.

On the basis of such a sale, the owner's yield will be 12.698% (case 11) and the revenue loss to the government $906,000 (the $960,000 loss shown above, less the $54,000 capital gains tax). It is doubtful, however, in the case of a 100 percent investor that a private sale could be made at a price quite as high as the HMC's option price. Thus if the investor makes a private sale, his yield is now likely to be about 10 percent.

It is estimated that the tax credit granted to the buyer at the end of seven years may be approximately $250,000 and that his tax savings through accelerated depreciation (net of capital gains recovery) may amount to about $200,000. Over a 50 year term the total tax incentives granted may conceivably amount to about $1,700,000. But no interest subsidy cost must be added on to this figure since there is no Federal mortgage on the project.

4. COMPARISON OF YIELDS AT DIFFERENT LEVELS OF EQUITY INVESTMENT

A comparison of the yields to be realized by investors in typical situations, at various levels of equity investment is as follows:

Sale at end of year	Equity investment (percent)		
	20	50	100
To HMC:			
2	19.12	23.314	25.359
10	12.51	12.787	13.132
To private party:			
10	....	12.249	10.0
20	12.24	....	....

5. CONSTRUCTION UNDER 221 (D) (3)

The following schedule shows the pattern of tax savings, tax costs and net yield for the builder of a 221 project over its first 20 years.

Year	Depreciation [1] (40-year 200 percent D.B.)	Amortization	Cash flow	Tax loss	Tax saving	(Cash flow return plus tax saving)
1	$62,500	$17,700	$9,000	$35,800	$17,900	$26,900
2	59,400	18,300	9,000	32,100	16,050	25,050
3	56,400	18,800	9,000	28,600	14,300	23,300
4	53,600	19,400	9,000	25,200	12,600	21,600
5	51,000	20,000	9,000	22,000	11,000	20,000
6	48,400	20,600	9,000	18,800	9,400	18,400
7	45,900	21,200	9,000	15,700	7,850	16,850
8	43,600	21,900	9,000	12,700	6,350	15,350
9	41,500	22,500	9,000	10,000	5,000	14,000
10	39,400	23,200	9,000	7,200	3,600	12,600
Subtotal	501,700	203,600	90,00	208,100	104,050	194,050
11	37,400	23,900	9,000	4,500	2,250	11,250
12	35,600	24,700	9,000	1,900	950	9,950
13	33,800	25,400	9,000	(600)	(300)	8,700
14	32,100	26,200	9,000	(3,100)	(1,550)	7,450
15	30,500	27,000	9,000	(5,500)	(2,750)	6,250
16	29,000	27,800	9,000	(7,800)	(3,900)	5,100
17	27,500	28,700	9,000	(10,200)	(5,100)	3,900
18	26,100	29,500	9,000	(12,400)	(6,200)	2,800
19	24,900	30,400	9,000	(14,500)	(7,250)	1,750
20	23,600	31,300	9,000	(16,700)	(8,350)	650
Subtotal	300,500	274,900	90,000	(64,400)	(32,200)	57,800
Total	802,200	478,500	180,000	143,700	71,850	251,850

[1] This is based on $1,250,000 cost of building—which does not include the demolition and site improvement as well as and costs.

a. *Initial Owner's Yield.*—If one assumes a sale by the initial owner at the end of the 10th year for approximately $90,000 above the mortgage, his rate of return is approximately 8.10% (case 12).

The $90,000 price above the mortgage is the $9,000 direct cash flow from the property capitalized at 10%.[30] It is unlikely that a higher price could be attained

[30] Actually the seller would retain only $31,000 of the proceeds of such a sale, since a $59,000 capital gains tax would be payable computed as follows:

Sales Price:		
	Cash	$90,000
	Mortgage	1,145,000
	Total	1,235,000
Less:	Adjusted basis	998,000
	Gain on sale	237,000
	x Rate (percent)	25
	Capital gains tax	59,000

since tax savings with regard to 221(d)(3) projects cease in the 12th year. Thereafter, the holder is limited to his $9,000 cash flow from the property less the tax thereon.[33] By the 17th year his return net of taxes is only $3,900 per annum.

b. *Revenue Loss.*—As indicated by the above table, the cost in tax revenues over a 10 year period of the 221(d)(3) project would be approximately $104,030. This would be reduced to $45,000 by the $59,000 capital gain pay-back on a sale at the end of the 10th year.

If, however, the builder gave the property to his foundation at that point (as it would be advisable for him to do) the government would incur a further tax cost of $45,000 as the builder offset the charitable deduction against his other income. This would increase the total tax cost of the project to $149,000 although it would increase the owner's yield slightly (Case 13).

This $45,000 or $149,000 ten year tax revenue cost of the project under section 221(d)(3) may be compared with the following 50 year tax cost for the project if it were constructed under the Urban Housing Development Act with an initial equity investment of 20 per cent.

1. Sale to HMC at end of—	
(a) second year	$119,000
(b) tenth year	297,000
2. Sale to private party with building remaining in private hands over a 50 year period	560,000

Thus, in the first and most likely case of an early sale to a HMC, the tax cost of a certified project may actually be lower than the tax cost of a comparable project constructed under section 221(d)(3).

Even at the opposite extreme, however, when the certified project remains in private hands over the 50 year period, the maximum additional tax cost—above the tax cost of a 221(d)(3) project—is only $380,000 to $490,000. This additional cost in tax revenues is more than off-set by the additional cost in rent supplements and interest subsidies (above the interest subsidy and real estate tax subsidies under the Urban Housing Development Act) that would be incurred by the Federal government in order to achieve comparable rental levels under section 221(d)(3). The computation is as follows:

Section 221 cost:	
Interest cost (3¼% of loan of $1,350.000	$459,000
Rent Supplements ($40,363 per year for 50 yrs	2,018,000
Less: Susidies under Urban Housing Development Act	2,477,000
Interest Subsidy	912,000
Real Estate Tax Subsidy (max. of $8,300 per year for 50 years)	415,000
Total	1,327,000
Additional Cost if Project constructed under section 22(d)(3)	1,150,000

The significance of this comparison is increased when one considers the fact that the initial owner's rate of return for a 221(d)(3) project would have been only about 8 percent—a level insufficient to interest private enterprise in the program. In contrast, the same owner's rate of return under the Urban Housing Development Act may normally range from 12–19 percent.

The $45,000 to $149,000 estimated tax cost, over 10 years for a project constructed under section 221(d)(3) may also be compared with the following 50

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[33] The average annual taxable income before depreciation during the second ten year period will be about $36,500 of which an average of $27,500 represents mortgage amortization and $9000 depreciation would be approximately $35,000 (straight line method)—30 year life based on a $1,075,000 cost for the building. Thus the buyer would have an annual taxable income of $1000 on which he would pay a tax of about $500 reducing his current yield to only $8.500. Moreover this yield must be discounted since this holder will probably not be able to find a subsequent purchaser who will assume the remaining mortgage and return the second holder's equity investment. A constantly increasing amortization component prevents any adequate return for a subsequent buyer who makes a substantial equity investment.

It may be noted that on the basis of a $1,500,000 purchase price, the buyer's depreciation would be approximately $41,600 per annum. This would give rise to an average annual tax savings during the succeeding 10 years, of about $2500. Thus on the buyer's investment of approximately $354,000 above the mortgage (that is the $1,500,000 price less the $1,146,000 remaining mortgage), he would be realizing a return of only $11,500 per annum—which is less than 8 percent. Even if the 150% declining balance method were used, the buyer's return in the first year would be less than 6 percent and would, of course, decline thereafter.

year tax cost for the project, were it constructed under the Urban Housing Development Act with a 100 percent equity investment.

1. Sale to HMC at end of
   - (a) second year $661,000
   - (b) tenth year 960,000
2. Sale to private party with building remaining in private hands over 50 year period........ 1,700,000

Thus, the added tax cost of the building constructed under this bill, with a 100 percent equity investment, may range from $410,000 to $1,550,000 in excess of the tax cost of a similar project constructed under 221(d)(3) with the most likely result closer to $410,000.

However, the rent supplements and added interest subsidy which the government would have to pay to achieve the same rentals for the 221(d)(3) project would be approximately $2,200,000.

The comparison is as follows:

221 project costs:

Interest Subsidy (3¼% of loan of $1,350,000)	$459,000
Rent Supplements ($40,363 per year for 50 years)	2,018,000
Total	2,477,000
Less: Subsidies under Bill Annual real estate tax subsidy (maximum of $8,300 per year for 50 years)	415,000
Additional cost if constructed under 221(d)(3)	2,200,000

After off-setting against the foregoing figure the additional tax incentives, it may be concluded that the project will cost about $500,000 to $1,800,000 less to the government if constructed under the Urban Housing Development Act.

The following schedules show the yield percentages realized to the builder of a certified project ("CP") or a 221(d)(3) in certain cases.

The yield percentage means the discount rate at which the present value of all future returns will equal the builder's equity investment.

In all cases involving a certified project, the builder's credit is treated as a return to be received one year from the date of the investment.

The subsequent returns in the case of a builder of a CP (and the only returns in the case of a builder of a 221 project) are:

(a) the builder's current yield during his holding period for the building, that is, his aggregate cash flow from rental income plus his tax savings, and

(b) his sales proceeds (net of capital gains tax, if any).

All of the cases are based on the following schedules of current yield which are annexed hereto:

Schedule No.	Builder of—	Percentage equity investment	Holding period (years)
I	CP	20	20
II	CP	50	10
III	CP	100	7
IV	221 project	10	20

The specific cases as to which rate of return is computed are as follows:

Case No.	CP or 221	Equity investment (percent)	Holding period (years)	Sales proceeds	CGT if sale not to HMC	Yield
	CP	20	2	271		19.12
1	CP	20	10	185		12.51
2	CP	20	20	104		12.24
3	CP	20	10	185	46	11.31
4	CP	20	20	104	26	12.14
5	CP	50	2	710		23.34
6	CP	50	10	577		12.787
7	CP	50	10	577	46	12.249
8	CP	100	2	1,442		25.559
910	CP	100	7	1,311		13.132
11	CP	100	7	1,311	54	12.698
12	221	10	10	90	58	8.19
13	221	10	10	[1] 45		9.11
14	221	10	20	[1] 45		8.95

[1] Sale or contribution.

SCHEDULE I

CP—20 PERCENT EQUITY INVESTMENT (300)—CURRENT RETURN—YEARS 1 TO 20

[In thousands]

Year	(1) Depreciation (20 years, 150 percent D.B.) [1]	(2) Cash [2] flow	(4) Mortgage amortization [3]	(4) Tax loss	(5) Tax saving (50 percent of (4))	(6) Builder's current yield ((2) and (3))
1	101.3	9	14.0	78.3	39.15	48.15
2	93.7	9	14.4	70.3	35.15	44.15
3	86.6	9	14.7	62.9	31.45	40.45
4	80.1	9	15.0	56.1	28.05	37.05
5	74.1	9	15.3	49.8	24.90	33.90
6	68.6	9	15.6	44.0	22.00	31.00
7	63.0	9	15.9	38.1	19.05	28.05
8(s/l) [4]	60.2	9	16.2	35.0	17.50	26.50
9(s/l) [4]	60.2	9	16.6	34.6	17.30	26.30
10(s/l) [4]	60.2	9	16.9	34.3	17.15	26.15
	748.0	90	154.6	503.4	251.70	341.70
11	60.2	9	17.2	34.0	17.00	26.00
12	60.2	9	17.6	33.6	16.80	25.80
13	60.2	9	17.9	33.3	16.65	25.65
14	60.2	9	18.3	32.9	16.45	25.45
15	60.2	9	18.7	32.5	16.25	25.25
16	60.2	9	19.0	32.2	16.10	25.10
17	60.2	9	19.4	31.8	15.90	24.90
18	60.2	9	19.8	31.4	15.70	24.70
19	60.2	9	20.2	31.0	15.50	24.50
20	60.2	9	20.6	30.6	15.30	24.30
	60.2	90	188.7	323.3	161.65	251.65
	1,350.0	180	343.3	826.7	413.35	593.35

[1] Depreciation is computed on a basis of 1,350 which under the bill includes demolition and site improvements costs 100.

[2] The cash flow equals the net operating income of 47 less the mortgage payments of 38. The mortgage amortization (col. 3) equals the total mortgage payments of 38 less the interest component thereof.

[3] Mortgage of 1,200, term 40 years, 2 percent interest.

[4] As under existing law, the builder switches to the straight-line method when this becomes profitable.

SCHEDULE II

CP—50 PERCENT EQUITY INVESTMENT ($750)

Current return, years 1 to 10

Year	Depreciation 50 percent DB 10 years	Cash flow	Mortgage amortization	Tax losses	Tax saving	Return
1	$202.50	$23.3	$8.8	$170.40	$85.200	$108.500
2	172.13	23.3	9.0	139.83	69.915	93.215
3	146.31	23.3	9.2	113.81	56.905	80.205
4	124.36	23.3	9.4	91.66	45.830	69.130
5	117.45	23.3	9.6	84.55	42.275	65.575
6	117.45	23.3	9.8	84.35	42.175	65.475
7	117.45	23.3	10.0	83.95	42.075	65.375
8	117.45	23.3	10.2	83.95	41.975	65.275
9	117.45	23.3	10.4	83.75	41.875	65.175
10	117.45	23.3	10.6	83.55	41.775	65.075
Total	1,350.00	233.0	97.0	1,020.00	510.000	743.000

SCHEDULE III

CP—100 PERCENT EQUITY INVESTMENT ($1,500)

Year	Depreciation (150 DB, 7 years)	Cash flow	Amortization of mortgage	Tax loss	Tax saving	Total return
1	$289.4	$47	0	$242.4	$122.20	$168.20
2	227.3	47	0	180.3	90.15	137.15
3	178.5	47	0	131.5	65.75	112.75
4	163.7	47	0	116.7	58.35	105.35
5	163.7	47	0	116.7	58.35	105.35
6	163.7	47	0	116.7	58.35	105.35
7	163.7	47	0	116.7	58.35	105.35
Total	1,350.0	329	0	1,021.0	510.50	839.50

SCHEDULE IV

221 PROJECT (10 PERCENT EQUITY INVESTMENT—150) CURRENT RETURN—YEARS 1 TO 20

Year	Depreciation (40 years, 200 percent DB)[1]	Flow	Mortgage amortization[2]	Tax loss	Tax saving	Cash flow and saving return
1	62.5	9.0	17.7	35.8	17.90	26.90
2	59.4	9.0	18.3	32.1	16.05	25.05
3	56.4	9.0	18.8	28.6	14.30	23.30
4	53.6	9.0	19.4	25.2	12.60	21.60
5	51.0	9.0	20.0	22.0	11.00	20.00
6	48.4	9.0	20.6	18.8	9.40	18.40
7	45.9	9.0	21.2	15.7	7.85	16.85
8	43.6	9.0	21.9	12.7	6.35	15.35
9	41.5	9.0	22.5	10.0	5.00	14.00
10	39.4	9.0	23.2	7.2	3.60	12.60
Total	501.7	90.0	203.6	208.1	104.05	194.05
11	37.4	9.0	23.9	4.5	2.25	11.25
12	35.6	9.0	24.7	1.9	.95	9.95
13	33.8	9.0	25.4	(.6)	(.30)	8.70
14	32.1	9.0	26.2	(3.1)	(1.55)	7.45
15	30.5	9.0	27.0	(5.5)	(2.75)	6.25
16	29.0	9.0	27.8	(7.8)	(3.90)	5.10
17	27.5	9.0	28.7	(10.2)	(5.10)	3.90
18	26.1	9.0	29.5	(12.4)	(6.20)	2.80
19	24.9	9.0	30.4	(14.5)	(7.25)	1.75
20	23.6	9.0	31.3	(16.7)	(8.35)	.65
Total	300.5	90.0	274.9	(64.4)	(32.20)	57.80
Total	802.2	180.0	478.5	143.7	71.85	251.85

[1] Based on 1,250 cost of building not including demolition and site improvement cost.
[2] Mortgage of 1,350, 40-year term, 3 percent.

SUGGESTED AMENDMENTS TO S. 2088

Page 1, line 2 of the description should now read: "additional employment opportunities for residents of urban and rural".

Page 1, line 3: "That this Act may be cited as the "Urban and Rural Employment".

Page 1, line 7: "in the Nation's cities and rural communities, and the social, physical and psychologi-".

Page 2, line 2: "to the residents of urban and rural poverty areas, but nothing in this".

Page 2, line 8: "mercial facility of such enterprise in an urban or rural poverty area,".

Page 3, line 11, place a period after the word "Act" and eliminate the rest of line 11.

Page 3, take out lines 12 and 13.

Page 3, add a new (3):

"(3) The term 'rural poverty area' means any county, without a city or any part of a city of over 50,000 persons, which the Secretary of Commerce, after

consultation with the Secretary of Labor, has determined is in need of assistance authorized by this Act. In designating any such county, the number of which shall not exceed the number of cities with urban poverty areas which qualify under this Act, the Secretary of Commerce shall be guided by, but not be limited to, the following standards—

"(A) the rate of unemployment and under-employment in such county and the immediately surrounding area;

"(B) the per capita income of the residents of such county;

"(C) the emigration from such county during the past three years;

"(D) the nature of industrial and commercial development existing in such county and the immediately surrounding area; and

"(E) the economic advisability of locating industrial and commercial facilities in such county:

Provided, That the number of rural poverty areas designated in any State shall not exceed the number of cities with urban poverty areas designated in any State."

Pages 3 through 6, succeeding numbers (3) through (10) become (4) through (11).

Page 5, line 8: "certification from the Secretary or the Secretary of Commerce, either at the industrial or".

Page 5, line 11, change the word "fifty" to "twenty".

Page 6, line 6: "The Secretary and the Secretary of Commerce shall have the power, after consultation with".

Page 6, line 9: "ticular urban and rural areas throughout the country."

Page 6, line 11: "CERTIFICATION OF ELIGIBILITY IN URBAN POVERTY AREA".

Page 7, lines 4 through 6: "opportunity to testify, has approved the establishment of an enterprise of such nature at the particular location, and so certifies to the Secretary;".

Page 7, add new (3): "(3) the Secretary determines that the person to whom the certificate for such enterprise is to be issued meets such requirements with respect to business and financial responsibility as he may prescribe:". "(Succeeding numbers (3) through (6) become (4) through (7))."

Page 8, line 2, change the word "fifty" to "twenty".

Page 8, take out lines 3, 4, 5, and 6.

Page 8, line 7: "of which not fewer than.

Page 11, line 6: "(C) of subsection (a) (4); and.

Page 11, line 17: "(a) (4) or (c) (2). In making a determination under this".

Page 11, line 22: "specified in subsection (a) (4) (B) shall not be grounds".

Page 12, line 4: "of subsection (a) (4) (B) of this section continue to".

Page 12, line 9: "applying subsection (a) (4) (B) of this section."

Page 13, add new Sec. 102. (a):

"CERTIFICATION OF ELIGIBILITY IN RURAL POVERTY AREA

"SEC. 102. (a) The Secretary of Commerce shall determine the number and type of jobs which must be created in any rural poverty area designated under section 3(3) in order to provide the necessary employment opportunities to use the human resources of, and to slow the migration from, such rural poverty areas due to lack of economic opportunity. When that number and type of jobs has been created in any such rural poverty area the designation under section 3(3) shall terminate."

Page 13, add new Sec. 102(b):

"(b) The Secretary of Commerce, after consultation with the Secretary of Labor, shall issue a certificate of eligibility for benefits under this Act to any person who is engaged in, or desires to engage in, an industrial or commercial enterprise, through a specified industrial or commercial facility located, or to be located, in a rural poverty area, if:

"(1) the person to whom the certificate for such enterprise is to be issued agrees, in such form and manner as the Secretary may prescribe—

"(A) in the case of an enterprise not then having an industrial or commercial facility located in a rural poverty area, to establish, within such period of time as the approving agency under paragraph (2) may require, such industrial or commercial facility (conforming to standards prescribed by the Secretary under subsection (d) of this section) at

a site specified or agreed to, by such agency within such an area, to conform it to standards prescribed by the Secretary under subsection (d) of this section;

"(B) to provide, in connection with its operations at such industrial or commercial facility located, or to be located, in a rural poverty area, that number of qualified jobs to be specified by the Secretary of Commerce but not to be less than 20 of which not fewer than two-thirds of all persons holding any such qualified jobs are persons who were prior to such employment low-income individuals who have resided in such county or the immediately surrounding area for six months or more;

"(C) to pay wages to persons employed in connection with the operations at any such facility at rates not less than the minimum wages determined by the Secretary of Labor under section 1(b) of the Act of June 30, 1936 (popularly known as the Walsh-Healey Act), as amended (41 U.S.C. 35(b)), to be the prevailing minimum wages for persons employed in similar work in the county or surrounding area in which such facility is located; and

"(D) to maintain records listing the names and residences of all full-time employees at the industrial or commercial facility for which the certificate is being issued, the date on which they were hired, their employment and economic situation at the time of hiring, and any other information required by the Secretary, and in the case of an industrial or commercial facility, which is to be part of an industrial or commercial enterprise also conducted by such person at other locations, or which is to be conducted by a person also engaged in other enterprises, to maintain records showing the portion of such person's taxable income or net operating losses allocable to the industrial or commercial facility for which the certificate is being issued, as if it were conducted by a separate entity, pursuant to regulations promulgated by the Secretary of the Treasury or his delegate under section 482 of the Internal Revenue Code, modified as may be necessary to fulfill the purposes of this Act.

"(2) the Secretary determines that the expected benefits to employment and to other aspects of the economic and social welfare of such rural poverty area warrant the granting of the income tax incentives under Title III of this Act as to the capital investment in such industrial or commercial facility; and

"(3) the Secretary determines that the issuance of such certificate is in accordance with the policy set forth in section 2 representing the relocation of industry.

"(c) The Secretary shall issue a separate certificate of eligibility with regard to each industrial or commercial facility which meets the requirements of subsection (a) regardless of whether such facility is operated by any person as part of a single industrial or commercial enterprise.

"(d) The Secretary shall issue a certificate of eligibility for benefits under this Act to any person who is a successor in interest to any person operating an industiral or commercial enterprise which has established an industrial or commercial facility in a rural poverty area and with respect to which facility a certificate of eligibility was issued under subsecton (a), if—

"(1) such person has been approved by the appropriate agency under paragraph (2) of subsection (a), and has been so certified by such agency to the Secretary;

"(2) such person agrees to continue to use the facility as an industrial or commercial facility, and to conform to the requirements of subparagraphs (B) and (C) of subsection (a)(3); and

"(3) the issuance of such certificate is in accordance, as determined by the Secretary, with the policy set forth in section 2 respecting the relocation of industry.

"(e) The Secretary shall terminate a certificate of eligibility issued to any person under this section to operate an industrial or commercial facility whenever he determines, after an appropriate hearing, that the person to whom such certificate was issued has failed, after due notice and a reasonable opportunity to correct the failure at such facility has been given, to carry out its agreement under subsection (a)(3) or (b)(2). In making a determination under this subsection, the Secretary shall be guided by, but not be limited to, the following criteria:

"(1) a reduction in the number of qualified jobs provided by any such enterprise below the minimums specified in subsection (a) (3) (B) shall not be grounds for termination of a certificate of eligibility issued to such enterprise, if the Secretary determines that (i) such reduction results from business or economic factors beyond the control of such enterprise, and (ii) not less than two-thirds of all the persons employed full time in such jobs by such enterprise to meet the erquirements of subsection (a) (3) (B) of this section continue to meet those requirements.

"(2) a change in the residence of any person employed by such enterprise, after his employment has commenced, shall not affect his status for purposes of applying subsection (a) (3) (B) of this section.

"(f) Any industrial or commercial facility for which a certificate of eligibility is issued under this section shall conform to such standards or design and construction as the Secretary shall by regulation require. Such regulations shall give due effect to any action taken by the locality in which such facility is, or will be located, to insure that it is so designed and constructed as to provide a decent, safe, and sanitary place of employment in an ethetically pleasing structure.

"(g) The Secretary shall keep interested and participating Federal, State, and local agencies fully appraised of any action taken by him under this section.

"(h) No certificate of eligibility shall be issued under this section to any person, unless application therefore is received by the Secretary prior to the expiration of ten years after the date of enactment of this Act."

Page 13, line 2 and line 12: Sec. 102. (a) becomes Sec. 103. (a) and Sec. 103. (a) becomes Sec. 104. (a).

Page 13, line 4: "under section 101 or 102 to file such reports from time to time".

Page 13, line 13: "of section 101(a) (5), an adequate relocation program".

Page 13, lines 15 and 16: "business concerns, and nonprofit corporations displaced through an acquisition of property, whether by eminent domain, agreement or any other means to permit the location of an industrial or commercial facility".

Page 16, line 17, Sec. 104 becomes Sec. 105.

Page 17, line 15: "in Certain Depreciable Property in Urban and Rural Poverty".

Page 21, line 20: "terminated under section 101(d) or section 102(e) of the Urban and Rural Employ-".

Page 23, line 2: "of Housing and Urban Development or, in the appropriate case, the Secretary of Commerce, certifies that such".

Page 23, line 21 and line 22: "under section 101(a) or section 101(c) or by the Secretary of Commerce under section 101(b) or section 101(d) of the Urban and Rural Employment Opportunity Development Act of 1967."

Page 25, line 13: "defined in section 3(6) of the Urban and Rural Empolyment Op-".

Page 25, line 16: "or, in the appropriate case, by the Secretary of Commerce in a section 40 certificate."

Page 25, line 19: "(as defined in section 3(5) of the Urban and Rural Employment".

Page 25, line 22: "has not been terminated under section 101(d) or section 102(e) of such".

Page 26, line 23: "standards prescribed under section 101(d) of the Urban and Rural".

Page 34, line 18: "101(a) (4) (D) or section 102(b) (2) (D) of the Urban and Rural Employment Op-".

Page 35, line 22: "3(6) of the Urban and Rural Employment Opportunities Develop-".

Page 37, line 2: "TRIES LOCATING IN URBAN AND RURAL POVERTY AREAS".

Page 37, line 6: strike out "D" and substitute "F".

Page 37, line 7: "LOCATING IN URBAN AND RURAL POVERTY AREAS".

Page 37, line 9, strike out "Sec. 251" and substitute "Sec. 271".

Page 37, line 14: "tary of Housing and Urban Development or, in the appropriate case, with the Secretary of Commerce, for low-income".

Page 37, line 15: "individuals who reside in an urban or rural poverty area or who".

Page 37, line 18: "under section 101 or 102 of the Urban and Rural Employment Opportunities".

Page 37, line 25: "the Secretary of Housing and Urban Development or, in the appropriate case, with the Secretary of Commerce, shall".
Page 38, line 4: "(2) all individuals to be employed in an urban or rural".
Page 38, line 19: "tary of Housing and Urban Development or, in the appropriate case, with the Secretary of Commerce such rules and".
Page 39, line 2, strike out "Sec. 252" and substitute "Sec. 272".
Page 39, lines 7, 8, 9, strike out "(d)", "(e)", and "(c)" and insert in lieu thereof "(e)", "(f)", and "(d)" respectively.
Page 39, line 11, strike out "(d)" and D and insert in lieu thereof "(e)" and F respectively.

Senator SMATHERS. I would like to congratulate the distinguished Senator from New York for his statement. Obviously, I agree with it, as I am a cosponsor of the bill. The amendments which he recommends make a great deal of sense insofar as meeting the needs which the measure is calculated to meet.

I shall ask if Senator Williams, of Delaware, has any questions.

Senator WILLIAMS. Mr. Chairman, I just have a couple at this time.

I understand the bill, as it is before us, provides that the sponsors will have to keep the project a minimum of 10 years to reap the full benefits. I understand you are proposing to amend that to a 7-year period. Is that correct?

Senator KENNEDY. It would require a 10-year period, a flat 10-year period unless the actual depreciation period was shorter. However, if the sponsors of the program sold the units to the tenants, he could do so after 2 years. He would have to keep it 10 years, or the depreciation period, unless he sold to the people who lived in these projects.

Senator WILLIAMS. I see.

Senator KENNEDY. Otherwise, there is a quite long required holding period.

Senator WILLIAMS. If he sells after 2 years, would he still retain the full investment credit?

Senator KENNEDY. No. On a private sale, he loses that.

Senator WILLIAMS. He loses the investment credit?

Senator KENNEDY. If he sold to anyone other than the home-management corporation.

Senator WILLIAMS. He could sell to a home-management corporation and he keeps all the tax benefits and his depreciation, and so forth?

Senator KENNEDY. That is correct.

Senator WILLIAMS. What did the 7 years have reference to?

Senator KENNEDY. Let's assume that the project costs $1 million. He has to put in at least 20 percent, which is $200,000. He can put in up to the whole $1 million. We try to make it attractive for him to put in as much money as possible. If he puts in $200,000—or 20 percent—he gets a depreciation period of 20 years.

If he puts up the whole $1 million on the project, he gets a depreciation period of 7 years. We originally had 10 years and changed it because the period wasn't attractive enough for the individual once he had to go above $500,000 or 50 percent; it was no longer an incentive for him to put the rest of the money in. We therefore made it more attractive by lowering the depreciation period to 7 years and changing the tax credit to 30 percent instead of 22 percent.

Senator WILLIAMS. I understand that.

Senator KENNEDY. There is also the depreciation change, Senator.

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Senator WILLIAMS. But in the depreciation, as I understand it, the bill as originally drafted provided that they could limit their depreciation to 20 percent of the normal period with a 10-year minimum.

For example, if it was a 40-year structure, 20 percent would be 8 years, but you would hit the minimum and they would have to use the 10.

What I am not quite clear on is, could they use the 7 years rollover rather than the 10 years?

Senator KENNEDY. Yes; for the first owner with a 100-percent equity investment.

Senator WILLIAMS. You meant the 7-year factor comes in that we would reduce this rollover period to 7 rather than 10.

Senator KENNEDY. That is correct.

Senator WILLIAMS. I believe I understand that now. I might say I will want to discuss this with the Treasury to see how the mathematics of this works.

Senator KENNEDY. Yes.

Senator SMATHERS. Senator Harris.

Senator HARRIS. Thank you, Mr. Chairman.

I want to say, Senator Kennedy, I share with you concern about the depth, and breadth, and crisis nature of the urban problem in this country. I think there isn't any way we can have the kind of America you and I visualize for our children unless we recognize what sort of crisis we are really confronted with and move forcefully to meet that crisis.

I think we can't do it in the old ways and I think you're quite right with this bill and with the companion bill concerning jobs, in deciding to build upon the very strong motivation in this country, and that is profitmaking in the private enterprise system.

You say in your statement on page 2, "This dialog which is needed will require more than words and more than sentiments of brotherhood." I think that is true. I think we ought to do these things because they are right, but I think we can't count on it being done for that reason.

I think we are going to have to try to make it more profitable for people to do the kinds of things we are going to have to do in this country and do it very rapidly in housing and especially in employment.

If I had to choose between the two, I would choose employment, because I think housing to some degree follows income, and income, particularly what people in poverty have, is an area that we haven't done very much with in the past.

Senator KENNEDY. As you know, I introduced a bill on employment which is now before this committee. I would hope that at some time in the future this bill will be considered by the committee.

Senator HARRIS. I wish we could have hearings on that bill also, on the whole subject of tax incentives for employment and training.

I think jobs for poor people where they are and the training to do those jobs is very important. I think that is a hopeful thing, that people do want to work, they do want the training to work.

Since they do, I think we ought to really move to try to provide those jobs and that training.

Senator KENNEDY. I agree with you, Senator. I think that we have to remember that these things are very interelated. To provide the housing and not provide the jobs does not make a great deal of sense and to provide jobs and not provide an adequate educational system, or decent places for people to live will not be very satisfactory.

It seems to me we have to supply education and training. We have to provide jobs and we have to provide housing. It has to be an interrelated program—an integrated effort.

Senator HARRIS. I agree.

I want to compliment you on the suggested amendment you have mentioned on page 8 of your statement in regard to homeownership. There is something almost akin to a religious feeling about owning your own home in this country.

I think your suggestions made about ownership are very good. As you recognize, it is difficult to do that where you are talking about multiple-family dwellings.

Senator KENNEDY. Yes. It is difficult, and that is why I had some reluctance at the beginning. Everybody wants to move in that direction, but the fact is that in many—really in all—of our major urban centers, there are major obstacles to a poor person owning his own home. It is offered as a panacea, but it is not a practical one immediately.

I felt that through this bill, and through a job bill so that people could find employment, we could move in the direction where people would have sufficient incomes and adequate preparation for owning their own homes.

Senator HARRIS. Another thing I want to discuss with you is the question of resettlement and relocation. It seems to me that that is the source of a great deal of bitterness and resentment around the country, and quite rightly so. We have all sorts of policies on highway relocation, urban renewal relocation.

I have found as I have traveled around the country in many of the major cities urban renewal areas where the people have been moved out and yet we haven't come along with the housing in which they are to be relocated.

Senator KENNEDY. That is right.

Senator HARRIS. It seems to me that your bill might be strengthened a little if you could spell out in more detail how the community will be consulted. I think you have, in some way, to give these people more power over the decisions that affect their lives.

I notice you mention that, but I wonder if there isn't some way that that could be spelled out better.

Senator KENNEDY. I agree with that. I think it is key. The relocation provisions that I have in this legislation are much stronger than any relocation provisions we have in any legislation at the present time.

I think one of the great problems that we have in our urban centers, and in the whole problem of urban renewal, is the fact that relocation has not been well handled at all. I think it is one of the sources of great bitterness.

There are two things: First, the relocation provisions in this bill are taken basically from the bill that was introduced by Senator Muskie last year. I think this bill is the best and most thorough piece of legis-

lation on this whole question. Perhaps S. 2100 provisions can be improved and perhaps the committee can go into it and develop ways in which it can be improved. But it is tremendously strengthened over the kinds of legislation that we have at the moment, which we are operating under at the present time.

Second, under this bill and under the employment bill—which I went into a little more detail in my prepared statement—nothing is done without consultation with the local community.

The local community makes the judgment and the city officials make the judgment. It is not the Federal Government that makes the determination as to what should be done. The people in the area decide what should be done, where this construction should take place, and decide it in conjunction with the city government.

It is possible, and in many of our most poverty stricken communities it is a fact, that you don't have any political structure. I think we have to start to build that political structure. That is what we are trying to do, for instance, in Bedford-Stuyvesant. I think it is all related to the question you raised at the beginning; namely, that these things are very interrelated one to the other. It does not do any good to just go in and put in a large public housing project, if you do not do anything about the schools, about education, about recreation, or crime. It doesn't do any good whatsoever.

I think that we can do something, but that will require some effort and initiative and leadership at the local level. We are trying to do that now in the biggest ghetto area in the United States, Bedford-Stuyvesant, where we have 400,000 people living under these conditions. But I think it can be done.

There are going to be problems with it as there is with any kind of a democratic system you establish. But it is the first time these people have really participated in their affairs or their future. They have to have a say in what they are going to do or what is going to be done. They have to have a say and an important say or the programs will be meaningless.

Senator HARRIS. There are some other questions I want to ask you. A real concern of mine is the one you mention at the top of page 8, the fear that people will be locked into the ghetto situation. I think you have a question akin to one that you have on Indian reservations.

Are these viable economic or other kinds of units? Is there an approach where you might have vest-pocket-type housing projects in various parts of the city that would be available only to the poor and not just in the ghetto area, itself?

Senator KENNEDY. I think you would have a tremendous problem about it in any one of these cities. I think first the transportation problem and the range of mechanical questions involved in moving people out and specifically into a housing unit in a different part of the city—a community which they are not used to—will create problems.

Second, I think you have the problem of whether these people can obtain jobs and be sufficiently trained and educated. If you take people out of Harlem and build a big housing project on 50th Street and Madison Avenue you create a lot of problems as to where they are going to get jobs in the highly skilled area. You need job and educational programs at the same time.

A child who goes to school in the ghetto area is a year behind by the time he gets to the third grade and 2 years behind by the time he gets to the sixth grade. He will not be equipped to enter the school system of the rest of the city.

So if you do something about all of these other matters at the same time, I think some planned breakup of the ghetto might make some sense.

Senator, I think that a completely open society is the ideal, certainly, but I don't think we are prepared for some of those things yet. As we move in that direction, and I am in favor of moving in that direction, we can solve even more of our problems. But while we are talking about taking people out of the ghettos and moving them into the suburbs, while we are moving in that direction, as a practical matter we are not making a great deal of active progress.

We have not made a great deal of progress. We have been talking about it for a long period of time. I don't anticipate we will make a great deal of progress in the future.

It seems to me we cannot wait until we reach a successful and effective open society before we start rebuilding the ghettos that are so run down, deteriorating, and rat infested.

Senator HARRIS. I believe the crying need in this country is for jobs and training of poor people. I am talking primarily about private jobs.

You, of course, know as well as anybody in the country, the problems there have been with building trade unions, and how, for various reasons, we just haven't been able to do very much about Negro apprentices and Negro journeymen in the building trades unions. In some cities the problem is worse now than it was a year ago or 2 years ago.

Senator KENNEDY. Yes.

Senator HARRIS. I don't think we can just sign pledges, as we have before, and I know you share that concern.

Is there any way to give more incentive for Negroes particularly, and poor people generally, to be brought into apprenticeship programs, particularly in the building trades?

Senator KENNEDY. We do that in the Bedford-Stuyvesant job incentive program which is a program outlined for bringing these people into unions. Let me just say that I think one of the problems, Senator, has been that the building we are talking about—the reconstruction that we are talking about—has gone on in the cities and has not taken place in the ghetto areas.

We haven't done any rebuilding, any rehabilitation, in the last 30 years, to speak of, in the ghetto area. What we have been arguing and fighting about during this period of time is taking the Negroes out of the ghettos and giving them jobs that might be held by somebody else who is working in some other part of the city.

If this is new employment, and it is in a person's neighborhood, because the rehabilitation and rebuilding is taking place in his neighborhood, then I think we will be much more successful in finding him employment and making him a part of a labor organization.

I have to go back to my own personal experience. We have had a program in Bedford-Stuyvesant and it has been a rehabilitation pro-

gram, even without these tax incentives. We have had some fine assistance from the Labor Department and from the poverty program, and also from some private foundations, such as the Ford Foundation, the Astor Foundation. In short, we had some money available.

We started rehabilitating some of the blocks in Bedford-Stuyvesant. It is a beginning. But the fact is we have had 300 or 400 young men between the ages of 16 and 30 or 35 who have been working on those programs. They have been doing the carpentry work, the plumbing work, the bricklaying work, fixing the sidewalks, doing work on the trees, all of this kind of work. All of these efforts had been worked out previously with the building trades.

They came in and played a major role themselves. Thus it is the people from the residences who by and large hold the majority of the jobs. Some of them are former union members. The vast majority are not.

We have worked out a wage scale in connection with the work that these people are doing. I think it has been very, very satisfactory. There was no major fight or struggle about it. It didn't appear in the newspapers.

But by sitting down and working out the difficulties with reasonable men and on a reasonable basis we were able to develop a program that has, at least up to the present time, been successful. I think you can do it.

Again, I think it will require effort. I think all of these things will require effort. I don't think any of them are easy. It is a very hard argument to say you have to give this Negro or Puerto Rican or Mexican-American a job, and because of this, some other man who has been a member of a labor union for years has to be deprived of his job.

They say there is not enough work available. If we start a major rebuilding program, a major job program, there will be more jobs for everybody. That is what we are talking about. It means more employment. It doesn't mean dividing the jobs that are presently available among a large group of people. We are talking about bringing in new jobs, new employment, in areas in which these people live. I think on that kind of a program you can have cooperation.

Senator HARRIS. The last question: I think you are quite right in saying we ought to take advantage of the social impact that tax laws have. I think we haven't done a very good job of that in the past. We have seen them only as revenue-raising measures. They do have social impact. I think there are much better ways that we can use that social impact.

The thing we must not do, I think, is make the problem worse for the cities and for the urban ghettos. That has been a concern of mine.

As you know, I think we have had some 5,300,000 poor southern Negroes move to the cities since 1950. So you have this problem of migration which mayors all over the country have mentioned to me as I have lately talked to them.

I notice at the bottom of page 10 you state that you have concluded that economically disadvantaged rural counties should be included in the proposal on tax incentives for jobs and training.

As you know, Senator Pearson and I have authored a bill which is before this committee along that general line. I do think you have to, in some way, integrate the building up of the city with the slowing down of the migration.

Senator KENNEDY. I agree with you. I think it was a deficiency and defect in the legislation that I originally introduced. I think the provision I have suggested fills that gap. I believe the legislation which you authored also deals with the problem. I think it is just a question of working out the language.

Senator HARRIS. I would hope that on both bills, your bill in regard to urban jobs and training, and the Pearson-Harris bill on rural jobs and training, might be the subject of a total hearing.

Senator KENNEDY. Yes. They should be considered together.

Senator HARRIS. Thank you, Mr. Chairman.

Senator SMATHERS. Senator Curtis.

Senator CURTIS. Senator Kennedy, what do your figures indicate to be the levels of rent that would have to be charged for the housing built under your proposal?

Senator KENNEDY. It would range, Senator, in very large cities, from about $73 to about $95.

Senator CURTIS. For what size unit?

Senator KENNEDY. Could I add that in some lower income areas, the rent could go down as low as $45 or $50.

Senator CURTIS. That is with the existing program of rent supplements or without it?

Senator KENNEDY. Without it.

Senator CURTIS. In other words, by the tax incentives to build, and the subsidized interest, the rent could be as low as $45?

Senator KENNEDY. Yes. In a larger community, in the communities where the unit would cost $15,000 to construct, it would range between $85 and $99.

Senator CURTIS. If it cost how much?

Senator KENNEDY. $15,000.

Senator CURTIS. Would that be the majority of cases?

Senator KENNEDY. No; not necessarily. It varies tremendously across the country. In some of the smaller communities it is much, much lower than that. But it is going to vary.

Senator CURTIS. I am directing my question to what you referred to as the slums and ghetto areas. Could you build any units there for less than $15,000?

Senator KENNEDY. Yes; you can, and you can completely rehabilitate units for less than that. I have said that the rent can be approximately $70 even in our largest cities.

My point is, Senator, that this bill would get the rent down to about this level. This is about $25 to $40 less than under any program that exists at the moment.

Second, the bill does not get to the very poor—to those who are on welfare—admittedly. That would still be a problem. That is why I think the companion bill to provide jobs is important because it gets people off welfare.

The rent supplement subsidy could be used as a supplement to this program, to lower the rents even further.

Senator CURTIS. You are suggesting this plus a rent subsidy?

Senator KENNEDY. No. I think this program stands on its own and has merit on its own; but it can also be used in connection with rent supplements.

The rent supplement program under 221(d)(3) and under the program that was discussed yesterday, involving the $1 billion that is going to be made available by the insurance companies, will require a rent supplement of $60 or so to bring the rents down to the $70 or $80 level.

If you want to, you could bring ours down from $80, say, to $50, by a $30 rent subsidy.

Senator CURTIS. That would be using both programs?

Senator KENNEDY. I think this legislation makes sense on its face and it still affects the poor and meets the problems of the ghetto. It could also, if you wanted to, be supplemented by rent supplements.

Senator CURTIS. I find this statement on page 2 of your statement:

> A bare majority of these men have full-time work at any rate of pay.

Just prior to that, you say:

> There can be little sense of accomplishment when we realize that in a typical big city poverty area, only about 45 percent of the adult men have full-time employment which pays more than $60 a week.

Then you say:

> A bare majority have full-time work at any rate.

It seems to me like there would be a near majority, then, who couldn't pay any $73 or $90.

Senator KENNEDY. It does not reach all the poor, as I said. It does not reach those on welfare. That is why I think that the job program is so important. I do not think putting a housing program in just by itself, Senator, is the answer, because people are not going to have the incomes to pay the rents.

But I think that if you had a job program at the same time to raise the level of employment and provide more employment for these people, and if you permitted the private enterprise system to come into the ghetto in an active way, we could lower the price per unit in the ghetto so that housing would not be as costly. Then the rehabilitation of housing would not be as costly, as it is at the present time.

We could lower the cost of the rents. But we do not have the kinds of programs to do so now. The private enterprise system has played no role whatsoever in rebuilding or providing new housing in the ghetto.

Senator CURTIS. What do the statistics show? Are there any people with sufficient income that they might secure adequate housing that do not have it?

Senator KENNEDY. I don't understand the question.

Senator CURTIS. Are there people with sufficient income either to buy a house or to buy an apartment, or to rent a house or apartment, who do not have adequate housing?

Senator KENNEDY. Yes.

Senator CURTIS. What is the trouble?

Senator KENNEDY. There is just no adequate housing available.

Senator CURTIS. I mean if they have the money.

Senator KENNEDY. The rents frequently are much, much higher. Rents are extremely high in many of these urban poverty areas. When these people move out of the areas, they do not know where they will get jobs. Frequently, if they move out of the areas they cannot get

housing anyway because of the fact that they are Negroes, Puerto Ricans or Mexican-Americans. They have to stay in the ghetto and the rents are very high for completely unsatisfactory housing.

I think Secretary Weaver said there were 4 million people in the category where they could afford too much to qualify for public housing but not enough to obtain decent housing on the open market.

Senator CURTIS. 4 million people who have sufficient income to provide themselves with housing and are unable to do so?

Senator KENNEDY. Secretary Weaver is going to testify and maybe he can answer that question specifically. I can answer the question that there are thousands and hundreds of thousands of people who have satisfactory incomes, but do not have adequate housing. They cannot get adequate housing. That is not only in the ghetto areas but it is in our rural areas as well.

Senator CURTIS. By satisfactory income——

Senator KENNEDY. I am talking about substandard housing. They have to be content with substandard housing.

Senator CURTIS. Their income would not be satisfactory unless it would be sufficient for them to secure housing without assistance, would it? Anyone whose income is so low that they cannot get housing without assistance would not have an adequate income, would they?

Senator KENNEDY. There are people with satisfactory incomes who cannot obtain housing in the United States.

Senator CURTIS. I notice also on page 2 you say, "We can take little pride in 30 years of low-income housing programs when our statistics show that 43 percent of all housing in the inner city is substandard, unhealthy, and dilapidated."

Senator KENNEDY. Yes.

Senator CURTIS. I also notice in the statement that is before us of the distinguished acting chairman, Senator Smathers, this statement——

Senator KENNEDY. Senator, I might add that I have a specific answer to your question. In the 1965 hearings on rent subsidies, Robert Weaver said:

> About 4 million of the Nation's families are within the income range where they are unable to afford decent housing, but have incomes above those permitted for admission to public housing.

Senator CURTIS. In Senator Smathers' statement I find this:

> The Federal Government, 30 years ago, acted to provide public housing for low-income groups. Yet over those 30 years, only 639,000 public housing units have been completed and four-fifths of these were built in communities that cannot be classified as poverty-stricken urban centers.

Senator KENNEDY. They are in areas that have a population of 25,000 or under.

Senator CURTIS. The remedy through direct Government assistance has been tried and found wanting, the Senator said.

I appreciate having those two statements because there are many people who have felt that public housing over the last 30 years was accomplishing something. I don't know, but I imagine it would be interesting to tabulate the total cost, the total administrative cost alone, of public housing on the various levels of government for the last 30 years.

I think it would be a rather shocking figure.

Senator KENNEDY. I do not think that Senator Smathers was saying—nor was I—that public housing did not benefit some of the people. The point we are making is that it benefited the poor, low-income people, in the smaller communities in the United States. It is not that it was worthless.

Senator CURTIS. Are there small communities that are poverty stricken?

Senator KENNEDY. It has not had an effect on the major urban centers. That is the problem. It has not had any real effect on the major urban centers. That is why we are concerned.

Senator CURTIS. It hasn't had any effect?

Senator KENNEDY. Not any major effect. There have been public housing projects constructed which have been very helpful. It is better that they were done than that none were done. But in the city of New York, according to a report isused there, between 1960 and 1965 we went from 420,000 substandard units to 525,000 substantard units.

Our housing is becoming dilapidated and substandard much more rapidly than new housing is being constructed. Any programs now under consideration will still not close that gap. That is what is of such concern. That is one of the reasons, Senator, why you have the tremendous dissatisfaction that exists in our ghettos. The fact is that the housing is bad; the living conditions for children are bad; the educational system is unsatisfactory; and people cannot find decent jobs. You would be unhappy, too, under those circumstances.

Senator CURTIS. Yes; I am just saying that the taxpayers have been spending something for more than a quarter of a century and the problem gets worse.

Senator KENNEDY. That is why I would like to move in a different direction.

Senator CURTIS. We paid an awful price for a chance to get worse in this country.

Senator KENNEDY. We have a chance to change it now.

Senator CURTIS. I think that is all, Mr. Chairman.

Senator SMATHERS. Senator Dirksen.

Senator DIRKSEN. No questions.

Senator SMATHERS. Senator Kennedy, we would like to invite you to sit here with the committee while we listen to the other witnesses.

Senator KENNEDY. Thank you.

Senator SMATHERS. We will insert into the record at this point the statement of Senator Pearson.

(The statement referred to follows:)

STATEMENT BY SENATOR JAMES B. PEARSON

URBAN HOUSING DEVELOPMENT ACT

Mr. Chairman, it is an honor and a pleasure for me to be here this morning to testify on behalf of the Urban Housing Development Act which I have cosponsored with the distinguished junior Senator from New York in an effort to create a large number of new low-cost housing units in the decaying cores of our sorely distressed metropolitan areas.

As the recent social explosions in the slums of Detroit, Newark, Cincinnati and 37 other American cities so tragically indicate, life in many of our metropolitan regions is proving unbearable for thousands of residents who have been trapped in a prison of poverty—a prison usually not of their own making. When summer's heat sears overcrowded families living eight in a room, when winter's cold sickens elderly residents of drafty, unheated tenements, and when hundreds of babies are hospitalized from the rat bites they have received during the night, it is time for

immediate and decisive action by the Congress to at least insure the availability of a low-cost sanitary home for all our citizens.

The Federal Government has not been idle, however. Indeed, it has attempted for the past 30 years to treat the complex problems of low-cost housing through a wide variety of programs. Noble as these efforts may have been, at best they have barely scratched the surface of a deep and growing cancer. Of the 630,000 units created since 1937 by these programs, less than one-fifth have been built in cities of over 25,000 people—the very areas where today the low-cost housing problem is so acute.

Thus, much more must be done if our large urban centers are to be rewarding places to live for all our citizens and not just the privileged few. The scope of this challenge is truly immense. The housing census of 1960, for example, classified four million urban housing units as substandard. Three million more were found in need of major repair and approximately two million others badly violated local codes or were seriously overcrowded. In sum, forty percent of housing in urban poverty areas was classified as substandard. Furthermore, there is no evidence this deplorable situation has improved in the past seven years. Quite the contrary, recent selective studies have shown that the problem is growing rapidly worse.

State and local administrations are finding that the cost of government is rising, while new revenue sources are dwindling. Even the vast financial resources of the Federal Government have been stretched to the limit by an expensive overseas war and a bewildering variety of domestic problems, of which low-income housing is only one. Thus, it is unrealistic to expect government, either Federal, State or local, to solve this difficult problem. Existing housing programs should be expanded, of course. And worthy new approaches, such as rent supplements, should be given an opportunity to prove their merit. These programs are only part of the answer, however. The long-run solution must rest with local initiative and private enterprise. For, it is here, and here alone, that creative solutions may be tailored to local problems and the vast resources of private enterprise brought into play to produce a blend of ideas and experience which will have a significant impact on our urban housing needs.

Private business has already shown considerable interest and imagination in meeting the challenge of low-cost housing. In New York City, for example, special 48-hour rehabilitation teams have proven that new techniques can swiftly renovate dilapidated dwellings at relatively modest cost.

Thus, experience indicates the willingness and capability of private industry to effectively treat our urban housing ills—when given an incentive. For the risks are simply too great to be borne alone. The bill under consideration today is designed to provide a small measure of financial security through public assistance and thus to stimulate the creation of 300,000 to 400,000 low cost housing units in our areas of greatest need. It would lower building costs through an extended interest rate subsidy and authorize tax abatement payments to municipalities to better enable them to lower real estate taxes on low-income housing projects.

This latter provision is particularly important, for, at present, property taxes are one of the most serious obstacles to the creation of low-cost housing in our major cities. In some areas they have reached an equivalent of 25 percent of total rents and thus impose a significant burden on those tenants least able to bear it. By providing an abatement subsidy, this bill would give significant relief to these hard-pressed tenants while protecting the fiscal integrity of municipal government.

In addition, this bill gives significant encouragement to the private entrepreneur through a sliding scale of tax credits related to the size of his equity investment. This stimulant encourages the investor to provide as much of his own equity as possible, thus fostering greater community involvement while extending the effect of the Federal subsidy.

This measure will encourage the construction and renovation of a significant number of two and three bedroom units that will rent for less than $100 per month. And it will make this contribution at relatively little public cost. In fact, the maximum cost of the interest rate subsidy and connected expenses is estimated at $50 million a year, a figure that is certainly not excessive in light of the enormous need that must be met and the multi-billion dollar budget that would be necessary were public financing to be relied upon exclusively.

But adequate housing, important as it is, is only part of the problem of the ghetto. Jobs must also be developed and filled in large numbers. For without jobs and an adequate level of income, even modest rents cannot be afforded by slum residents unless they are full subsidized.

A recent study by the Department of Commerce indicates how great the problem of full urban employment will become in the next decade unless forthright action is taken now. The report shows that the 29 most populous metropolitan areas of our country would have to lose 4.8 percent of their population to achieve a 4 percent unemployment rate at projected employment levels. Such a population loss is highly unlikely to say the least, especially when one considers the fact that in the decade 1950-1960 these same areas experienced a 10 percent population growth.

Furthermore, most of the new jobs that are being created in our urban areas are located in the suburbs. Most of these jobs are beyond the reach of ghetto residents because of the high skills required, the long commuting distance, and the unavailability of adequate housing open to low-income minority group members.

It is true that the long-term solution to the low-income housing problem requires both the improvement of job skills and the availability of low cost housing in the suburbs where the jobs are located. We should work toward the realization of these goals, of course, but we must also face the problems of the present.

As the distinguished Senator from New York and I proposed just two months ago, jobs must be developed in the ghetto areas of our cities now. Such a step must be undertaken immediately if we are to effectively reduce ghetto unemployment and provide our less fortunate fellow citizens with the dignity of a job and the ability to afford the low-cost housing to be constructed by the bill under consideration today.

In addition, we must face the problem of a continuing migration from the rural to the urban areas of a large number of unskilled workers—a migration which severely compounds all the problems mentioned earlier. As Senator Harris and I suggested in the Rural Job Development Act which we introduced on July 21, jobs must be provided in the rural areas too if our urban problems are not to grow beyond all hope of redemption.

In every case—rural job development, urban job development, and the provision of low cost housing—the Federal Government can do a great deal directly, but it can do even more indirectly. By providing an imaginative stimulus, our national government can release the immense resources and considerable experience of private enterprise, which, when coupled with local guidance and initiative, can begin to move our poorer citizens toward a fuller, more productive life and can offer substantial hope where none now exists.

I believe the Urban Housing Development Act offers the opportunity of taking a significant step in this direction by providing decent, low cost housing for our urban ghetto dwellers and I urge its favorable consideration.

Thank you, Mr. Chairman.

Senator SMATHERS. Our next witness is the Honorable Robert C. Weaver, the Secretary of the Department of Housing and Urban Development.

STATEMENT OF HON. ROBERT C. WEAVER, SECRETARY OF HOUSING AND URBAN DEVELOPMENT; ACCOMPANIED BY HON. ROBERT C. WOOD, UNDER SECRETARY, AND HON. PHILIP N. BROWNSTEIN, ASSISTANT SECRETARY FOR MORTGAGE CREDIT AND FEDERAL HOUSING COMMISSIONER

Senator SMATHERS. Mr. Weaver, you may proceed as you like.

Secretary WEAVER. Thank you, Mr. Chairman and members of the committee.

I appreciate this opportunity to appear before your committee to present our Department's views on a bill that is directed at one of the most serious urban problems facing us today.

The Urban Housing Development Act of 1967, S. 2100, declares that its purpose is to assist private enterprise to provide new or substantially rehabilitated housing in urban poverty areas for low and lower middle income persons at rentals they can afford.

This goal is fully in accord with the declaration of national housing

policy set out in the Housing Act of 1949 and with the goals set for this Department in the law which created it.

The development of means to meet the large need for adequate housing, for those families and individuals who cannot afford housing in the normal private market, is an activity to which I have devoted a major portion of my professional life and a goal toward which many of the programs of HUD are directed.

Before I comment on the specifics of S. 2100, I would like, by way of background, to detail briefly the principal programs of HUD that help adequately house the lower income members of our society at prices they can afford.

I believe that these programs are good programs and have helped many thousands of families to find good housing that they otherwise would not have been able to find. This is not to say that present programs are solving the problem, or that they are the only means of helping solve it. Nor does it imply that we have perfected methods to involve to the maximum degree private enterprise in this activity.

On the contrary, there is a constant need to refine old methods and develop new methods if we are to do all that remains to be done.

In recognition of this, the President has appointed a committee under the chairmanship of Edgar Kaiser to probe into the matter, and the President and HUD have instituted actions to accelerate the process of achieving good low-cost housing.

Foremost among our programs and the oldest is the low-rent public housing program. This program, first authorized in 1937, has provided decent housing for hundreds of thousands of low-income families.

We now have approximately 657,000 low-rent housing units available for occupancy, with an additional 177,000 units under contract.

Public housing, once quite controversial, has now generally come to be an accepted function of government to help house those with the lowest incomes. Innovations in recent years have contributed to this acceptance.

These innovations include the leasing from private owners of units in existing housing, the scattering of public housing residences in small projects or individual units, and the turnkey program which permits private builders to carry out many of the preliminary functions such as site acquisition and design as well as the actual construction.

We are very pleased with the accelerating progress under the turnkey program, and we believe that its close tie-in with private enterprise has contributed immensely to its success.

As you know, the President just a few weeks ago announced his approval of a plan, recommended by me and endorsed by the Kaiser committee, to explore one further ramification of the turnkey theory—the use of private management companies to run the low-rent housing project as well as to build it.

More recently, I reported to the President that by emphasizing the turnkey method and by giving priority in processing to projects which can be put under contract within 9 months, we shall at least double the annual number of public housing projects placed in occupancy over the next 12 months.

Thus, we become more responsive to the needs of our poor by achieving greater participation by private enterprise in the low-rent housing program.

In 1961, we initiated the first national moderate income housing program. From the outset it has deeply involved the private sector of our economy in the provision of housing for those who cannot afford it.

This is FHA's section 221(d)(3) below market interest rate program which permits nonprofit, cooperative, and limited-dividend sponsors to build rental and cooperative housing with 3-percent mortgages insured by FHA.

In order to keep the record straight, I think I should point out that this is different from the 221(d)(3) program that is involved in the rent supplement program.

In the rent supplement program it is not the 221(d)(3) below market interest rate program, but the 221(d)(3) program with a market interest rate which is utilized.

So here the same type of subsidy, which is used basically to effect the reduction in rents in Senator Kennedy's bill, is utilized also in the 221(d)(3) below market interest rate program.

As of June 30, 1967, some 145,000 housing units for moderate income families and individuals have been provided or are being processed under the program—the maximum at this time that can be funded under the special assistance functions of the Federal National Mortgage Association.

FNMA is the permanent mortgagee for these mortgages because of their below market interest rate. We shall continue to expand this source of credit with $500 million for further special assistance provided for in this year's budget. This is a program that can be quickly expanded as more special assistance funds are made available.

It is interesting to note that 69,000 of the units have been or are being provided by limited-dividend sponsors, private individuals, or corporations who have invested at least 10 percent of the cost of the project out of their own funds and resources. Clearly there has been no shortage of sponsors or lack of interest in this program.

The most recent of our major housing programs is the rent supplement program. Born in controversy and still embroiled in controversy, it is, I believe, the most significant recent step that the Federal Government has taken to assist in housing low-income families.

It has the decided advantage of deeply involving the private sector of the economy. Not only is the housing built, owned, and managed privately, but it is also designed to be financed privately at a market interest rate.

With the $32 million so far authorized by Congress for annual rent supplement payments, 439 projects with 33,900 dwelling units have been approved for construction. Of these, 13,900 will be owned by limited-dividend sponsors. This has occurred in the short span of 16 months since the first appropriation was made for the rent supplement program.

On the basis of these and other programs and the authorizations and appropriations we are seeking incident to them, we shall be able in the next 12 months to finance 113,000 units of low-income housing and 64,000 units of moderate-income housing.

During this period there will be the following volume of housing starts: 90,000 units of low-income housing and 44,000 units of moderate-income housing.

These data are presented not to suggest that they meet the total need, but to indicate that the current activity is substantial.

More important is the fact that on this basis substantial and rapid expansion can be effected.

Only yesterday morning at the White House, a group of major insurance companies of the Nation announced the earmarking of $1 billion to be invested in supporting housing and employment opportunities in the neglected areas of our cities and for the deprived people who live in our central cities.

In announcing this significant evidence of private enterprise's commitment to urban America, and particularly to the urban poor, the spokesman for the insurance industry specifically identified rent supplements as the area into which it would probably move most rapidly.

Here is evidence, as in the case of the turnkey approach, of how existing programs can be and are being utilized to secure meaningful involvement by private enterprise.

I have set out briefly some of the major existing activities of HUD in the field of providing housing for low- and moderate-income families in order to establish a framework within which to comment on S. 2100. The program contemplated by this bill parallels some features of these existing programs. It also proposes a major step into a new area of incentives to encourage the provision of such housing. This is the extensive use of a variety of income tax incentives. These make S. 2100 a complicated bill with extensive variable features.

As a result, it is somewhat difficult to evaluate the program's prospects in the light of past experiences, but we can estimate its cost as compared with existing programs.

The sponsor of this legislation, Senator Robert Kennedy, has outlined its provisions. I shall not repeat what he has said.

At the outset, there occur to me three major questions which I believe need to be answered in an attempt to evaluate the proposal. The first basic question is this: How does the cost of the proposal compare with the cost of established programs?

The costs to the Federal Government are significantly greater under the program laid out in S. 2100 than those under our present 221(d)(3) below market interest rate program. Although it is difficult to develop the exast Federal cost per unit under S. 2100 because of the variable tax benefits, our analysis indicates that, for a dwelling unit with a capital cost of $12,500, the monthly cost to the Federal Government under this bill would run between $50 and $104 for a unit renting a approximately $84 per month.

This compares to a cost of $31 per month under the 221(d)(3) below market interest rate program with the same $84 rental, if it were simply modified to permit, as does S. 2100, 50-year loans at a 2-percent interest rate with a Federal grant for local tax abatement.

We would be happy to put these figures in a table and into the record so they can be analyzed.

Senator SMATHERS. Without objection, we will make them a part of the record.

(The following information was received by the committee:)

COMPARISON OF S. 2100 WITH SECTION 221(d)(3) BMIR PROGRAM

For purposes of comparison, it is assumed that there are five identical buildings containing 120 dwelling units costing $12,500 each; three financed under S. 2100, one with a 20 percent equity, one with a 50 percent equity, and the other with an equity of 50 percent plus $1,000 (so as to bring the equity over 50 percent in order to obtain the more favorable accelerated depreciation method, termed "sum of the years digits"), one financed under the existing Section 221(d)(3)

Below Market Interest Rate (BMIR) Program, and one financed under a modified Section 221(d)(3) BMIR Program (50 year loans at 2 percent interest and Federal grants to compensate for local property tax abatement). In each instance, the dwelling units would be "substantially rehabilitated" existing structures (in order to achieve a development cost of $12,500 per unit) and the owners would accept the dividend limitations prescribed. Total development cost is assumed at $1.5 million, of which 10 percent is land cost, which coincides with the figures used by Senator Kennedy in his illustrations set forth in the Congressional Record of July 13, 1967 (page S 9608).

Three sets of comparisons are made. Table one shows the elements of cost determining the monthly rental under the five situations and the rates of return on the equity investment indicated by the "percent equity". The maintenance and operation expense of $40 and the local property tax of $16 shown in the table are based on FHA experience. The cash rate of return on equity is about 3 percent under S. 2100 and 6 percent under 221(d)(3) BMIR.

Pursuant to Section 102(a)(1) of S. 2100, where the equity percentage is greater than 20 percent, the gross occupancy charge is, nonetheless, calculated on the assumption that the capital cost of the housing is financed by an 80 percent loan and by a 20 percent equity. This produces a slightly higher return on equity to the owner, since the monthly capital charge on this assumed distribution of financing is somewhat higher than the monthly capital charge resulting from the actual distribution of financing (50 percent loan, 50 percent equity), and this excess accrues to the owner as a return on equity. As explained in footnote d of Table 1, the actual monthly debt service on a loan of $6,250 (50 percent of $2,500) is $16.49 and the actual monthly return on the 50 percent equity is $15.63.

To achieve the same lowest rental obtainable under S. 2100 ($82.80 under the 20 percent equity situation), it is assumed that the Section 221(d)(3) BMIR Program would be modified to permit 50 year 2 percent interest rate loans and to provide grants for local property tax abatement. Since the capital charges of $35.93 under the modified 221(d)(3) BMIR exceed the capital charges of $33.15 (loan amortization of $16.38 plus return on equity of $6.25 plus equity guaranty premium of $.52) the 20 percent equity case under S. 2100 by $2.78 the grant for tax abatement must be correspondingly larger to achieve the same rental. Thus the payment in lieu of tax shown on line 7 of table 1 is correspondingly smaller, $3.85 less $2.78 equals $1.07.

The rates of return on equity investment shown in the bottom part of Table 1 represent average rates of return over the minimum holding period needed to obtain the tax benefits under S. 2100. This is 10 years in each instance except for the case where the equity is 50 percent plus $1,000, where it is assumed that the property is sold to a Home Management Corporation after 8 years (so as to obtain a waiver of the capital gains tax). For the other cases it is assumed that the property is sold after 10 years and the sales proceeds are reused by the owner for another "low income" housing project. While an 8 year time span and a 10 year time span are not strictly comparable, these two time spans have been used to show the range of prospective costs to the Government under S. 2100, as explained below and in Table 2. Inasmuch as the initial owner is "free and clear" of the housing project after the minimum holding period, such period is used as the time span for purposes of discounting to present values the various returns and the tax benefits described in the following paragraph.

To calculate the rates of return, it is assumed that the owner in each instance is in the 50 percent tax bracket and that he has ample income from other sources against which he could apply tax losses and tax credits to obtain full advantage. Accoordingly, from the rental income (net of assumed 7 percent vacancy loss) deductions were made for those items that are deductible under the Federal income tax law, i.e., maintenance and operation expense, local property taxes or payments in lieu of taxes, the equity guarantee premium, interest on the mortgage loan, and depreciation. This produced a tax loss in each of the 10 years. To this net loss after taxes were added the value of the tax credit and the value of the capital gain (after an assumed 25 percent capital gains tax in the two cases under Section 221(d)(3) BMIR) to produce a total tax benefit. The total tax benefit was then combined with the cash return on equity to produce an annual total return. The sum of such annual total returns for the 10 years, divided by 10 (eight years divided by 8, where the minimum holding period is 8 years) was then contrasted to the respective equity investment in order to obtain an average rate of return on investment.

Average rates of return over a 10 year period fail to reflect the fact that some benefits do not occur until later years and, hence, have a lower value to the owner today. To account for this time discrepancy, present values of the actual

returns during each of the first 10 (or 8) years were calculated using an 8 percent rate of discount (a rate of return that is permitted under the Section 207 FHA insurance program).

Table 2 shows the non recoverable costs to the Federal Government resulting from the five cases of Federal assistance under review. There are six subsidy elements shown in Table 2.

So long as there is a Federal debt outstanding, the Federal Government incurs an interest cost, assumed to be 4 percent (the average interest rate of the outstanding Federal debt as of June 30, 1967), for every dollar of debt that the Treasury is unable to extinguish, either because it has lost tax revenues on account of tax relief or has made expenditures for other purposes, and thus has less money for debt retirement. It is assumed that this interest cost will continue for each successive year, as well as the present year in which the tax revenues are foregone or the Federal expenditures are made. For purposes of consistency, a four percent interest rate is also employed to calculate the present value of the actual costs incurred on account of the various subsidy items and also to measure the degree of subsidy inherent in Federal loans bearing a two or three percent interest rate.

With respect to the tax benefits, the points of comparison are the proposed changes from existing tax law. Thus, the more favorable accelerated depreciation under S. 2100 is compared to what an owner would obtain under existing law (e.g., accelerated depreciation on a 40 year life span). Neither tax credits for investments in residential properties nor waiver of the capital gains tax are provided under existing tax law.

TABLE 1.—COMPARATIVE RENTS AND RATES OF RETURN UNDER S. 2100 AND SECTION 221(D)(3) BMIR PROGRAM

	S. 2100			221(d)(3) BMIR	
	20 percent equity	50 percent equity	50 percent equity plus $1,000	Existing program	Modified program
A. Determination of monthly rental:					
1. Maintenance and operation expense [1]	$40.00	$40.00	$40.00	$40.00	$40.00
2. Loan amortization (debt service)	[2] 26.38	[2,3] 26.38	[2,3] 26.38	[4] 40.27	[2] 29.68
3. Return on equity	6.25	[3] 6.25	[3] 6.25	6.25	6.25
4. FHA mortgage insurance premium	...	...	...	...	...
5. Equity guarantee premium [5]	.52	1.30	1.30	...	...
6. Local property taxes [1]	...	...	...	16.00	...
7. Payment in lieu of taxes	[6] 3.85	[6] 3.89	[6] 3.89	...	[7] 1.07
8. Net monthly rent	77.00	77.82	77.82	102.52	77.00
9. Assume 7 percent vacancy [8]	5.80	5.86	5.86	7.71	5.80
10. Gross rent paid by tenant	82.80	83.68	83.68	110.23	82.80
B. Returns on equity investment (project cost: $1,500,000; 120 units at $12,500 each):					
1. Percent equity	20	50	50	10	10
2. Amount of equity	$300,000	$750,000	$751,000	$150,000	$150,000
3. Average annual return: [9]					
Undiscounted	[10] $84,163	[10] $176,953	[11] $212,544	[10] $39,614	[10] $38,124
Discounted at 8 percent [12]	$53,216	$116,160	$153,917	$23,481	$23,008
4. Average annual rate of return (percent): [13]					
Undiscounted	28.1	23.6	28.3	26.4	25.4
Discounted at 8 percent	17.7	15.5	20.5	15.7	15.3

[1] Based on FHA experiences.

[2] 50-year loan at 2 percent interest.

[3] Pursuant to sec. 102(a)(1) gross occupancy charge is calculated on assumption of 20 percent equity and 80 percent loan, even though owner-mortgagor actually has a 50 percent equity. In effect, the impact on the rental resulting from capital charges (loan amortization plus return on equity) is increased from $32.12 (16.43 plus 15.63) for the 50 percent equity to $32.63 (26.38 plus 6.25) for the 20 percent equity.

[4] 40-year loan at 3 percent interest.

[5] Based on 0.25 percent of equity investment per year. Since sec. 102(c) authorizes the collection of an equity guarantee premium to "maintain the fund on a sound basis," it is assumed that a proportionate premium related to size of equity would be collected, even though such proportionate premium would be at variance with method of determining gross occupancy charge prescribed in sec. 102(a)(1).

[6] 5 percent of net monthly rent.

[7] Difference between $77 and sum of 1st 3 items.

[8] 7 percent of gross rent paid by tenant.

[9] Cash returns plus value of tax losses to owner in 50-percent tax bracket.

[10] Sum of actual returns during 1st 10 years divided by 10.

[11] Sum of actual returns during 1st 8 years divided by 8.

[12] Present value of actual returns, using 8 percent rate of discount.

[13] Average annual returns (line 3) divided by amount of equity (line 2).

TABLE 2.—COMPARISON OF FEDERAL COSTS FOR PROJECT COSTING $1,500,000 (120 UNITS AT $12,500) OVER MINIMUM HOLDING PERIOD[1]

Subsidy element	S. 2100			221(d)(3) BMIR	
	20-percent equity	50-percent equity	50-percent equity + $1,000	Existing program	Modified program
1. Interest rate subsidy	[2] $176,720.00	[2] $110,460.00	[2] $88,240.00	[3] $98,030.00	[2] $198,820.00
2. Waiver of insurance premium [4]	53,543.00	33,465.00	27,354.00	60,240.00	60,240.00
3. Grants for local property tax abatement [5]	87,480.00	87,190.00	68,752.00		107,570.00
4. Tax credit [6]	45,000.00	180,000.00	180,000.00		
5. Accelerated depreciation	[7] 175,790.00	[7] 476,502.00	[8] 473,726.00		
6. Capital gains tax exemption	[9] 187,144.00	[9] 337,500.00	[10] 319,174.00		
7. Total cash cost	725,6/7.00	1,226,417.00	1,158,246.00	158,270.00	366,630.00
8. Interest cost [11]	132,393.00	238,727.00	195,657.00	35,266.00	81,095.00
9. Grand total cost [12]	858,070.00	1,465,144.00	1,353,903.00	193,536.00	477,725.00
10. Present value of grand total costs [13]	718,789.00	1,247,558.00	1,202,266.00	165,418.00	382,106.00
Average actual costs per unit per month [14]	59.59	101.75	117.53	13.44	31.09
Average present value of actual costs per month [15]	49.92	86.64	104.37	11.49	26.53

[1] Minimum holding period necessary to obtain tax benefits; assumed to be 10 years in each instance, except where owner furnishes equity capital equal to 50 percent of cost plus $1,000. For the latter it is assumed to be 8 years, upon the expiration of which the housing project is sold to a home management corporation.

[2] Difference in annual debt service on indicated loan amount between a 50-year loan at 2 percent and a 50-year loan at 4 percent (the average interest rate on the outstanding Treasury debt, as of June 30, 1967).

[3] Difference in annual debt service on $1,350,000 between a 40-year loan at 3 percent and a 40-year loan at 4 percent

[4] ½ percent of outstanding loan balance in each year.

[5] 50 percent of monthly difference between $16 and indicated payment in lieu of tax times number of months in minimum holding period, times number of dwelling units.

[6] Tax credit rate (per sec. 1392 investment credit) applied to total project cost.

[7] 50 percent of annual difference between depreciation allowance over shortened lifespan (20 years and 10 years respectively) with depreciation over 40-year lifespan (usual life of residential property), with depreciation calculated by the 150-percent declining balance method.

[8] 50 percent of annual difference between (1) depreciation allowance calculated by the sum of the years digits method with an estimated lifespan of 10 years and (2) depreciation allowance calculated by the 150-percent declining balance method over a 40-year lifespan.

[9] Capital gains tax that might have been paid, but waived because owner reused proceeds from sale of housing project for another "low-income" project.

[10] Capital gains tax that might have been paid, but waived because property sold to a home management corporation.

[11] Simple interest at 4 percent per year on annual cash cost times number of years remaining during minimum holding period (including present year).

[12] Total cash cost plus interest cost.

[13] Present values of annual grand total costs, discounted at 4 percent.

[14] Grand total costs divided by number of dwelling units times number of months in minimum holding period.

[15] Present value of grand total costs divided by number of dwelling units times number of months in minimum holding period.

Secretary WEAVER. The second question is: Are rewards as great as those proposed in S. 2100 necessary to attract private enterprise into this field?

Our experience suggests two alternative possible approaches which I believe to be more effective. The first is to offer an opportunity for limited-dividend sponsors to make a much smaller long-term commitment of capital and look to the accelerated depreciation provisions under present law as the incentive to remain involved over a period of 10 or more years.

Only last week, I talked to a group of investors in San Antonio, Tex., who were already committed to sponsoring some 1,600 units of 221(d)(3) housing. They stated they would like to expand their operations.

The president of a large corporation recently indicated that a consortium of industries might undertake a much larger program of a similar nature, again utilizing the 221(d)(3) program but limiting its long-term investment to 10 percent of the cost.

A second approach, which needs to be considered as an alternative, would involve the construction of low- and moderate-income housing by private enterprise and the spinning off of the finished product to a limited-dividend or a nonprofit sponsor. The latter would purchase and manage the housing.

Already, several large corporations, such as U.S. Gypsum, have done just this. Only yesterday they announced another project of this nature.

In Atlanta, the Celotex Corp. is constructing a 221(d)(3) development which will be purchased and managed by a local church.

And, of course, there is no reason why any type of ownership could not buy competent management. This could be done on a fee basis and is already being proposed as the latest development in turnkey public housing.

Several turnkey developers are proposing 221(d)(3) projects on sites to be shared with the turnkey public housing. They have proposed that they provide combined management for both developments, and that they stay with the 221(d)(3) project.

The third basic question relates to the fiscal and tax implications of S. 2100. Since I am not an expert in the field, I shall defer to the Treasury Department on this matter. Under Secretary Barr who will follow me will discuss this aspect of the bill in detail.

S. 2100 presents other problems. First and primarily, I am concerned about the severe geographic limitations contained in the bill for the location of these housing projects. Only housing constructed in poverty areas located in major metropolitan areas would be eligible for the very significant Federal subsidies set out in the bill. This I believe to be a serious mistake.

We have severe urban housing problems in smaller urban areas as well as those with a population in excess of 250,000. Fewer than 125 standard metropolitan statistical areas out of a total of 231 would qualify for these new housing projects. When I say new, I don't mean new construction, but new programs.

More significant, however, is the limitation of these projects to existing poverty areas. I agree wholeheartedly that housing is needed for those living in our poverty areas, many of which are racial ghettos.

I concur entirely with the Senator. It is not right to talk about doing nothing in these areas and only looking to opening opportunities outside of them. These are two sides of the same coin and we have to do both simultaneously.

Therefore, I would certainly encourage placing housing in these areas in all appropriate cases. However, to limit this housing solely to these areas would be undesirable. It would tend to strengthen the barriers that already confront the poor and the minority groups and prevent them from breaking out of these areas and becoming assimilated into the general stream of our society.

To consider restricting a major housing aid program primarily to the ghetto would be a significantly backward step. I believe that any program of this nature should be available for housing built in any section of our urban areas.

Although the bill states that its aim is to provide housing for low and lower middle-income persons, the income-to-rent ratio set out in the bill is in effect directed generally toward those families in the latter income group. This is brought about by the fact that a new tenant may pay as low as 18 percent of his annual income for rent as opposed to the public housing program which normally requires a tenant to pay 20 percent of his income for rent and the rent supplement program that requires a tenant to pay 25 percent of his income for rent.

At a monthly rental of $84 per month for a unit costing $12,500 and the income-to-rent ratio prescribed by the bill, the income level served would be $5,600 per year.

Senator KENNEDY. I was not sure that you were clear about where it says "may pay." It says "may pay" as low as 18 percent but it does not require it.

I think that figure of $5,600 is misleading.

Secretary WEAVER. I think the problem here, and this may be covered by the bill because it may be optional, is if you are going to get down to the income groups we have been talking about, that you were talking about this morning, he is going to have to pay more than that.

Senator KENNEDY. I agree with that. But it says "may pay."

Secretary WEAVER. This was the top.

Senator KENNEDY. But it is quite clear in the bill. I do not know why you brought it up.

Senator SMATHERS. Please proceed, Mr. Secretary.

Secretary WEAVER. The effort to involve tenants in the operation of the project through the home-management corporation is a move in the right direction. This direction is comparable to our experiments with the cooperative form of ownership and one which we have been encouraging local housing authorities to take in their federally assisted low-rent public housing projects.

However, I am concerned about some of the implications of such involvement under the specific provisions of the bill. Although the bill is vague as to the exact nature and degree of involvement to be given the tenant organizations, it would seem that the owner of the property might have to turn over to his tenants major management decisions which can substantially affect the continuing value of his equity. This very vagueness could give rise to a most difficult problem in the operation of the housing development.

There is a significant difference between involving the tenants of a low-rent public housing project in some management decisions—and I think they should be, much more than they are—where you have a governmental entity, and involving them in management decisions on a broad scale for a project that is privately owned.

Although, of course, they should be involved there, too.

Another problem is the means of assuring continuity in the policy of the management organization where membership consists solely of tenants, at least during the first—now it would be two—8 years when they have no financial stake in the property and where it is reasonable to expect a frequent turnover in tenants.

The CHAIRMAN. Mr. Secretary, if I could interrupt you for a moment, let me ask you about one thing that does concern me very much about this bill. This is a very interesting bill and certainly deserves study.

Your statement deserves more study than I have been able to give it to this point. What concerns me about this bill to a considerable extent is that it would seem to me that in these congested areas our objective should be to try to move people out of them, into the suburban areas, and to perhaps build some industries out there, and to build some better housing and provide better transportation for people there.

If one plant wants to provide 500 jobs for low-income people, it might be a good idea to give them some incentive to put a plant out

from the city and to provide some very modern facilities to get the people back and forth.

Perhaps they could provide high-speed transportation at off-peak hours, for example, to get the people back and forth. I should think that with regard to a lot of these so-called ghetto areas, our objective should be to tear the thing down and build some parking in its place, or else put parks in.

What is your reaction to that?

Secretary WEAVER. I must say that I think, as I said earlier, we have here two sides of the same coin. But let me point out several things. In the first place, I think that, regardless of the present conditions in these ghetto areas, many of them are very good real estate. Harlem is one of the most desirable parts of New York City. So is the South Side of Chicago. Northwest Washington is good real estate.

I think it would be a mistake to say that we will despair of these areas and not have any more housing in them. I think they have to be rehabilitated. But I think by the same token that simply rehabilitating these areas is not enough. Many of them, and I must disagree slightly with the Senator, have pretty high densities and some of them, if you look at the natural increase of population, would not be able to absorb this natural increase without having even higher densities. Even if you are going to rehabilitate them, you still have a problem of relocation, a problem of dispersal.

Also, I think, while it is possible and probably desirable to have some new industry in these areas, most of the residents in the area now employed are employed outside of them and this will continue.

So you have to have transportation, you have to have dispersal, and I think you have to have rehabilitation, all three simultaneously.

The only difference between the Senator and myself on this is probably the mix.

The CHAIRMAN. I would like to ask you one further question about this matter. It has to do with the regional problems, which might not concern you too much, but which is very vital to me.

Senator Kennedy does a magnificent job of representing that great State of New York. I am doing my humble best to represent a State smaller in population, although perhaps tops in quality, Louisiana.

Can you tell me how Louisiana will get its share of money? We are not a high-income State.

Secretary WEAVER. I would think that New Orleans, La. certainly would qualify for this type of development, and perhaps Baton Rouge and Shreveport, depending on the size of their metropolitan areas.

The CHAIRMAN. Do you think you can work this thing out in such a fashion or do you think you can work it out in such a fashion that we don't wind up making the poor States poorer while we make the rich States richer?

Secretary WEAVER. I think that legislation or an activity designed to accomplish the purposes of this bill, with which I am in large agreement, would extend its benefits pretty much across the country, more or less on the basis of population distribution. More of it would go into the more populous States. Any program that deals primarily with people has that effect.

The CHAIRMAN. That doesn't concern me, New York getting more money because they have more population. But I want to be sure that

we don't work something out where New York gets it all. You think we can work it out where a little State like Louisiana can get our proportionate share of this?

Secretary WEAVER. I have many more problems with this bill than that problem.

The CHAIRMAN. As far as I am concerned, I don't know of any more basic problem in the bill than that.

Secretary WEAVER. Just as I defer to the Treasury on the tax problems, I will defer to you on that problem.

Senator WILLIAMS. Do you feel sure after New York and Louisiana get through dividing there will be just a little bit left for the other 48 States?

Secretary WEAVER. On that I can give you great assurance.

I agree with the desirability of permitting a home-management corporation representing the tenants living in a project to purchase the project.

Here I will have to revise the rest of this because I speak of the 8 years and you talk about 2 years. Let me say that with the 2-year modification some other problems come up.

The first one is whether or not this would be an incentive, as I am afraid it might be, for the owners to tend to milk the property, and also, and to me more important, this could alter both your and my figures as to the tax benefits on the one hand and the cost of the program to the Federal Government on the other hand.

I am not a lightning calculator, so I cannot talk to that at the moment.

Again, I had some problems about, as you know, the use of local tax abatement because of the constitutional and the local legal problems. Here you have proposed an amendment which would deal with this.

It seems to me, and I just saw it this morning, this would meet the problem.

I would like to discuss briefly the relocation payment provisions of the bill.

I believe it would be a mistake to provide for relocation payments which differed substantially from those now applicable to all other HUD programs.

I would like the record to show that the programs of HUD have the only relocation benefits that are both uniform and of a high standard. They are not as high as I would like to see them, but they are much higher than any of the others. But to have one program in an agency which isn't consistent with the others is difficult. I have been bringing the others up to urban renewal.

The problem presents itself in this case with respect to the payments authorized for displaced families and individuals.

These payments are substantially the same as those approved by the Senate when it passed S. 1681 last year.

As you know, this would provide a comprehensive and consistent approach to relocation throughout the Government, one which I support very strongly.

I believe it is better to treat the relocation problem as a whole and not on a piecemeal basis.

Therefore, I would recommend that any relocation payments authorized by this bill be the same as for other HUD programs, or that new, uniform standards be extended to all HUD programs or, preferably, to all federally assisted programs as was provided in S. 1681.

In other words, I am not against the higher standards, but I would like to see them universal, and I would like to see the standards of HUD consistent.

I have spoken somewhat at length on the problems, as I see them. The concerns I have expressed should not be taken as an indication of any disinterest on my part, or that of the administration, in finding new and better means of providing housing for lower income persons. I am deeply concerned about these problems, but I am also concerned about devising efficient and effective means of solving them.

I would urge the committee to consider seriously the questions and issues raised by the proposal; and I would also urge it to consider the possibility of building upon existing programs.

We are continuously seeking ways to make these existing programs operate more efficiently and to become more responsive to their potential users.

One example that immediately comes to mind is the turnkey method of providing low-rent public housing. The great advantage of turnkey is not only that it deeply involves private enterprise, but that it also enables us to provide public housing so much more quickly, and somewhat more cheaply.

By taking the turnkey route, the time it takes to provide a project ready for occupancy has been reduced by 50 to 60 percent.

Another significant innovation is what we call accelerated multifamily processing. We are experimenting with this in several of our regional offices. It involves giving the regional office more authority in processing and approving FHA multifamily insurance applications.

With AMP we expect to be able to reduce processing time on multifamily cases by as much as two-thirds, thereby enabling us to provide more expeditiously this housing, a good part of which is for low- and moderate-income persons.

Among the projects that could be speeded by AMP are section 221(d)(3) below market interest rate housing and rent supplement housing.

My experience suggests that the most effective means of achieving a large volume of privately financed and managed low- and moderate-income housing lies in these directions.

I recommend, therefore, that careful consideration be given to a reappraisal of the roles of private, profit-motivated enterprise, limited-profit investors, and nonprofit organizations.

While the latter have a vital role to play, I am convinced, as this bill implies, that profit-motivated enterprise is most effective in producing quickly a sizable amount of housing.

Therefore, I would propose that we look to such enterprise as the means for building the bulk of the shelter that is needed.

At the same time, I suggest that some of those who are interested in developing the needed shelter may, because of the possibility of small long-term investment and rapid depreciation, wish to remain

as the owners, operators, and managers of the resulting housing. This they can do, and increasingly are doing in the 221(d)(3) below market interest rate and rent supplement programs.

Many others who are highly capable of planning and constructing low- and moderate-income housing, through rent supplements or 221(d)(3) developments, do not wish to remain as long-term investors. These can spin off the finished product (completed housing) to limited-dividend, nonprofit, or cooperative groups. The latter would own the properties. They would either manage them directly or purchase management on a contract basis.

The result of improving and expediting these programs would be an accelerated volume of new construction and rehabilitation and the provision of management more responsive to the needs and aspirations of the tenants.

Such an approach would, as does our current turnkey public housing plan, utilize fully private enterprise in both construction and management. It would be attractive to the private entrepreneur who choses a short-term involvement and to the one who elects to stay with the development for a longer term. And the cost to the Federal Government would be readily ascertainable.

I appreciate the opportunity your committee has given me to present these comments. I would be pleased to answer any questions you have.

Senator SMATHERS (presiding). Thank you very much, Mr. Secretary.

I shall ask you just a couple of questions and then turn you over to the other members of the committee.

Mr. Secretary, what is your information as to how many people in the low-income groups today are not adequately housed?

Secretary WEAVER. Well, of course, any of these figures are estimates, but the bulk of the low-income families in this country are not now adequately housed and, in addition, as the Senator pointed out, we have a large number who are not low income who are still not adequately housed.

Most of these are the people who are living in the ghetto or the prototype of the people who are living in the ghetto.

Senator SMATHERS. Is it your judgment that we are gaining ground or losing ground with respect to providing low-income families with adequate housing?

Secretary WEAVER. We are gaining. Unfortunately, a lot of the statistics that have been used have been based upon a redefinition between the two periods of study.

I have just received the preliminary estimates, for example, from the 1966 survey of economic opportunity conducted by the Census Bureau for OEO. These estimates indicate that, whereas in 1960, 16 percent of the Nation's occupied housing was substandard, by 1966 it was only about 10 percent.

So we are gaining. We are not gaining as quickly as we ought to, but we are not losing ground, as some of the earlier figures suggested.

Senator SMATHERS. Do you believe that we are gaining in the ghettos in the larger cities of the United States, providing more housing for these people, or is the housing situation deteriorating in the ghettos?

Secretary WEAVER. Let me say two things:

In the first place, I don't think we have definitive data, but every indication I have would suggest that, particularly in the larger and the more highly crowded ghettos, the situation is not improving, and probably deteriorating.

Senator SMATHERS. I thought that is what I heard you say a moment ago in answer to a question from one of the committee members. I gathered that you implied, if you did not state explicitly, that with the increase in the population of the ghettos, the rapid rate of growth of people of low income, we are not keeping up, and that there is no way under the present programs to keep up with the problem of adequate low-income housing.

As a matter of fact, we are losing ground. It is for that reason that some people were thinking of moving low-income groups out to suburbia.

Is it not a fact that in the ghettos the population is running much ahead of the increase in housing?

Secretary WEAVER. There are two things that are occurring. In the first place, you are getting a movement of people not to the suburbs from the ghettos, but into other parts of the central city, some of whom are able to upgrade their housing as their incomes have moved up.

At the same time you are getting a movement of people into these areas who are low income and who remain low income. The ghettos have never adequately housed these people. In some of our cities, or most of our cities, I would say, practically all that I have seen data on, the number and proportion of substandard housing is declining.

But in the pockets of poverty the numbers are declining much more slowly than elsewhere, and the population is increasing. So the relative situation is becoming worse in these areas.

Senator SMATHERS. So the relative situation becomes worse. In essence, we are losing ground. If that is the case, then, does that not indicate that we need some new approach to this problem?

Secretary WEAVER. I think it indicates that we need an expansion in this area, and that we have to do more and do it more rapidly than we are doing it. I don't say we have to have a new approach, because I am not at all convinced that there is anything substantial that the new approach would do that we can't do with existing approaches. I am also convinced that with the existing approaches we can do it with less cost to the Federal Government.

Senator SMATHERS. You have made reference to a new turnkey public housing program, in which private builders are building low-cost housing. How significant has that been in terms of units? How many turnkey public housing units have thus far been built by private investors?

Secretary WEAVER. I think it is around 7,000 to 10,000 units that are now in various stages, some in completion and some under construction. We are getting now, as I mentioned, all of the public housing units that can utilize the turnkey method, and as a result of that, we will double the number of units that will be ready for occupancy in the next 12 months over the last 12 months without any increase in authorization.

Senator KENNEDY. How many were ready for occupancy in the last 12 months?

Secretary WEAVER. We will go from 35,000 to 70,000.

Senator KENNEDY. Then the answer to Senator Smathers is that there was 35,000 prepared for occupancy.

Secretary WEAVER. I don't think he asked that question. He asked about how many were under turnkey.

Senator SMATHERS. My question is how many are under it and how many have you built?

Secretary WEAVER. We will now be building all that are authorized under the authority we have from the Congress. My point is that we can build more if we get more authority and we can build them much more rapidly with the turnkey approach than we could before.

Senator SMATHERS. Is it your judgment that the Congress is going to appropriate funds for more of this type of public housing?

Secretary WEAVER. I would defer to your judgment on that.

Senator SMATHERS. Frankly, my judgment is that the Congress, is looking for some new approach. As a matter of fact. even though in our State we have had a relatively satisfactory public housing program, almost everybody is looking for a new and better method of doing it.

This bill, as I understand it, is designed to get private enterprise into the program.

Secretary WEAVER. Let me say two things there: The current bill is not going to be a substitute for public housing. I don't think it was intended to be a substitute for public housing. It cannot provide housing through new construction in our higher cost cities, where the greatest problem is, at rents which will be comparable to the public housing program. Nobody has ever said that it would.

So we still have the problem of providing housing for the lowest income elements of our population. Insofar as there are units in these areas which are structuraly sound and which can be acquired at a reasonable price and rehabilitated, this will meet a part of that need. But in the high-cost areas it will not, and I don't think the Senator ever has said that it would, provide housing for a large number of low-income people through new construction.

Senator SMATHERS. Is it not a factual statement that with respect to the building of adequate housing for low-income people in the ghettos and the areas which breed riots and crime and disease, we are losing ground?

Secretary WEAVER. This is one of the tricky statistical concepts. I would rather put it this way: Whether we are losing ground or gaining ground, if we are gaining it, we are gaining it very, very slowly.

Senator SMATHERS. You are losing ground with respect to population. That is what you said a moment ago.

Secretary WEAVER. I think there is no question in my mind and no question in your mind that we are far from providing the volume of housing that is necessary and that we need to accelerate materially, much more than we are doing now, much more than this bill would do, in order to meet the needs that a society which is affluent should meet.

Senator SMATHERS. You say on page 16:

I am convinced, as this bill implies, that profit-motivated enterprise is most effective in producing quickly a sizable amount of housing. Therefore, I would propose that we look to such enterprise as a means for building the bulk of the shelter that is needed.

It seems to me that that is exactly what this bill seeks to do.

Secretary WEAVER. It certainly does, but I think there are other ways of doing it that will be equally as effective and less expensive.

Senator SMATHERS. Essentially, what you are saying is that we should do it by doing more of what we have been doing.

Secretary WEAVER. By using more of the new departures than we have been doing, rather than what we were doing 5 or 6 years ago.

Senator SMATHERS. Senator Williams.

Senator WILLIAMS. I just have one question, Mr. Secretary.

On page 5 of your statement you have this statement:

Yesterday morning at the White House a group of major insurance companies of the Nation announced the earmarking of $1 billion to be invested in supporting housing and employment opportunities in the neglected areas of our cities and for the deprived people who live in our central cities.

My question is: To what extent will these funds be guaranteed by the U.S. Government?

Secretary WEAVER. Insofar as they are involved in mortgages, they will be FHA-insured.

Senator WILLIAMS. One hundred percent guaranteed?

Secretary WEAVER. FHA-insured; yes.

Senator WILLIAMS. It is contemplated that they will be through the FHA; is that not true?

Secretary WEAVER. Yes, sir.

Senator WILLIAMS. So, in effect, what this means is that they will be loaning $1 billion on mortgages which carry, in turn, a 100-percent Government guarantee.

Secretary WEAVER. Yes, but they will be purchasing them at a price that they are not now able to be sold at. They are going into areas where they haven't been before, and they are buying the types of mortgages they haven't bought before, at a price which nobody has paid before.

Senator WILLIAMS. I understand the mechanics of it.

What rate of interest would be allowed?

Secretary WEAVER. It depends upon which mortgage. But if they buy, as they say they will, rent supplement paper, 221(d)(3) at a market interest rate, it will be at 6 percent.

Senator WILLIAMS. That would be a 6-percent Government-guaranteed obligation; is that right?

Secretary WEAVER. That is right.

Senator WILLIAMS. That would be about 1 percent more than could be obtained in yield from a Government bond invested at the same time; is that correct?

Secretary WEAVER. I imagine so. I don't know.

Senator WILLIAMS. But they are all 100 percent Government guaranteed?

Secretary WEAVER. Yes.

Senator WILLIAMS. That was my understanding. I wanted to be sure.

When you speak of this being the great venture of private industry, they are really moving in with a Government guarantee of 100 percent.

Secretary WEAVER. And moving in at a price that is favorable to our program.

Senator WILLIAMS. And slightly favorable to the lender when you can get a 6-percent, 100-percent Government-guaranteed mortgage. A 6-percent Government-guaranteed note is not too bad, either.

Secretary WEAVER. That is not a competitive return in today's market. They will not get 6 percent. These mortgages cannot be sold at as favorable a price in the market.

Senator WILLIAMS. Thank you.

Senator SMATHERS. Senator Kennedy, the committee would like to extend to you the opportunity to ask any questions you might have.

Senator KENNEDY. Thank you, Mr. Chairman.

Just to follow up what Senator Williams said; Is it correct that they will build under 221(d)(3)?

Secretary WEAVER. No; they will not build. They will finance. You have to differentiate again with 221(d)(3). The 221(d)(3) mortgage, which has the same type of subsidy as you would use under this bill to keep your rents down, has an interest rate subsidy. They would obviously not purchase because at the present time the interest rate is 3 percent and under your program it would be 2 percent.

But they would buy 221(d)(3) mortgages at a market rate of interest, and these are the mortgages on which the rent supplements are based.

Senator KENNEDY. How much is a unit in the city of New York, Chicago, or Los Angeles under 221(d)(3) going to rent for?

Secretary WEAVER. Are you talking about below market? Which program?

Senator KENNEDY. How much rent supplement will you have to pay to get the tenant in there?

Secretary WEAVER. It depends upon the tenant's income.

Senator KENNEDY. What do you expect with a tenant income of $4,000?

Secretary WEAVER. The supplement, depending again upon the cost of the unit, would vary from $40 to $60 a month.

Senator KENNEDY. It probably would be up to $70, would it not, in a major city?

Secretary WEAVER. It depends upon, again, the type of construction. But it might go as far as that.

Senator KENNEDY. And that would be very rare that you got down to $40, would it not as a practical matter?

Secretary WEAVER. It all depends upon what his income is. As you say, if it is $4,000, then there is the size of the family. It depends upon how large a unit he needs. If he needed a 2-bedroom unit, it would be less.

Senator KENNEDY. How many 221(d)(3) units are being constructed in the ghettos at the present time?

Secretary WEAVER. In New York City we have just to give you one example—but you asked in the ghettos.

Senator KENNEDY. Yes, not just in the city.

Secretary WEAVER. I don't know. I couldn't tell you.

Senator KENNEDY. Do any of your assistants have that information? I don't want to be rude, but that is what we are discussing.

Secretary WEAVER. You have to define what you mean by a ghetto. For example, we have provided over one-third of this aid on urban renewal sites. Most of these urban renewal sites were parts of slums and are often in areas that would be surrounded by slum areas.

Would that be a ghetto? For example, we have just financed a 221(d)(3) cooperative in Southwest Washington, which was, as you know, one of the worst slums in Washington. It is now rehabilitated. Is that in the ghetto?

Senator KENNEDY. It was a ghetto at one time before rehabilitation went on.

Secretary WEAVER. If you take that definition, about 30 or 40 percent.

Senator KENNEDY. For instance, in Harlem, how much 221(d)(3) has been placed in Harlem?

Secretary WEAVER. I can't give you Harlem. I can give you New York City. About 2,000 units.

Senator KENNEDY. In New York City?

Secretary WEAVER. In New York County—Manhattan.

Senator KENNEDY. 2,000 units in what period of time?

Secretary WEAVER. Since about 1962, when we got the regulations out on it.

Senator KENNEDY. And what do they rent for?

Secretary WEAVER. We will have to supply that to you.

Senator KENNEDY. Approximately what do they rent for?

Mr. BROWNSTEIN. I would say that the average rent would probably be, for a two-bedroom unit, around $120 a month for new construction, but much less for rehabilitated.

Senator KENNEDY. Let me ask you about another place. How about Watts? How much 221(d)(3) have you placed in Watts?

Mr. BROWNSTEIN. We have a couple of projects there, but not as much as in Harlem.

Senator KENNEDY. How many do you have?

Mr. BROWNSTEIN. I can't answer you specifically, Senator, but we have a couple of 221(d)(3) projects of which I am aware in Watts.

Senator KENNEDY. Can you tell me how many 221(d)(3) you have in Bedford-Stuyvesant?

Secretary WEAVER. I don't keep these figures in my head.

Getting back to your earlier point about the rent, I think it should be indicated that the basic component of reducing rent under both S. 2100 and the 221(d)(3) below market interest rate program is primarily the same. It is an interest-rate subsidy.

The difference between the two is that the subsidy you propose is a subsidy to bring the interest rate down to 2 percent and we have it down to 3; you make it 50 years and we have it at 40 years.

In addition to that, you have the provision for the local tax abatement which is a new item. But the machinery for keeping rents down is basically the same. There is very little difference between them. There is nothing in your bill that couldn't be put, by a simple amendment, into ours, or from ours that couldn't be put in a simple amendment into yours.

Senator KENNEDY. My point is that we are not doing it at the moment.

Secretary WEAVER. There are 800 units under 221(d)(3), for Bedford-Stuyvesant.

Senator KENNEDY. When were they constructed?

Mr. WOOD. There were approved, I understand, by the board of directors of the Bedford-Stuyvesant Restoration Corp., but are only proposed. By the way, the Restoration Corp. and the New York City Planning Commission recently approved 1,200 low-rent, public housing units for the area, out of a reservation given the New York City Housing Authority 2 years ago.

Senator KENNEDY. Are they available yet?

Mr. WOOD. No.

Senator KENNEDY. How many units are there actually in Watts?

My point is, that 221(d)(3) is inadequate. When you talk about 2,000 units in Manhattan which rent for $120 a unit that hardly deals with the problem.

Secretary WEAVER. Let me answer that in two ways. The volume of our program is determined by the amount of special assistance funds that are made available just as it would be in your program. The limitation on the amount of housing is the amount of special assistance funds that will get you the below-market rate of interest.

We have many developers who have indicated and have already placed applications for 221(d)(3) which cannot be accepted because we don't have the money to finance them. There is no problem of the program being slow now. The problem is getting the financing.

Senator KENNEDY. You said during the 1965 hearings on rent supplements that the 221(d)(3) program has been successful, "but it has served only the top of the moderate-income families and it has not gotten down to the people who are still between it and public housing. It serves a little bit of the layer between public housing and private, but you have a whole lot left in there and this whole lot is getting larger."

Secretary WEAVER. And this can be said in part of your proposal, and it can be corrected in 221(d)(3) by the simple device of making the same type of financial arrangements, to wit, 50-year mortgages at 2 percent.

Senator KENNEDY. I think that would be a step forward. Are you going to suggest it for 221(d)(3)?

As I said in my testimony, I am not wedded to these figures. What I would like to do is make more housing available. But what concerns me is that really, Mr. Weaver, as both of us know, and as all of your assistants know, the housing programs that have been in existence up to the present time have not made housing available for those in the low-income group.

Secretary WEAVER. And your program will not either, unless it is adequately financed. No program will, but the point I am making is that the programs we have, if they are adequately or further financed, will be effective.

Senator KENNEDY. If there are improvements made in 221(d)(3)—changes along the lines that presently exist in the legislation that Senator Smathers and I have introduced—that will make it more available for people who live in the ghettos.

Secretary WEAVER. But 221(d)(3) is not designed primarily to deal with the lowest income problems, and I don't think your bill is either.

But rent supplements are designed to do that. You cannot use your bill to house the people who are now in the public housing level of

income if you are going to provide new construction or if you are going to provide major rehabilitation of buildings that are expensive.

Senator KENNEDY. The legislation that I introduced along with other Senators and Congressmen reduces the rents to anywhere from $70 to $90 or $70 to $100. In the example you used, it gets it to $84 a unit as compared, under 221(d)(3), to about $120 or $130 a unit.

That has an effect on a sizable portion of the population. But it can go beyond that. As I said in answer to Senator Curtis, you could have a rent supplement which could take this reduced cost down to $50. But at least you have a manageable situation if you have it at $70 or $80.

My concern, quite frankly, with the $1 billion program that was announced yesterday is that using it, with 221(d)(3) will produce a rent supplement that is going to be tremendous.

Secretary WEAVER. You are not talking about that.

Senator KENNEDY. Could I finish?

We are talking about rents of $120 and to get this sum down into the area of the people for which this housing will be available means that you have to get it down to $60 or $70.

Secretary WEAVER. Obviously neither the program that you are proposing nor the programs that we have now, except for rent supplements and for public housing, get down to $60 and $70. Neither one of them does this.

The second thing is——

Senator KENNEDY. Mr. Weaver, I think it is fair to separate these. You can't associate the legislation we have suggested and what we are considering today with 221(d)(3).

Secretary WEAVER. Yes, you can.

Senator KENNEDY. It is $30 or $40 less.

Secretary WEAVER. All you have to do is give it the same favorable financing which you have in yours. Why create a whole new instrument if you can take an instrument you have and by a simple action make it as effective as the other one?

Senator KENNEDY. Are you suggesting that?

Secretary WEAVER. I am not here to suggest legislation. I am here to answer questions on your bill.

Senator KENNEDY. Do you think it would be a good idea?

Secretary WEAVER. It could well be. But let me say, before I would suggest such legislation, I would have to first look and see whether or not we are proliferating programs and whether or not we have now within the existing tools other programs that might do this. It may well be that we don't. If so, then this would be a suggestion which I think would be desirable.

But I do want to clear up one thing which constantly has come up in this hearing, and that is that there are two 221(d)(3) programs. The 221(d)(3) program which is comparable to the program that you are talking about in your bill is one of an interest subsidy. It is now fixed at 3 percent.

Rent supplements do not go on top of that program. It is not a rent supplement plus an interest supplement. The mortgages carry a market rate of interest. This is what the insurance companies are talking about buying at 6 percent.

On this basis the rent is then reduced by a supplement. So you don't have two supplements. You have one supplement. Therefore, that supplement in cash has to be greater than it would be if it were put on top of, say, your proposal or on top of a 221(d)(3) below-market interest rate mortgage.

Further, we can produce at a much lower cost in subsidy, at any rental level under 221(d)(3) than under the proposal that is before us. I think this has to be considered, if for no other reason than you are always going to have a limited amount of money for subsidy, and if you can get cheaper subsidy you can get more housing with the amount of subsidy you have.

Senator KENNEDY. I don't want to take too much time, Mr. Weaver, but where you say 145,000 units—and I am just making this point because I am concerned about the fact that under any of these programs there hasn't been enough housing construction—you say 145,000 units for moderate-income families and individuals were provided or are being processed under the program as of June 30, 1967.

How many does that mean were constructed, for instance, last year?

Secretary WEAVER. We have the construction figures for next year.

Senator KENNEDY. How long have they been under consideration?

Secretary WEAVER. It would be about 30,000 or 35,000 of them. I could give you those figures.

Senator KENNEDY. When you say "for moderate-income families and individuals have been provided or are being processed," what does that mean? How long have they been in process?

Secretary WEAVER. There are three stages, as you know. First, a person comes in with a proposal and, if it is feasible, he then goes out with a reservation of funds. We have to reserve the funds since it is a below-market interest rate.

He then goes out and begins to develop the project. Then he comes in with the project and the project is approved and a commitment, a mortgage commitment, is made.

Soon after the commitment is made, he goes into construction.

So there are three stages. First, reservation; then commitment; then construction. And fourth, completion.

It takes anywhere from—depending upon the size of the place—12 to 18 months just to carry out the construction. At the best, it takes 6 months to do the planning and to get the package put together.

Senator KENNEDY. How many of these were constructed last year and how many were being processed?

Supplied for record: 11,652 units completed in the last fiscal year; 18,343 units had commitments issued; and applications for 33,729 units were in various stages of processing.

Secretary WEAVER. I will give you those data.

Senator KENNEDY. You do not have that data? Have some of these been in process for 3 or 4 years?

Secretary WEAVER. Our processing in multifamily, up until recently, ran extremely long, sometimes as long as 18 months. This is what we have now attempted to change and we have cut it down to around 6 months.

Senator KENNEDY. Have some of these 145,000 been under process for a number of years?

Secretary WEAVER. Yes.

Senator KENNEDY. Do you know how many were constructed last year?

Mr. BROWNSTEIN. The completions last year, Senator, were probably around 11,000, and construction was started on about 13,000 units last year.

Senator KENNEDY. Is it correct that out of the public housing that only 20 or 25 percent of them have been in communities of larger than 25,000?

Secretary WEAVER. No, I would doubt that very seriously. We have, for example, some 600,000 units now in occupancy and over 100,000 of those are in New York City. So that figure could not be. That might represent the number of cities that are involved, but for the number of units, it would not be true.

Senator KENNEDY. I am recalling your testimony before the Ribicoff committee, when you said that four-fifths of the public housing program serves communities with less than 25,000 population.

Secretary WEAVER. That is what I am saying. It is the number of communities. In other words, more than four-fifths of the communities with federally assisted low-rent housing projects are under 25,000, but almost four-fifths of the units are in communities with a population in excess of 25,000.

Senator KENNEDY. Four-fifths of the public housing program serves communities of less than 25,000.

Secretary WEAVER. That is a misintepretation of the data quoted there, because the data will show that this is the number of communities that are being served, four-fifths of them are under 25,000, but the exact opposite is true for the number of units.

Senator KENNEDY. And how many public housing units were constructed, for instance, last year?

Secretary WEAVER. Last year? 35,000.

Senator KENNEDY. And how many of those went into the ghettos of large cities?

Secretary WEAVER. I wouldn't be able to tell you. The majority, I would guess. I can get this for you, but we have to go through each one and figure out what is a ghetto and what isn't a ghetto. In other words, the data are not kept on this basis.

Senator KENNEDY. We are having severe problems in the country and they are focused in some of these ghetto areas. It would seem to me that it would be helpful to know what we are doing in the way of housing—to know what kind of programs we have.

Secretary WEAVER. We can provide it, but I can't give it to you off the top of my head.

Senator KENNEDY. You do not have anybody here with you who knows that?

Secretary WEAVER. No. Let me point out that this is not a one-way street. We have great opposition from many of the communities about putting public housing in the ghettos, and there is great opposition among the nonwhites in many urban communities about making the ghettos more of a one-income type and putting more public housing into them.

So while this may be a good statistic for some purpose, other people consider it an undesirable development. We are trying to diversify

this. We are trying to say that the programs will not be satisfactory if they only build in the ghettos. We don't say we won't build in the ghetto, but we say we have to build in the ghetto and other places, too.

Senator KENNEDY. I am concerned. From my own personal look at some of these areas, I do not see that we are making progress in housing, Mr. Weaver. I do not think that the programs we have had in existence up to the present time have made any impact on the lives of the people who live in these ghettos.

I think that public housing has not, and 221(d)(3) obviously has not. I do not think just a continuation of the programs that we have at the present moment is going to give us the answer.

As I say, we may find some fault with some of the figures in S. 2100. I think the principle of interesting the private sector in becoming actively involved in solving this kind of a problem would be extremely useful. You pointed out in your book that the only way they are going to do that is if there is a profit incentive. This legislation makes an effort to give them that profit incentive.

I do not see how you are going to get them interested and actively involved in any of these programs unless you do that. I support the rent supplement, but the rent supplement is really the most expensive possible way in which to accomplish the task of making low-income housing available through the private system.

Secretary WEAVER. Let me reply, if I can recall all of your statement, in this way:

In the first place, the fact that the problem has not been solved and that the problem still exists, and that there are still great areas of lack of progress, I don't think is due to the programs. I think it is due to the scope of the programs, which has been determined by the appropriations and the authority that has been given to these programs by the Congress.

Right now, many of our programs are before the Congress for appropriations. I think the efficacy of these programs is determined in large part by the amount of funds that are made available for them. Insofar as the interesting of private enterprise is concerned, I think we have been interesting private enterprise, and I think we are continuing to interest private enterprise.

I think there is a large sector of the private enterprise system which finds a 10-percent investment and rapid depreciation attractive to it. They must, because they are coming in. There are more of them lined up in front of our offices on the 221(d)(3) program than we have money to support the projects.

Some of them are somewhat hesitant about putting much long-term investment in. We have evidence of actual bodies, actual projects, actual people to indicate that we are involving private enterprise.

This is also true in our turnkey public housing, and it has been true in the recent action of the insurance people. We are involving the private enterprise people and we have a commission set up to find out how to involve them more completely and I think a commission of highly qualified people.

Senator KENNEDY. You mentioned "Only last week I talked to a group of investors in San Antonio, Tex." Where is that project to be constructed?

Secretary WEAVER. In San Antonio, El Paso, Oklahoma City, and Los Angeles.

Senator KENNEDY. For instance, in Los Angeles will it be constructed in Watts?

Secretary WEAVER. I don't know. They haven't submitted their application. I hope it won't be constructed in Watts because I would like to see some housing open to moderate-income people which is not in the ghetto.

Senator KENNEDY. But this is for really moderate-income people.

Secretary WEAVER. Just as your program is largely for moderate-income people.

Senator KENNEDY. Mr. Weaver, we keep going back and forth on that. It just does not happen to be correct. When you talk about a rental of $120, it is quite different from a rental of $70 or $80. That is all. It happens to be quite different.

Secretary WEAVER. Of the poor people in America, in the ghettos, very few can afford to pay $70 an $80 a month.

Senator KENNEDY. That is correct. So I would say if you want to get it down below that you can use the rent supplement or a further refinement of what we have suggested. If $70 or $80 is not low enough, then you can use a refinement of what we suggested—by giving lower interest charges or amortization forgiveness, or else you can use the rent supplement.

But it is quite different than when you talk about 221(d)(3) and you talk about the people who are lined up to invest. I agree they are lined up, but they are lined up for middle-income housing. They are not lined up to help the people we are trying to help through this legislation. That is the point.

Secretary WEAVER. Senator, this program was proposed and developed as a program for moderate-income people. If it is to be utilized, and if we want to utilize it for the same income groups that you are proposing to meet in your program, this can be done by a very simple matter of putting it on the same financial terms, 50 years and 2 percent.

When you talk about putting rent supplements on top of S. 2100, or rent supplements on top of a below-market interest rate, that is a very expensive program. You would have a combined expense which I think would be very, very large.

Senator KENNEDY. Just to get 221(d)(3) down by rent supplements to the level where we are renting under our legislation will cost a great deal of money. The legislation that we have suggested and recommended here, hits the low-income groups and it is much less expensive than if you had a rent suplement that got your rents down in 221(d)(3).

Secretary WEAVER. The rent supplement does not go with the 221(d)(3) program we are discussing. The rent supplement goes with a 221(d)(3) mortgage with a market rate of interest. So you have no subsidy and no expense to the Government for that money—but only for the supplement. This is exactly what we have done with the deal we have worked out with the insurance people.

All you have to do to get down to the income group you are talking about under the existing 221(d)(3) program is to amend the bill

and make the term of the loan 50 years, the percent of interest 2 percent, and provide the grants to local communities for tax adjustment.

You come out almost exactly the same, a matter of a dollar or so one way or the other. That is all I am saying.

Senator KENNEDY. Thank you.

Senator SMATHERS. Thank you, Mr. Secretary.

May I just say to you that we appreciate your statement. If it were the opinion of the Congress that we need a new approach, that the old approaches have not been sufficient, and if the Congress did enact this type of program, you would be happy to administer it, would you not?

Secretary WEAVER. I would have to look at it from a different point of view then—to see how workable it was. I have no objection to any bill that would accomplish the purposes that are outlined in this bill.

Senator SMATHERS. Thank you very much.

The committee will stand in recess until 2 o'clock.

(Whereupon, at 1:10 p.m. the committee recessed, to reconvene at 2 p.m. the same day.)

AFTER RECESS

(The committee reconvened at 2 p.m., Senator George A. Smathers presiding.)

Senator SMATHERS. The meeting will come to order.

Our first witness this afternoon is the very distinguished Under Secretary of the Treasury, a former Member of the U.S. Congress, an expert in many fields, Joe Barr.

Joe, proceed as you like.

STATEMENT OF HON. JOSEPH W. BARR, UNDER SECRETARY OF THE TREASURY, ACCOMPANIED BY JEROME KURTZ, TAX LEGISLATIVE COUNSEL, TREASURY DEPARTMENT

Mr. BARR. Thank you, Mr. Chairman.

Mr. Chairman, I am pleased to have this opportunity to testify on the bill, S. 2100, which provides certain encouragements to the construction or rehabilitation of low-income housing.

We recognize that this hearing will serve to call attention to various approaches to the goal of increasing the supply of adequate housing in poverty areas. Both the goal and the desire to explore all approaches are most laudable. As is always the case with Government policies, we must be ready to evaluate alternative means of achieving our objective and consider that objective in the light of other calls upon our resources. The bill introduces new ideas in the approach to the problem of low-income housing, such as the increased reliance on equity investment, which justify a very careful study.

I shall address myself to the tax and loan provisions of S. 2100. Briefly, the bill allows generous investment credits, generous depreciation provisions, generous capital gain treatment after 10 years, a partial relief from local property taxes, and a generous low-interest loan.

All of these tax and loan benefits are conditioned on the housing project meeting certain standards as to acceptability as low- or

moderate-income housing. These standards are administered by the Secretary of HUD.

I shall not add anything to the evaluation of these provisions as respects a desirable housing policy since Secretary Weaver has already commented on this. I shall have a few remarks to make later on about the problem of linking tax treatment to findings as to compliance with conditions established by Government departments other than Treasury.

I shall not undertake to repeat the details of the bill's tax provisions, but I shall draw your attention to certain broad aspects of the way these tax provisions are set forth in the bill.

(1) The investment credit and the depreciation provision are structured to provide more tax benefits the larger the proportion of equity that is put into the project, though as I shall point out later the structure of the bill as a whole does not always provide a better rate of return for higher equity.

(2) The investment credit and the depreciation provisions are structured to yield tax benefits even if the housing project itself is unprofitable. Actually, the depreciation is so generous that the normal expectation would be for the housing project to show a loss for tax purposes; and the only way the taxpayer could realize the offered tax benefits would be to use them against taxable income from other sources. This would be easy if the housing investor is a large company with diversified interests, especially non-real-estate interests, because even ordinary real estate investments tend to show losses for tax purposes.

To facilitate this use of excess deductions on the housing project, the bill also amends subchapter S, the provisions that allow certain corporations to elect to be taxed in a way generally similar to the taxation of partnerships. This will permit the organization of an eligible housing project by a group of individuals with the intent of using the excess deductions against their ordinary income from other sources.

(3) Finally, the various tax benefits are designed to encourage a 10-year holding period by the original investors. The provisions dealing with sale are also structured to encourage sale to another organization that will have the purpose of offering low-income housing.

GENERAL REMARKS ON THE TAX INCENTIVE APPROACH

I want to comment first on this use of tax incentives to encourage nonrevenue objectives involving a narrow group of taxpayers.

My first point is that there are no special tax disadvantages to real estate investment. There would be a case for considering changes in the tax law if it were contended that the tax law provides special tax disadvantages or tax barriers to housing investment. The advocates of this legislation have not claimed that present tax law is loaded against real estate investment or against low-income housing investment. Rather, they state that the problem arises within the housing field, that given the level of building and rehabilitation costs, construction cannot be undertaken which yields a positive profit when rents are charged which are a reasonable proportion of the income of moderate- and low-income individuals. The advocates of S. 2100 contend that this inconsistency between building costs and reasonable rent levels should be offset by very generous tax provisions.

This makes S. 2100 plainly an effort to achieve nonrevenue objectives through the tax system. What can be said about this?

To answer this question, I would like to start off by saying that we ought to begin with the asumption that an investigator chooses between alternative investments on the basis of net aftertax income in relation to investment.

I shall address mystelf later to the question of whether there are differences from the investor's standpoint or the Government's standpoint between dollars that are "paid" as tax reductions and dollars that are "paid" in other ways. It is useful first, however, to recognize the basic similarity between a dollar benefit received from tax savings and a dollar benefit from direct Government outlays. Each is a buck.

A tax saving can always be reproduced by some form of Government payment program. A tax credit of 10 percent of an investment provides the same result as giving an investor 10 percent of the cost of his investment. Allowing a taxpayer to speed up depreciation deductions by taking, say, 20 percent of the cost in the first year permits a corporate taxpayer to reduce its taxpayment by 48 percent of this deduction in the first year, and it increases the taxpayments at some future time when the deduction would otherwise have been taken. This benefit can be reproduced by offering the taxpayer an interest-free loan equal to the amount of tax saving from the rapid depreciation to be repaid in the future when he would have otherwise taken the depreciation.

I cannot stress this point too strongly. There is no magic which permits Government to give away tax dollars and have a lesser budget impact than if it had given away expenditure dollars, nor does a dollar of net budget cost have a different impact on the investor's after-tax rate of return if it is incurred as tax reduction or as direct outlay.

While there is this broad comparability between tax incentive programs and loan or expenditure programs, there are some significant differences which must be kept in mind. To be very clear, let me specify that I am comparing a tax and an expenditure program which produces the same net benefits for the investor and has the same net cost to the Government.

For illustration, one may want to think of a tax incentive which provides an annual tax credit for low-income housing investment exactly equal to the benefit that the investor would gain from an annual direct payment, which we might call a rent supplement. This hypothetical tax credit, could be made available under exactly the same terms that rent supplements are made available under present law. The question comes down to: "What are the advantages or disadvantages of building this rent supplement program into the tax law?"

One difference is that the tax route does not provide assistance to the individual or corporation which has limited income from other sources and which therefore cannot make full use of the tax incentives. A system of direct payments on the other hand could provide benefits even where the particular housing investment was the only activity of the investor being benefited.

One would think that this was a general disadvantage of providing incentives through the tax system. The supporters of S. 2100, however, apparently believe that it is the large businesses which ought to be

attracted into the low-income housing field and that they take it as nc disadvantage to their tax approach that the benefits are only helpfu to taxpayers with incomes from other sources. This I might add is not a particular advantage of the tax approach since this sort of condition could be built into the rent supplement program if we agree that the condition is a desirable one.

Another difference between the tax and expenditure routes is that the tax benefits, where they are related to increased deductions, vary in amount according to the effective tax rate of the taxpayer. The tax benefit of rapid depreciation can be as high as 70 percent for the individual taxpayer in the top bracket or as low as 14 percent for a low-income investor. S. 2100 does provide some tax benefits that work through extra deductions, so that it will thus afford different relief for different taxpayers.

This I should point out works in directly the opposite direction to the normal incentive generated by a free pricing system. In a free pricing system the usual response to shortages is an increase in price and, consequently, an increasing income to people who can provide the service in short supply. This increasing income would be subject to the usual tax rules, and a person in the 70-percent bracket would find that he could keep 30 percent of income earned by providing the services just as he could keep 30 percent of any other income he had earned. The investor in the 30-percent bracket would find that he could keep 70 percent in both cases. When we structure the incentive, however, as an additional tax deduction rather than as a price increase, the incentive is far more attractive to the high-income taxpayer than it is to the low-income taxpayer.

It becomes a matter of careful calculation for each investor, and his tax adviser, to determine how much this extra depreciation is worth in the particular case and whether or not this justifies accepting a lower before-tax return. It may be useful to point to the analogous situation of tax-exempt bonds. One cannot answer the general question: "Are municipals a better investment than U.S. Governments?" without examining, and making assumptions, about the future total income prospects of the investor. The value of the tax exemption depends upon future tax rates. It is well known that tax-exempt bonds are attractive investments to high-income taxpayers but not to low-income taxpayers. It is also suggested in the literature on the tax exemption that this constitutes a rather inefficient incentive because the net incentive effect must work through the marginal investor who will get less advantage from the exemption than higher bracket investors, and some of the benefit afforded the high-bracket investor is wasted.

Another difference between the tax solution and the expenditure solution is that reliance on tax incentives for nonrevenue objectives divides the Government consideration of social problems.

Let me go back to my hypothetical example of a tax credit system which provided exactly the same benefits as a rent supplement program. By throwing these benefits into the tax system we have not changed the basic fact that this is still a major housing problem, but we have gotten the Treasury Department and the Finance Committee and the Ways and Means Committee into the act at the cost of reducing

the ability of the Department of HUD and the congressional committees that normally deal with housing problems to act on the total housing picture.

I don't want to suggest that the two tax committees are necessarily inadequate to decide on housing policy—or on all other social problems—but I can speak from a personal standpoint that I see no reason why the Treasury Department has any particular competence in making judgments as to what constitutes good housing policy; and converting the rent supplement arrangement into tax credits would simply push the Treasury into this position.

A further aspect of converting an expenditure program into a set of tax benefits is that it tends to get isolated from the budget review process. An expenditure program is examined regularly in the preparation of the President's budget and in the appropriation process. A tax provision rarely gets reviewed. I might suggest that the whole problem of tax reform to a large extent comes down to incentives and preferences that have been adopted at various times and never systematically reviewed to determine whether the Government is getting what it pays for.

This does not mean that under a direct program we cannot provide a particular investor reasonable assurance that benefits agreed upon will in fact be forthcoming. It does mean that under a direct program we can make changes in the program when these become desirable, whereas experience has shown time after time that it is extremely hard to make changes where tax benefits are involved.

A final difficulty of structuring these benefits into the tax law is the precedent problem. There are an enormous number of other tax incentive proposals. The list is so long that I could not include them all, but let me give you the flavor of it. There are bills to provide—

A tax credit for tuition and expenses of higher education.
A tax credit to encourage contributions to higher education.
A tax credit to encourage worker training.
A tax credit to encourage industrial pollution control.
A tax credit to encourage airport development.
A tax credit for underground transmission lines.
A tax credit for exports.
A tax credit for freight cars.
A tax credit to encourage gold mining.
A tax credit to encourage hiring older workers, and so on and so on.

I cannot help but observe that if we go along this tax incentive route the Treasury Department would soon be making the crucial decisions in almost all matters of domestic economic policy. This would, of course, require a larger staff; and it has enormous possibilities for empire building. We would, however, prefer to decline this honor.

I might add, Mr. Chairman, if all these tax incentives were adopted, there would not be much use for any Government departments but the Treasury Department, the State Department, and the Defense Department.

The proponents of S. 2100 imply that there might be some net advantages of the tax approach over the expenditure approach. I shall address myself to two of these. One argument advanced is that the

Congress might vote for a tax program where it would not vote for an expenditure program which provided precisely the same benefits at precisely the same cost—or even a lower cost. I question the validity of this argument. In a democracy we must face up to some decisions, and we must be willing to abide by the decisions that our procedures reach. The Congress may or may not be willing to approve a program of budget losses and housing benefits. If that program is rejected on its own merits, it would seem that restating it as a tax reduction is akin to seeking a backdoor expenditure where it is harder for people to see just what are the costs and benefits involved in the expenditure.

Another argument which seems to be implied in support of S. 2100 is that the business response to a tax incentive would be better because there is a feeling that there is something wrong about accepting a direct payment from the Government but something honorable about earning one's tax bill through tax benefits.

Basically, this viewpoint attributes a good deal of irrationality to business firms. It says in effect that they would not make a careful comparison of net returns but would arbitrarily reject some worthwhile profit prospects because the incentives were cast in the form of a direct subsidy rather than a tax subsidy. The experience with the SST program—and other subsidy programs—suggests that business firms do make careful calculations on their profit prospects taking direct subsidies into account. In fact, since the benefits of tax incentives vary depending on the estimated tax position of the investor, the calculation of the expected returns in a specific case can become more complicated when special tax benefits are involved. It seems disingenuous to assume that investors will do a lot of things in order to gain somewhat uncertain benefits in the form of tax reduction that they would not do to win benefits of exact calculable amounts through some other system.

The particular incentives of the bill S. 2100

Secretary Weaver has discussed some cost comparisons of S. 2100 and other methods of providing incentives to low-income housing. The evaluation of the particular incentives under S. 2100 in terms of returns to the investor requires analysis of the benefits under a variety of assumed patterns of investing in real estate and a variety of tax situations of the investor. The complexities here are so involved that we hesitate to offer any general conclusions. Some comments are appropriate, however.

The bill provides increasing tax benefits for investors with a higher portion of the cost of the project covered by equity investment. The bill defines equity investment as the difference between the total cost of the project and the face amount of any mortgage insured under section 235 of the National Housing Act. This treats as a 100-percent equity case a project financed largely by a conventional mortgage. This would produce the result, for example, that if the project is financed with a 70-percent commercial mortgage, then the investment credit in the first year would be equal to the entire real equity investment in the project.

After the first year the investor could have gotten the full amount of his own investment back from the investment credit alone and in addition would have substantial benefits from the accelerated depreciation which is offered and from the net return provided in the

bill. The value of the depreciation deductions alone, in the first 5 years of operation for a taxpayer in the 70-percent bracket, would be equivalent to an additional return equal to more than his initial investment.

Over a 20-year holding period the bill seems to provide tax benefits in gross amount equal to about the full cost of the project, even after making allowance for the payment on the mortgage if we assume that the mortgage is a 20-year 6-percent loan. After the 20 years an investor who had put up a $1 million project and was in a sufficiently high tax bracket would seem to have made tax savings of $1 million; and he would be the outright owner of a housing project which on the basis of experience with real estate values would still be worth not much less than $1 million, and under the bill he would be entitled to start taking depreciation on a restored basis of $700,000.

In different circumstances, where there is no conventional mortgage, it appears that despite the intentions of the authors of the bill the rate of return under S. 2100 will not be better for a high-equity investment than it will be for a low-equity investment.

I might add that this statement should be modified in light of Senator Kennedy's testimony this morning.

This is likely to be the case if the taxpayer is in a lower bracket. In one sense this is a problem that could possibly be modified by restructuring the bill. The apparent objective of making high-equity investment relatively more attractive could be accomplished by either charging a higher rate on the guaranteed loan or by providing sharper graduation of the investment credit as Senator Kennedy has done. The heavy reliance in the structure of benefits on rapid depreciation would seem to make the results of the bill necessarily erratic between taxpayers at high or low marginal tax rates.

One point to be drawn from this goes back to the point I made earlier that the use of tax incentive devices makes it extremely difficult to calculate how much we are paying for an increase in some desired investment.

Another problem in this portion of the bill has to do with whether or not we really want a very high equity investment. In a basic sense the cost to Government of any system of incentives for low-income housing will have to be the difference between what we expect the tenants to pay in rent and the total return necessary to make the investment attractive to an investor.

Lenders expect a lower return than equity holders. If 90 percent of the initial investment can be accomplished through borrowing with a return of about 6 percent on that 90 percent, the cost of the total program to the Government will be less than it would be if 50 or 90 percent of the investment represented equity funds and which would require Government contributions large enough to provide a prospective 12- to 15-percent aftertax rate of return on those equity funds.

To accomplish our goals in the low-income housing field as economically as possible, it would appear that we should rely heavily on the use of borrowed funds. The leverage provided by borrowed funds can guarantee a sufficiently high return on a net equity investment so as to attract equity investors. Some advice that we have gathered from people in the real estate business suggests that increasing available

mortgage money for low-income housing would be fully as effective, and cheaper, than attracting more equity money. On this point the committee will want to get views from people with knowledge of the real estate business.

Since this committee is particularly concerned with the Government's administrative budget, it should be pointed out that any program which can be operated through the private banking system with a loan guarantee will involve lower administrative budget deficits than a program which requires the Government to provide the loans directly. The device of 2-percent interest in S. 2100 will require direct Government financing and mean substantially high short-term budget costs for any net incentive provided.

We have some technical problems with the draft of S. 2100 which I shall not go into, but I shall submit a statement for the record on these points.

THE TAX LAW AND REAL ESTATE INVESTMENT GENERALLY

It is appropriate to add some remarks on the general situation of investment in real estate including housing under the present tax law.

Real estate investments qualify for the accelerated depreciation methods provided under the 1954 code revision. There is no record of critical consideration at that time of the appropriateness of applying these methods to buildings, and indeed it appears that these methods were adopted entirely with investment in machinery and equipment in mind.

Due in part to the inappropriateness of the allowable depreciation, a pattern has developed in building investment wherein the original investors often hold the property for much less than the useful life during which time the depreciation deduction is very high in relation to the cash flow, resulting in little or no current tax. When the depreciation base is largely exhausted, the property is sold; and a substantial capital gain is realized. The Treasury made recommendations in both 1961 and 1963 for cutting back on this pattern of realizing normal investment returns at capital gain rates. A slight cutback was enacted by the Congress in 1964.

Another part of the picture of the tax treatment of real estate investment is that the 7-percent-investment credit does not apply to buildings. In substance we have the result that real estate investment gets tax encouragements in forms different from those offered investors in machinery and equipment. The Treasury Department is engaged in research to evaluate the impact of present tax provisions and possible alternatives on real estate investment, and several outside consultants are involved in the research.

In conclusion, let me repeat my initial comment that S. 2100 raises important issues. I have tried to draw attention to several major aspects, including the technique of casting benefits in the form of specialized tax reductions and the emphasis on high-equity investment. Both of these aspects have disadvantages of which the committee should be aware. I believe that these hearings, providing, as they do, an opportunity carefully to consider and weigh as objectively as possible the varying approaches to an objective which we all share, will prove to be a very helpful step forward in this area.

Mr. Chairman, I would like to say that I agree with the authors of the bill that the problems we face in this area are so serious that we must give careful consideration to every suggestion made for solving them.

I do appreciate the opportunity to join with this committee in discussing what we ought to do about what we all admit is a problem of great magnitude in this country.

Senator SMATHERS. Do I understand your testimony to be that you do not believe that the tax system should ever be used to bring about any social betterment or improvement in conditions?

Mr. BARR. Mr. Chairman, as you know, the Congress in its wisdom at various times has used the Internal Revenue Code to achieve social objectives. I mention charitable deductions as one example, and I also mention the special provisions for the blind and for the aged. Congress has seen fit at times to give tax benefits for social purposes. I am not saying that should never be done.

Senator SMATHERS. Were you and the Treasury against those proposals?

Mr. BARR. Mr. Chairman, I was not in the Treasury at the time. I do not know what their attitude was at the time. I do make this distinction, Mr. Chairman. We have consistently opposed the use of the tax code for narrow or specialized purposes.

In this situation we are considering a problem that involves urban housing but not all urban housing. We are considering a problem that involves a portion of urban housing.

Senator SMATHERS. Is it your judgment and the Treasury's judgment that the riots in Newark and Detroit and Watts are a specialized problem that is not of concern to the Treasury and the people of the United States?

Mr. BARR. It is indeed of concern to the Treasury and to every reasonable man in this country, Mr. Chairman. It must be attacked. The only issue we are raising here: Is the tax code the appropriate vehicle?

Senator SMATHERS. You do agree that under certain circumstances you have recommended tax credits to achieve social purposes?

Mr. BARR. Not a tax credit, Mr. Chairman.

Senator SMATHERS. Not a tax credit?

Mr. BARR. No, sir.

Senator SMATHERS. Did the administration recently recommend a bill to provide a tax credit or tax deduction for people who make political contributions?

Mr. BARR. We recommended a deduction, Mr. Chairman.

Senator SMATHERS. That is almost the same thing, is it not? Would you support a deduction for the people who build low-cost housing?

Mr. BARR. Mr. Chairman, a tax incentive for political contributions would apply across the board, it would be available to every American citizen.

Senator SMATHERS. Do you think every American is interested in fighting crime and poverty?

Mr. BARR. I do.

Senator SMATHERS. Don't you think that is the concern of every citizen who pays taxes, that even if he lives in Florida, in a small remote town without riots in the streets, he recognizes that crime and poverty

hurt the image of America and eventually cost everybody money? Certainly in your home State of Indiana I am sure everybody deprecates the vandalism and the riots that have occurred in other areas of the country.

I do not understand how you and the Treasury can say that this is a narrow problem and base your opposition on the argument that the tax credit envisioned by this bill should not be given because only a few, you say, will get it.

Mr. BARR. Mr. Chairman, when I say it is a narrow problem, I do not mean to say it is not a national problem of prime importance. Of course it is. What I am saying is that the credit would go to a relatively small portion of the population those who invest in these properties in a relatively small portion of the geographical area of this Nation. That is the term of reference I am using when I say it is a narrow problem.

Senator SMATHERS. Do you think that the people of Indiana, your home State, are as much concerned about the problems that recur in New York or Detroit or Los Angeles, the Watts area as they are about Thailand or Israel?

Mr. BARR. Speaking as an ex-Congressman, and not a very good politician but an ex-politician, I would say they are more concerned about these riots, Mr. Chairman. I would also say I represented an urban area with a ghetto. I know what these problems are because I worked in them, myself. On one occasion at least I worked with President Kennedy in this area in attempting to develop the kind of housing that you are trying to develop here, and we were successful.

Senator SMATHERS. I want to get back to the Treasury's position. I know of your concern, but I want to see if I understand the Treasury's position correctly. You are more concerned about the riots and the ghetto problems and the problems that result from ghettos and slum housing than you are about some of the underdeveloped countries; but why is it that the administration recommended an investment credit, for example, to American industry if they would go into Thailand, Israel, and some countries in Latin America?

Mr. BARR. Mr. Chairman, that credit was simply the 7-percent investment credit. That was a negotiating matter. We are faced in those countries with real problems. Our investors in those countries are faced with real problems.

Senator SMATHERS. I don't question that. But is that a bigger problem than the problem in Detroit, the problem in Watts, the problem in Newark?

Mr. BARR. Mr. Chairman, let me make this clear. We have not said that we would not grant the 7-percent investment credit to this housing in these areas or to rehabilitation in these areas. I want to make it very clear that we have this whole area under study. If we could scrub up what we consider to be some of the abuses in the real estate area, we might very well be prepared to propose that the investment credit be extended.

Senator SMATHERS. Would you call it a fair statement on my part to say that possibly the major portion of the opposition of the Treasury stems from the fact that they did not make this recommendation first?

Mr. BARR. I would hope that we would not be in such a parochial position.

Mr. Chairman, I think you have seen us in action too often for such a statement. We have opposed, as I said, a tax credit for education, for contributions to higher education, for manpower training, for pollution control—wherever there is a tax credit proposed for what we consider specialized objectives, we have consistently said that this is not the appropriate way to do it.

I want to make it very clear that we are not opposed to spending money in this area. We are opposed to using a tax device when we think there are better and more efficient methods available, and that is to put the money on the line.

Senator SMATHERS. You said in your statement that a buck was a buck.

Mr. BARR. Yes, sir.

Senator SMATHERS. You are a former Member of Congress and you have testified before this committee many times. Is it your contention that a buck spent by the Federal Government is more useful than a buck spent by private enterprise or by business?

Mr. BARR. No, I did not say that. I said that whether private enterprise gets a dollar from tax reduction or a dollar from a direct Federal payment does not affect their aftertax return. I think in the climate in which we are living today it is the aftertax return that a reasonable investor looks at.

Senator SMATHERS. Is it not a fact that you have heard many economists state that a buck spent by a private investor in some private enterprise has a greatly increased multiplier effect over the same buck spent by Government?

Mr. BARR. I have heard it, but I don't agree with it.

Senator WILLIAMS. I would like to support the Republican philosophy of our chairman at this point.

Senator SMATHERS. I am usually supporting the administration, as my friend from Delaware knows, but when they come before us and say they oppose this measure because they have a very serious and conscientious objection to using the Internal Revenue Code to achieve social purposes, then that bothers me, because the record is full of illustrations of this administration using the Internal Revenue Code for all types of goals which it felt desirable; accelerated depreciation is one example.

Mr. BARR. That is not a social purpose, Mr. Chairman.

Senator SMATHERS. You came before us and said it was for the purpose of providing more jobs.

Mr. BARR. Is that a social or economic purpose?

Senator SMATHERS. The question is: Is it uneconomical to eliminate ghettos and crime and the expense that goes with it? Is that uneconomical?

Mr. BARR. Go ahead, Mr. Chairman; we just don't agree on the terms.

Senator SMATHERS. I want to read what the distinguished Secretary Fowler said when talking about accelerated depreciation for various categories of machinery:

> In coordination with other policies these tax measures will greatly increase the propects of combating successfully unacceptable levels of unemployment. They will aid in and reduce the cost of public and private programs for reducing

poverty, eliminating depressed areas, which is what we are trying to do, facilitating an adjustment by management and labor to go with dynamic disciplines of modern industrial society.

I can just hear him now. Then he went on to say:

Of course these measures are not the end but the beginning, particularly if they prove reasonably successful in the achievement of these broad objectives. There will always be an unfinished task of adapting our tax and fiscal policies to changing economic environment in a manner that will strengthen our economy and maintain our preferred pattern of economic organization.

What I don't understand is how you, as Henry Fowler's right-hand man, can come down here today, a few short months after that stirring address by the Secretary, and take a totally contrary position.

Mr. BARR. Let me see if I can explain this position. Secretary Fowler was speaking about realistic depreciation guidelines, not accelerated depreciation.

Senator SMATHERS. I will turn you over to the kind and tender mercies of Mr. Williams.

Mr. BARR. Thank you, Mr. Chairman. We will let it stand there.

Senator WILLIAMS. Mr. Secretary, I agree with you in supporting the objectives of this bill, but in order that we may understand it better and its application, I would like to follow through a hypothetical case just how this act would work, assuming it is passed.

Mr. BARR. All right.

Senator WILLIAMS. As I understand it, the bill related to the 22-percent tax credit. That has now been changed to 30.

Mr. BARR. That is correct.

Senator WILLIAMS. I also understand that the recommendation this morning was that the minimum period in which the writeoff would be as provided in the bill was 20 percent of the normal life, and if the normal life of the building was 40 years, 20 percent would be 8 and I think we have a minimum of 10. Is that correct?

Mr. BARR. That is correct.

Senator WILLIAMS. I understand this morning they changed this minimum to 7.

Mr. BARR. That is my understanding.

Senator WILLIAMS. That would apply in place of the 10?

Mr. BARR. Yes.

Senator WILLIAMS. So my questions will be directed on the basis of the 30 percent with the rollover on the basis of 7 years.

Mr. BARR. All right, sir.

Senator WILLIAMS. On page 4 you refer to a tax credit of 10 percent of the investment providing the same result as giving the investor 10 percent of the cost of his investment. I understand that, but the same thing would be true in this case.

For example, taking as a hypothetical case a million-dollar project. The tax credit would be 30 percent.

Mr. BARR. That is right.

Senator WILLIAMS. And we will assume for the moment that this taxpayer is in the 50-percent bracket, for the corporation it would be 48 percent, but it would be 53 percent if you get your 10-percent tax surcharge. But we will use the 50-percent bracket in this computation. Now, this taxpayer will get an immediate credit of $300,000.

Mr. BARR. That is correct.

Senator WILLIAMS. That will actually reduce his investment, remaining investment, and as you pointed out it is a partial payment, it reduces his investment in this case to $700,000.

Mr. BARR. That is right, sir. How much are you assuming that this hypothetical person is investing?

Senator WILLIAMS. For the moment we will use the $1 million, either all his own money or conventional financing.

Mr. BARR. All his own money or conventional mortgage financing?

Senator WILLIAMS. All of his own money. He has $300,000. He has $300,000 tax credit and he is in the 50-percent bracket. He may be an individual—first, if it is a corporation it will be practically 50 percent. The bill also provides that they would get the benefit of subchapter S which means that they could incorporate this project and still commingle the results with their personal tax return.

Mr. BARR. That is correct.

Senator WILLIAMS. If they are in the 50-percent bracket as a personal individual taxpayer, they would get the full benefit of this tax credit on this basis.

Mr. BARR. You would get the benefits of the cost incurred by the project. It would flow not to the corporation, but to you directly as an individual.

Senator WILLIAMS. To you directly as an individual?

Mr. BARR. That is correct.

Senator WILLIAMS. So if you start out with $300,000 tax credit, this individual, which would reduce his cost, actual cash outlay to $700,000.

Mr. BARR. That is correct.

Senator WILLIAMS. Under this latter proposal, in 7 years he could write off as depreciations the full $1 million, could he not?

Mr. BARR. That is correct. He could write off the total building cost. He can't write off the land.

Senator WILLIAMS. That is right. We are talking about the project.

Mr. BARR. Right.

Senator WILLIAMS. He could write off not only the $700,000 which is the remaining cost, but the $300,000 which he has just taken as a tax credit.

Mr. BARR. That is right.

Senator WILLIAMS. If he is in the 50-percent tax bracket that tax writeoff is 7 years and would be worth a half million dollars, would it not?

Mr. BARR. That is correct.

Senator WILLIAMS. He would have this $300,000 tax credit, or a total of $800,000 he got back in cash on his investment at the end of 7 years, is that correct?

Mr. BARR. That is correct.

Senator WILLIAMS. At the end of 7 years, under this bill as I understand it—and we will assume for the moment he is keeping this project—he can roll his base for depreciation purposes back up to $700,000; can he not?

Mr. BARR. That is correct. Senator Kennedy said something this morning about a capital gains provision at this juncture. I am not quite clear on that. It might not be completely $700,000 but it would be in that area.

Senator WILLIAMS. I checked with the staff and we were unable to find any provision where the capital gains tax was applicable. If it is we could put it in. As it is now, as we understand it, at the end of 7 years he would set it up on his books again for depreciation purposes. Even though he had written it down to zero at the end of the 7 years, he would set it up on his books again at $700,000.

Mr. BARR. That is right.

Senator WILLIAMS. During the next 7 years he would write that next $700,000 off and that would be another $350,000 tax credit, would it not?

Mr. BARR. That is correct. That is a tax benefit he would have.

Senator WILLIAMS. Tax benefit. At the end of that 7 years the building is 14 years old.

Mr. BARR. That is right.

Senator WILLIAMS. He can take this rollover again and set it up on his books again at $700,000, could he not?

Mr. BARR. That is right.

Senator WILLIAMS. He writes it off again in the next 7 years and gets another tax benefit of $350,000; is that correct?

Mr. BARR. That is correct.

Senator KENNEDY. I want to make sure when he says "yes," that he knows it is yes.

Mr. BARR. That is our understanding of the proposal, Senator. You made a statement this morning——

Senator KENNEDY. I don't want to interrupt, but we have had conversations with other representatives of the Treasury Department and come out with a quite different answer than you are giving. So what you are saying, comes as rather a surprise to me.

Mr. BARR. Let me defer to the technical staff.

Senator KENNEDY. I did not want to interrupt.

Mr. BARR. I have prepared several examples that we have worked through—not exactly the same computation, but somewhat the same computation—for a 70-percent investor, for a corporation, and for a 50-percent investor, and it checks out generally with the information I have.

Senator WILLIAMS. As I read the bill, this is the way it appeared to me.

Mr. BARR. The one thing I want to make clear, Senator Kennedy, is that your capital gains provision could reduce some of these figures slightly.

Senator WILLIAMS. If the capital gains is applicable and put in——

Mr. BARR (continuing). It would not reduce the basis.

Senator WILLIAMS. It would reduce the benefit. As I interpreted the bill and as it was interpreted to me——

Mr. BARR. We don't have the provision. We don't understand precisely how it operates. If I am in error on these statements, I would like to supply it for the record.

Senator TALMADGE. You may submit it and it will be included in the record.

Mr. BARR. Thank you.

Senator WILLIAMS. Now we have a building 21 years of age. The normal life of these buildings is 35 or 40 years, but we will use 35 years now.

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The first year the tax benefits would be $800,000. The second year——

Mr. BARR. The first cycle.

Senator WILLIAMS. The first cycle.

Mr. BARR. Right.

Senator WILLIAMS. The second cycle would be $350,000.

Mr. BARR. Correct.

Senator WILLIAMS. Third cycle, $350,000?

Mr. BARR. That is right.

Senator WILLIAMS. The building is 21 years old and we have written it down to zero for the third time. Now, we set it up on our books again at $700,000; is that right?

Mr. BARR. Yes.

Senator WILLIAMS. The fourth cycle we get another $350,000.

Mr. BARR. That is correct.

Senator WILLIAMS. At the end of the fourth cycle, 28 years, we have put it up again and rolled it over another cycle, $700,000, depreciated out we get another $350,000; it that right?

Mr. BARR. That is correct.

Senator WILLIAMS. That brings a total of $2,200,000 tax benefits that I have had in tax reductions out of a building that originally cost me $700,000; is that correct?

Mr. BARR. That is correct.

Senator WILLIAMS. And I would still own the building?

Mr. BARR. You have omitted one thing, sir. There is a rent computation in here that you can earn up to $30,000 a year on this.

Senator WILLIAMS. That would be over and above this?

Mr. BARR. Yes. The rent of the corporation after tax would be $15,000.

Senator WILLIAMS. These earnings up to 6 percent on your money would be over and beyond what I am speaking of as tax benefits?

Mr. BARR. Up to 3 percent; that is right.

Senator CURTIS. If you would let the slumdweller own this you would abolish poverty in one generation.

Mr. BARR. I am afraid that there are not many slumdwellers in the 70-percent bracket.

Senator WILLIAMS. I have discovered a neat way I can go out of politics and make a good living. That is why I want to be sure I am correct.

On this project you still have a million dollar investment and you keep possession of the property for the entire 35 years?

Mr. BARR. That is right.

Senator WILLIAMS. By depreciating this property five times and with the first $300,000 tax credit I have reduced my tax obligation $2,200,000 from what I would have paid, and I still own a $700,000 building. That is correct; is it not?

Mr. BARR. Yes, sir.

Senator KENNEDY. Could I interrupt for a minute? It really is not correct.

Mr. BARR. There is a capital gain. The only distinction is that we don't know what the capital gains provision is.

Senator WILLIAMS. You would have to pay the capital gains on the profits when you distribute them; sure.

Senator KENNEDY. I am saying if you really want to get the facts on the record——

Mr. BARR. I certainly don't want to give some misinformation.

Senator WILLIAMS. Let us start all over again.

Mr. BARR. Senator Kennedy, if you or the gentleman with you will correct us where we are wrong, I don't want to misinform this committee.

Senator WILLIAMS. I don't say what was intended, I am not getting into that. I am speaking of the bill as it is. This is the way as I interpret it and this is the way the Treasury interprets it.

I want to go into another hypothetical case. Suppose I and my brother each start out now and we each build a building at a million dollars, and again we will call it conventional financing or all our money. At the end of 7 years, I would have collected the $300,000 tax credit.

Mr. BARR. That is right.

Senator WILLIAMS. Less the depreciation, the full million?

Mr. BARR. That is right.

Senator WILLIAMS. We are going to assume for the moment we are both in the 50-percent bracket. Depreciating this full $1 million in the first 7 years, which is worth $500,000 to us, that is $800,000——

Mr. BARR. That is correct.

Senator WILLIAMS (continuing). That each of us has recovered on this property which was a million-dollar property. This is the end of the first 7 years.

Mr. BARR. All right.

Senator WILLIAMS. Now I sell my property for $1 million.

Mr. BARR. All right.

Senator WILLIAMS. I reinvest the proceeds within the year, as provided under this bill, by buying my brother's property for $1 million. Of course, he would have reinvested, and we each write out a check and make a bona fide transaction.

Mr. BARR. You are assuming that your brother has a qualified investment.

Senator WILLIAMS. That is correct; both qualified projects.

I buy his and I pay him a million dollars. He buys mine and pays a million dollars. Now, if we both reinvested the proceeds from our sale within a year, we would not be subject to capital gains; is that correct?

Mr. BARR. That is the way I read the bill.

Senator WILLIAMS. This is a new investment in the property because that is a new property to me. I collect another $300,000 tax credit; do I not?

Mr. BARR. Just a minute. Will you excuse us? This is a new wrinkle.

Senator WILLIAMS. My understanding is that if I reinvest these proceeds within a year in another project and it is approved, I will get another investment tax credit.

Mr. BARR. I am informed by counsel that you are correct.

Senator WILLIAMS. Now I have $300,000. Now I can depreciate that full $1 million because I have a million-dollar cost in this new property.

Mr. BARR. That is right.

Senator WILLIAMS. So I have over $500,000.

Now I have $800,000 for the second time around.

Mr. BARR. That is correct.

Senator WILLIAMS. Now the building is 14 years old. My brother and I sit down and get into a little negotiation. I decide to buy that property back again and give him a million dollars again for his property, and he buys my property for a million dollars again. Can I go through the cycle a third time under the bill?

Mr. BARR. Assuming that the Secretary of HUD would certify and that it is a bona fide sale.

Senator WILLIAMS. That is right, it would have to be. I would get $300,000 again.

Mr. BARR. Right.

Senator WILLIAMS. I won't even follow it through the remainder of the five times, but I can do it five times; is that not true, under this bill?

Mr. BARR. Yes. There is no limit on the number of times.

Senator WILLIAMS. I would not be subject to capital gains in this latter case because I am really investing the proceeds within a year. Is that correct?

Mr. BARR. Yes.

Senator WILLIAMS. So, there is no capital gains procedure.

Mr. BARR. No.

Senator WILLIAMS. In that instance in the 5 years I would take $4 million without paying any capital gains back on an investment that I put up of $700,000. Is that correct?

Mr. BARR. It is correct.

Senator WILLIAMS. It is correct?

Mr. BARR. To the best of my knowledge.

Senator WILLIAMS. I think this is one of the most far-reaching proposals, and I would say there would be a tremendous amount of building. I wonder if we would not put a roof over America with that.

As I get it, I want to be sure, I can incorporate these projects under chapter S, filing it under chapter S, use these as charges against my own personal taxes; is that correct?

Mr. BARR. That is correct.

Senator WILLIAMS. Assume that the individual is in the 70-percent bracket, he would get the same $300,000, but he would get $700,000 tax benefits as he depreciates it; would he not?

Mr. BARR. Let me check my example.

Senator WILLIAMS. With a million-dollar project——

Mr. BARR. You are right, 70 percent of the million, $700,000.

Senator WILLIAMS. Take this same case of a man with a million-dollar project; 70-percent bracket, too.

Mr. BARR. All right.

Senator WILLIAMS. He collects the first year $300,000 tax credit, and he depreciates a million dollars' worth of property; in the 70-percent bracket he gets a million dollars back. He gets his back the first 7 years; does he not?

Mr. BARR. Yes.

Senator WILLIAMS. If he and his brother or any other nonrelated individual in that approved project can buy and sell every 7 years, they can each collect a million dollars every 7 years; is that correct?

Mr. BARR. Yes, sir; the way we read the bill.
Senator WILLIAMS. I have no further questions.
Senator TALMADGE. Senator Kennedy.
Senator KENNEDY. May I ask some questions?
Senator TALMADGE. Yes.
Senator KENNEDY. We had a conversation before the hearing started this afternoon in connection with some of these matters. As I think I explained to you at that time, Senator Williams, I think that the bill covers these kinds of problems that you have outlined. Obviously if it does not, we can strengthen it.

As far as the individual selling to another individual after a period of 7 years, as I explained to you before, I think it was covered adequately and satisfactorily in the amendment that I offered this morning to insure protection against that kind of problem. The bill and its amendments deal with these kinds of difficulties which constitute the objections that you raised about the legislation.

The kind of situation you described really is no longer possible if it ever were possible under S. 2100.

Senator WILLIAMS. If the Senator will yield, I am just speaking of the bill on which we are holding hearings. I will point out to the Senator that I think some of the amendments aggravated the problem rather than corrected it because you raised the investment credit from 22 percent to 30 percent. You increased the benefit 8 percent in that category. When you reduce the minimum limitation from the rollover from 10 years to 7 years, you make it possible to get an extra rollover in the life of it.

I know that the Senator, I am sure, never intended to do this, but I think this is something that has to be reexamined. I am just speaking of what the bill does as the bill is before us on which we are holding hearings.

Senator KENNEDY. There were those two amendments, and also some other amendments which I referred to in my testimony today which deal with the very problems and questions you are raising.

Senator WILLIAMS. I will say the bill as it was, as it was pointed out, would be one of the greatest bonanzas that had ever been passed. Rather than a bill to take care of the poverty-stricken individuals, this would really be labeled more or less the poverty bill for the multimillionaires.

I don't think it was intended, and I don't think this Congress would pass any such proposal.

Senator KENNEDY. As I said, even before the hearings began, any of these technical matters could be easily straightened out. To permit bonanzas is not the intention of the bill. I clarified that when I testified this morning. We put the amendments in to be sure this kind of practice did not take place. I explained to you personally it could not take place. I am glad to have that in the record. The fact is that the results you achieve could not occur under this legislation. The legislation that we are discussing is S. 2100, with the amendments I have suggested.

Mr. BARR. Senator Kennedy, with the permission of the chairman and Senator Williams, we would be delighted to take your amendments and add them to the record with computations.

Senator KENNEDY. Will you do that and submit it for the record? Would you like to have it clarified?

Senator WILLIAMS. After the amendments have been printed, certainly we will examine it. I do not for a moment say that this was intended. We are holding hearings on this bill. There were no amendments before us at the time we started the hearings.

Senator KENNEDY. Senator, a lot of the things you have said in this exchange would not ever take place under the bill as submitted. I think I should have the right to clarify that. Certainly the amendments clarify some other aspects of the bill. If you want to have the facts in connection with the bill, I will be glad to help you.

Senator WILLIAMS. I do. I want all the explanations. These provisions are not in the bill. I know you did not intend them; I am sure of that. The point is if this bill was enacted as it is, the Treasury would make the decision and interpretation as to how I as a builder would be treated, and this is their interpretation. That would stand regardless of what my intention would be or yours in the bill. I am sure that will be corrected. I am just trying to point out the applications of the bill which is all I have had before me for the last couple of days, no suggestion of amendments. I was analyzing the bill as it is. It looked like it would be much more attractive to go into the real estate business and the building business than to run for President of the United States or stay in Congress.

Senator TALMADGE. Thank you very much. Is there anything further?

Senator KENNEDY. Could I ask a question?

Senator TALMADGE. Senator Kennedy.

Senator KENNEDY. I have a list here of situations in which tax incentives have been used. I can mention other cases in which tax credits have been used. Senator Smathers touched on some of these examples briefly. They are as follows:

(1) Accelerated depreciation in 1954 to stimulate investment in the American economy.

(2) Additional first year depreciation grants to aid small business in 1958.

Are you opposed to those two measures?

Mr. BARR. Senator Kennedy, in 1958 I was not associated with this Government.

Senator KENNEDY. Do you say those should be repealed?

Mr. BARR. Did you refer to the accelerated depreciation in 1962 or 1954?

Senator KENNEDY. 1954.

Mr. BARR. We did propose, Senator Kennedy, that portion of the accelerated depreciation as it applies to real estate be modified. We proposed this in 1962 and in 1964.

Senator KENNEDY. Some of that accelerated depreciation still is in existence?

Mr. BARR. That is correct.

Senator KENNEDY. My point is, Would you be in favor of repealing it at the moment?

Mr. BARR. I would have to supply that for the record. I haven't looked at these provisions. Let me say this, Senator Kennedy. We have not suggested that they be repealed.

Senator KENNEDY. Let me give you all of these I have here:

(3) Reduction for research and experimental expenditures;

(4) Intangible drilling costs, exploration and developmental costs for mining and percentage depletion—all of these are incentives for the discovery and exploitation of mineral resources;

(5) Deductions for charitable contributions;

(6) Deductions of tax and interest to promote homeownership;

(7) Tax benefits to encourage the use of private pension plans;

(8) Tax benefits for various organizations to promote certain religious and charitable activities;

(9) Rapid amortization to encourage the production of grain storage facilities;

(10) Stock options to encourage key employee ownership;

(11) Favorable tax treatment for Western Hemisphere trade corporations;

(12) Deductions for the premiums for paying health insurance;

(13) And just recently passed in Congress, a tax credit for investment to Thailand.

It seems we can use the code for other social and economic objectives and for investments in Thailand and Israel. Then why cannot we use it for other areas where we need it so greatly?

Mr. BARR. We are not at this moment prepared to state we are opposed to using the 7-percent investment credits to re-hab housing or as a matter of fact to any housing. This and other tax aspects of real estate financing are under study. May I also add that in 1962 and in 1964 we made proposals to curtail what we thought were unreasonable aspects. I wrote down the list as quickly as I could as you were reading it. In certain areas such as intangible drilling expenses, pension plans, and stock options, to name a few, we have urged the Congress to change these provisions.

Senator KENNEDY. I think the question is whether you would be in favor of repealing those exceptions. The point of your testimony was that really tax incentives should not be used for any social and economic purposes. The fact is that we are already down the tax incentive road. The fact is that 12 or 14 exceptions are on the books at the very moment. There are some which have been suggested or recommended. We just passed a treaty recommended by the administration for a 7-percent investment credit for industry in Thailand.

At various times the administration has suggested a 30-percent tax credit for investors in less developed countries. My point is that if we can do it for all these other groups, if we can do it for other countries, why can't we do it for the greatest problem facing our country at the moment?

Mr. BARR. Senator Kennedy, we are, as I say, arguing from only a very restricted base. We agree with the objectives that you are approaching here. We do say that in attacking the problem of a segment of urban housing or the totality of urban housing, we do not believe that the tax route is the most efficient way of approaching this problem.

Senator KENNEDY. Secretary Fowler and Assistant Secretary Surrey have supported some of these tax incentives. You certainly are not asking for repeal of all of them at the moment.

Mr. BARR. The only one we have supported has been the 7-percent investment credit which had broad economic impact which is used by nearly every taxpayer in the United States who has any connection with business or a profession.

Senator KENNEDY. The administration supported 7 percent for Israel and 7 percent for Thailand.

Mr. BARR. That is purely extending a domestic benefit to make sure that our investors in Thailand, Israel, and the rest of these other countries are treated fairly and equally.

Senator KENNEDY. If you called Harlem and Watts, Thailand and Israel, would you permit it to happen there?

Mr. BARR. We have not said that we would not extend the 7-percent-investment credit either to rehabilitate housing or new housing in the ghetto.

Senator KENNEDY. Assistant Secretary Surrey said we must constantly ask ourselves how tax changes can contribute to the achievement of full employment and growth, an achievement that would solve many of our national problems.

Mr. BARR. That is correct.

Senator KENNEDY. It seems to me that in the legislation we are suggesting it would do just that. It would abide by what Secretary Fowler stated and what Secretary Surrey said was necessary.

Mr. BARR. I do not disagree with either of them. These are indirect approaches. We are trying to promote full employment and growth. The social benefits that flow from full employment and growth are one of the types of benefits, not the only benefits.

Senator KENNEDY. Thank you.

Senator TALMADGE. Thank you very much, Mr. Secretary.

Senator KENNEDY. Mr. Chairman, could I call Mr. Ziegler for a couple of minutes to respond to several of these points?

Senator TALMADGE. Yes.

Mr. BARR. I just want to make sure we have not misinformed the committee. If we are in error, we will be delighted to discuss this. We have studied this bill. We have given it serious study. We have tried to give it the attention it deserves. If we are wrong in our answers, we will be delighted to correct the record.

Senator KENNEDY. Will you identify yourself for the record?

STATEMENT OF STEPHEN S. ZIEGLER, OF YOUNG, KAPLAN & EDELSTEIN, NEW YORK, N.Y.

Mr. ZIEGLER. My name is Stephen Ziegler, attorney at law, member of the bar of the State of New York, member of the firm of Young, Kaplan & Edelstein, New York City.

My firm advises business on a wide range of business transactions, tax consequences. I, myself, have been a lecturer on tax matters before the Practicing Law Institute. I have several articles on tax matters in tax publications. Comments I have submitted on various revenue bills and regulations have received serious attention in the Treasury Department.

I would like to discuss for a moment the revenue cost of a project constructed under the bill.

The numbers just read off were read very quickly and they sounded very good but unfortunately they were not correct. First of all, in computing taxable losses and tax refunds you just don't take the depreciation deduction and multiply by the tax rate. First you have to subtract the rental income for the project to find out what is left over as tax loss which can be offset against the builder's other income.

The figures just read off before completely omitted to do that.

Mr. BARR. Mr. Ziegler, I pointed that out to Senator Williams, and he admitted an error in his computation. But it is additional return.

Mr. ZIEGLER. Yes; it is additional return, of course, but still and all it is not tax loss to the Government.

Mr. BARR. Senator Williams was discussing return, not tax loss. I reminded him there was $30,000 a year return he could get on that million dollar investment that should be worked into these computations and we have so worked them in in our computations.

Mr. ZIEGLER. I have seen your computations. We have made computations based on the example you used. I would like to take those figures and run through at least one hypothetical case.

First of all, under the bill as originally submitted the basic life we start from is not the traditional 40 years. We start with an automatic 50 years. The bill starts from a higher base although it applies certain reductions in useful life. In a case of a builder making a 20-percent equity investment he gets a credit of 3 percent of the cost of the building, which we will assume is $1,500,000. So his credit is only $45,000.

Over the first 10 years of the building's life the man has depreciation deducitons of about $748,000. These are computed under the 150-percent declining balance method. It is less rapid than the method which the builder could use under existing law, that is, the 200-percent declining balance method. After we subtract the builder's income from the property, part of which goes to the builder and part of which goes to pay off the mortgage, we find that the builder has tax losses over 10 years of approximately $500,000.

Assuming that the builder is in a 50-percent bracket he thereby realizes tax savings of $250,000. Let us add that to his $45,000 credit and so far he has realized tax savings of about $297,000.

Mr. BARR. There are a few assumptions you must make as you move along. You say this is a million and a half dollars project. Now the assumption you are making is—how much of this is equity capital?

Mr. ZIEGLER. I am assuming $300,000 is equity capital, the minimum; and the balance of one million two is Government insured loan.

Mr. KURTZ. That was not the assumption in Senator Williams' example.

Mr. BARR. Senator Kennedy, use a hundred precent equity so we will be consistent.

Senator KENNEDY. Let me ask you a question so that we get both of them. Is it correct that under this legislation it will be less costly to the Government than under either 221(d)(3) or under rent supplement to produce a specified rental?

Mr. ZIEGLER. Yes, sir. No matter what the income, no matter what the investment, when you take the tax cost of this bill, add it to the interest cost, add it to the real estate abatement cost, it will be less than the interest cost and the rent supplements that would have to

be paid to achieve the same rent under 221 or under the rent supplement program.

Let me run through the two tax examples and then we will add up all the costs, including the interest cost.

Assuming that the builder sells out at the end of 10 years to the Home Management Corp., which would be advantageous for him to do because it maximizes the amount of his return from the property, there would be no more tax benefits granted in this case. It has been cut off at $297,000. How does it compare with the cost of the same building if it is constructed under existing law? If the same building were somehow put up under 221(d)(3), and we contend that nobody would put it up because he would not make a high enough return, over the first 10 years the builder would get tax deductions of approximately $500,000. Those are computed on the double declining balance method of depreciation which is more rapid than the method under the bill but which the builder can use under existing law. After subtracting his cash flow the 221 builder has a tax loss of $208,000 which produces a saving of about $105,000. He, of course, gets no credit under existing law. So far he has $105,000 tax saving. At the end of 10 years the 221 builder is faced with quite a problem. The amortization parts of his mortgage payments are quite high now. He is no longer making even a 6-percent yield from the property. Clearly he will not go on holding it. If at that point he sells he will have to pay a big capital gains tax. He would not want to do that.

Secretary Weaver today indicated the kind of choices he would make. He would give it to a charitable foundation or nonprofit corporation.

Let us assume the value of the building above the mortgage is about $100,000. He would get another $50,000 tax deduction. This means that the total tax cost of the building to the Government even though it is constructed under existing law is $150,000 over the first 10 years.

This is done all the time. In 1964 the administration put into the hearings before the Senate Finance Committee a memorandum containing 50 pages of examples of this type of tax saving under existing law.

In summary, we find that the tax cost of the building under the bill was $297,000 over the first 10 years and the tax cost under existing law was $150,000. Completely apart from any other factor, this additional tax cost may be necessary in order to induce the builder to put the building up. Based on the figures which I have just given you and which are also assumed in the testimony underlying Secretary Weaver's figures, the builder in the 221 project would have only realized a yield of about 8.1 percent. This is not enough to interest many private enterprises in the program. Together with the added tax saving the builder under the bill would get a yield of about 14 percent, which is acceptable although not unreasonably high.

Senator KENNEDY. I am not sure that anybody is going to get all of those figures. I am sure you understand them. Maybe two or three other people here do also. I think one of the great problems is insuring that everybody really assimilates these figures. You have a memorandum that deals with this in depth.

Mr. ZIEGLER. Yes.

Senator KENNEDY. I think maybe you could submit that memorandum and it might be studied by the Treasury Department.

Mr. BARR. May I suggest that Mr. Ziegler meet with the technicians of the Treasury and let them get in a room and battle this out and either come up with a joint memorandum or come up with a memorandum showing where they disagree.

Senator TALMADGE. The big problem is that you are both starting with two different assumptions.

Mr. BARR. You are right.

Senator TALMADGE. You might insert your material in the record there but if there are imperfections in the bill I am sure the distinguished authors will want to know it and take corrective action accordingly and present suitable amendments, modified versions, to the Senate Finance Committee for consideration.

Without objection we will let both the Treasury and Mr. Ziegler submit their statements for the record.

(The committee subsequently received the following memorandums. For additional information on this matter see also p. 419.)

THE UNDER SECRETARY OF THE TREASURY,
Washington, D.C., November 3, 1967.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
New Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: When I testified before the Committee on Finance in connection with S. 2100, I mentioned that the Treasury Department would submit a supplemental statement concerning technical problems with the bill. However, the amendment offered by Senator Kennedy, Amendment No. 316, have cured these problems, and the Treasury does not desire to submit such a statement.

The Treasury was also invited to prepare an analysis of the tax and cost features of the bill to clarify questions concerning the proper interpretation of it and amendments offered at the hearing. The Treasury has completed this task, and I enclose a supplemental statement which discusses the bill's tax provisions, rates of return to investors, and estimates of budget costs. This analysis was prepared after soliciting the views of others, including some who worked with Senator Kennedy in preparing the bill, but the report is the work of the Treasury and presents only the Treasury's conclusions on these matters.

Sincerely yours,

JOSEPH W. BARR.

SUPPLEMENTAL STATEMENT PREPARED BY THE TREASURY DEPARTMENT IN CONNECTION WITH S. 2100 AND AMENDMENT NO. 316

At the public hearings on S. 2100 the Treasury Department was invited to submit a supplemental statement outlining the tax provisions in the bill. In part, this invitation was extended because controversy arose over the tax benefits conferred under the bill. This controversy in turn was built on confusion surrounding the introduction of Amendment No. 316, which is in the nature of a substitute for S. 2100. Since the terms of that Amendment were not before the Committee on Finance at the time of the hearings, reference to its provisions created uncertainties as to the tax provisions of S. 2100.

One purpose of this statment is to clarify the examples discussed at the hearings. In doing so, the tax consequences of the bill as originally introduced are first considered in Part I. This analysis is followed by a short description of the changes made by Amendment No. 316 and a brief analysis of its most salient features, including a sale by the initial holder to his tenants' organization, a home management corporation. The bill as amended is then analyzed in greater detail in Table 1.

Part II of this memorandum describes the rates of return to investors and Part III describes the overall cost of the bill under the NIA and Administrative budgets. These were matters in dispute at the hearings.

Part IV is a summary of the effect of the bill.

I. TAX PROVISIONS

In evaluating and comparing the original bill and its amendments, it is proper to start with the model which led to the discussion at the hearings. It was described by Senator Williams as a $1 million project excluding land cost (p. 152, lines 7 and 8, and p. 152, lines 30–32),[1] and was financed without assistance under the bill[2] (p. 152, lines 7–9). The assumed life of the building was 50 years, but the tax benefits were calculated over only a 35 year period for a taxpayer with an effective tax rate of 50% (p. 151, line 51).

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The benefits under the bill can not be ascertained until the holder's "equity investment percentage" is first determined. This percentage is the ratio of the taxpayer's equity to the cost of the project. Section 1391(6).[3] The taxpayer's equity is the cost of the project less any mortgage financed under the bill. Section 1391(5). Since no mortgage existed in the model, the taxpayer's equity would be the project's cost. The equity investment ratio would thus be 100%.

Under section 1392(a)(1), a 100% equity holder was entitled to a tax credit equal to 22% of the project cost which included both the land and the building cost.[4] In addition, under section 1393(b) a 100% equity holder would be entitled to reduce the buildings' depreciable life to 20% of the assumed 50 year life, or to 10 years. This period is also just equal to the taxpayer's "maximum holding period" under the bill. Section 1391(7).

In addition to the credit and accelerated depreciation, an original holder who retained the property beyond his maximum holding period and who also certified that he would continue to hold such property in conformity with the bill would have been "treated as having sold and purchased such property, on the first day after the end of such maximum holding period." Thereafter, the owner was treated as a subsequent holder. Section 1394. The price at which this sale and purchase occurred was the total of the original equity investment plus the unpaid principal amount of any mortgage financed under the bill less the amount of credits allowed. Since there was no such mortgage, the fictional sale and purchase price would be the original cost less the credits allowed. On a $1 million project with a 22% credit, the sale and purchase would be deemed to occur at $780,000. The purpose of the fictional sale was to provide the holder whose project would have been entirely depreciated, with additional basis for depreciation over another "maximum holding period."

Under the original bill, a gain on a sale, including this fictional sale, was not recognized if the taxpayer made a qualified reinvestment. Section 1396(b)(1). A qualified reinvestment was defined as an expenditure paid or accrued which would fall within the definition of a "qualified expenditure" under the bill. This definition included the acquisition price to a subsequent holder. Section 1391(9)(B). Hence, the fictional purchase was a qualified reinvestment, and the fictional sale was thus exempted from tax.

With this outline, it is apparent that during the first 35 years, the builder of a $1 million project would receive a 22% credit or $220,000, and would have depreciated the building over an initial 10 year period, a second 10 year period, a third 10 year period, and finally five years out of a fourth 10 year period. The basis during the first 10 years would have been $1 million and in each of the other periods, the basis would have been $780,000, that is, the project cost less the credit. Thus, the total depreciable amount would have been $3,125,000 on total cost of $1 million. If the taxpayer were in a 50% tax bracket, the net after-tax benefit of these deductions would be $1,562,000 which when added to the credit would total $1,782,000 of after-tax benefits. There would have been no capital gain or other tax paid on the restoration of basis at the end of each 10 year period.

The dispute at the hearings grew out of an effort to adapt the foregoing to the bill as it had apparently been amended. At that time Senator Kennedy's open-

[1] References to page numbers are to these printed hearings, unless otherwise noted.
[2] In this discussion "financed without assistance under the bill" means equity investment in the usual sense plus the proceeds of a conventional mortgage not insured under sec. 235 of the National Housing Act.
[3] Unless otherwise noted section number references are to sections of the Internal Revenue Code as they would be added by enactment of the bill.
[4] Since the land cost was excluded from the model discussed, it has been ignored in the computation of the credit.

ing remarks contained the only available statement of the amendments. He had stated that the maximum holding period had been reduced to seven years, the credit increased to 30%, and a capital gain tax imposed on the basis restoration (p. 67, lines 25–28).

These modifications, as stated by Senator Kennedy, led Senator Williams to believe that there could be four complete restorations of basis in a 35-year period (p. 154, lines 42–45). Senator Williams then stated that the entire $1 million would be depreciated during the first seven years but that the basis on each later restoration would be only $7,000.[5] Thus, the total depreciation during the 35 years considered would be $3,800,000. To a taxpayer in the 50% bracket the depreciation would amount to an after-tax benefit of $1,900,000 which when added to the $300,000 would total $2,200,000, exactly the amount claimed by Senator Williams. (See p. 154, lines 19–21, and p. 154, lines 42–45.) Under Secretary Barr stated that these figures would be modified by the capital gain provisions as amended but that the effect of the Amendment was unclear (p. 152, lines 50–53, and p. 154, lines 49–50). *Thus, the total benefits of the original bill with the amendments outlined in Senator Kennedy's statement were as stated by Senator Williams except for a capital gains tax of slightly less than $65,000.*

If the building were sold at the end of each 7 year period, and if the seller reinvested after each sale by purchasing another project of the same size, on each purchase he would claim the credit extended to "subsequent holders".[6] Section 1392(a)(1). This credit was assumed to be $300,000 on each purchase.[7] Furthermore, he would be entitled to depreciate the cost of his purchased project which by assumption would be $1 million, and his depreciation deductions over the 35 year period would rise from $3,800,000 to $5 million. Thus, on each purchase there would have been a total after tax benefit of $800,000, a $300,000 credit plus $500,000 in depreciation benefits. The total after tax benefit over a 35 year period would be $4,000,000 less a capital gains tax of $65,000.

Under the amendments stated by Senator Kennedy, this analysis was essentially correct except it failed to take into account the reduction in credit for "subsequent holders" and the capital gains tax, which Under Secretary Barr noted—both of which were contained in amendments not then available. Later, it was learned that a subsequent holder could not reduce his holding period to less than 10 years, but that information was not available at the hearings. Thus, the model discussed at the hearings and the analysis there made were correct[8] except for the matters just noted which were changed by amendments not yet referred to the Committee on Finance and not mentioned in Senator Kennedy's statement.

B. Amendment No. 316

Amendment No. 316 modified a number of the foregoing provisions. There was no change in the definition of equity investment, however, and the hypothetical taxpayer discussed above would be a 100% equity holder. His credit as a first holder was raised to 30%. Subsequent holders with the same equity investment were limited to a 23% credit, however. Section 1302(a). The amended bill also makes clear that only the first holder may have a "maximum holding period" of seven years. Thereafter, the period is 10 years. These changes are illustrated in the example below where the taxpayer is assumed to hold the building for 35 years.

Under the Amendment basis is restored at the end of each maximum holding period (in this case at the beginning of the 8th, 18th, and 28th years) by the same fictional sale and purchase technique. However, the amended bill would impose a capital gains tax on the fictional sale from the holder to himself because the fictional purchase would not qualify as a reinvestment under the amended bill. Section 1394(c)(2).

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[5] This would be the $1 million project cost less a 30% credit of $300,000.

[6] At one point the buyer of the project was stated to be the holder's brother. (P. 155, lines 29–32.) Under the bill, the brother would not have been recognized as a subsequent holder. Section 1391(11). The buyer was later identified as a "non-related individual." (P. 156, lines 51–53.) Of course, such a sale would have to be a bona fide sale and not a disguised exchange. (P. 156, lines 9–10.)

[7] When the amended bill was finally made available, it became clear that the largest credit to a subsequent holder was 23%, not the 30% mentioned at the hearings.

[8] Mr. Ziegler was called to state the effect of the amendments, but at no point in his testimony does he specify the respects in which this analysis was incorrect.

The price at which the fictional sale and purchase occur was also changed. It is an amount equal to the basis of the project less what would have been straight line depreciation deductions computed by use of a 50 year life. Since the project will always have a zero basis at the time of such sale, gain will always be realized. Gain recognized is, however, limited to the amount by which this fictional sale price would exceed the unpaid balance on a mortgage for 80% of the project cost, maturing in fifty years, bearing 2% interest, and insured under the bill.[9]

On these assumptions, the total depreciation claimed during the first 35 years would be approximately $2,980,000 which would amount to an after-tax benefit of $1,480,000 to a 50% taxpayer. The credit would be $300,000, and the total capital gain tax would be nearly $161,000. Hence, the total after-tax benefits would be about $161,000.

If instead of retaining the building the holder were to sell it and reinvest in a similar project, the tax benefits would be those just mentioned plus the additional credit on each subsequent purchase. These credits would be slightly more than $580,000 and the after-tax benefits over the 35 year period would increase to almost $2,200,000.

It should also be noted that the amendment to the bill changed the provisions dealing with sales to home management corporations. Such sales can now occur after the project has been held for two years. On such a sale there would be no gain, and none of the credits or depreciation in excess of straight line depreciation would be recaptured. This sale provides the greatest return to the builder and is extensively analyzed in part III of Table 1.

C. Conclusions

First, the initial credits result in high returns in the early years of a project. Hence, the longer a project is retained, the lower the average return becomes. This trend is reinforced by the high accelerated depreciation in the project's early years. This declining return is partially offset by the periodic restoration of basis. However, the basis restored becomes progressively less, and the benefit is considerably smaller in comparison to earlier years.

Second, the declining return to one who retains his project is accentuated by the extension of credits to subsequent holders. By offering a new round of credits for the purchase of used property, the bill nearly compels the sale of a project and the purchase of another or construction of a new one. Thus, the credits for purchases of used property when taken with the declining return on a retained project are an economic compulsion to sell, and the stability desired by the sponsors might not be obtained.

Third, by the use of conventional financing which is then defined as equity under the bill, an investor can reduce his risk substantially. For example, in a $1,000,000 project financed by an investment of $200,000 and a conventional mortgage for the balance of $800,000, a $300,000 Federal tax credit would be granted. If there were no personal liability for the financing, not uncommon in real estate transactions, the taxpayer would never have any amount at actual risk. Indeed, he is $100,000 richer after filing his tax return for the year of construction.

However, since the project will not produce high rents, a lender making a conventional loan might require personal liability on the note.[10] Even so, the 70% taxpayer is not risking anything other than the cost of borrowing $800,000 for two years. That is, he obtains an initial credit of $300,000, and he will have a basis of $1 million in the project, which if abandoned, would reduce his taxes

[9] In order to retain the model discussed at the hearings, land costs should be ignored. However, land is nondepreciable, and the amount of gain in each of the fictional sales would be understated if land values were entirely ignored. Hence, for the purposes of the analysis, a land cost of $150,000 has been assumed reasonable for a $1 million building. The gain on each fictional sale has therefore been increased by $150,000 and the tax by 25% (assuming the highest capital gain rate) or $37,500.

[10] Some might argue that personal liability on the mortgage is the equivalent of a cash investment since the ability to raise funds has been depleted to the extent of personal liability. While this contention has some merit, it overlooks the substantial benefits accruing to the investors, and a good part of these benefits is sufficiently immediate, *e.g.*, in the first two years a 70% taxpayer realizes a before financing cash flow of about $600,000, to constitute a fund to which the lender can look for repayment. Also, the project itself does have some value even though it might not be adequate security for the entire loan. Consequently, the argument has not been accepted in stating conclusions herein, but it should be kept in mind when reading this paper.

by 70% of the basis or $700,000. Thus, the credit insures him against any loss. The 50% taxpayer, however, actually risks a loss of $200,000 plus borrowing costs. The 30% taxpayer would risk $400,000 plus borrowing costs.

Fourth, conventional financing not only reduces the risk but also increases the return on the actual equity. A conventionally financed project obtains the tax benefits designed to yield a high after-tax return on the entire project cost. Since this return is higher than the financing cost, the differential between the return provided by the tax benefits and the financing cost adds to the return on actual equity and increases it considerably.

Finally, the sale to a home management corporation provides the greatest return to the investor. In Table 1 such a sale has been analyzed for taxpayers in the 30%, the 50%, and the 70% effective tax brackets. The net cash returns to an investor are startlingly favorable, running from $337,000 for the 30% taxpayer, to $405,000 for the 50% taxpayer, to $470,000 for the 70% taxpayer.

If rates of return are stated as a percentage of the risks involved, the benefit to high bracket taxpayers is apparent. The 70% taxpayer has a return in excess of $470,000 while risking only financing costs of the conventional loan. The 50% taxpayer has a return of about $405,000 on a $200,000 risk for approximately a 102% annual return. The 30% taxpayer, however, would receive only $337,000 on a $400,000 risk for about a 42% return. It must be emphasized that these returns are on risk, not on actual cash outlay. The cash outlay was all recouped upon filing the first tax return.

These results are startling. *As the risk increases, the return decreases.* This result will almost always follow from the use of tax deduction incentives as an inducement to investment.

TABLE 1.—*Financial benefits under S. 2100 as amended by Amendment No. 316*

I. Benefits Assuming Retention for 50 years:

Assumptions:

Equity, as defined in the bill: 100%.
Mortgage: 6%, $800,000 principal for 20 years.
Cost of project: $1,000,000.
Cost of land: $200,000.
Cost of building: $800,000.
Depreciation method: 150% declining balance.
Life to first holder: 7 years.
Life to subsequent holder: 10 years.
Life of building: 50 years.

Under subsection (a) an electing holder's basis is restored to an amount computed under subsection (b). Thereafter, except for credits, he is treated as a subsequent holder. The amount of the restored basis is the project cost less straight-line depreciation computed on a fifty year life. (§ 1394(b) of the Code and § 101(a)(5) of the bill.) The amount to which the basis is restored is also the "sales price" for computing gain. Gain is recognized only to the extent that the amount realized exceeds an amount equal to the unpaid balance on an 80%, 50 year, 2 percent interest loan under the bill, assuming no defaults, (§ 1396(d)(2)).

1. COMPUTATION OF GAIN AND TAX ON RESTORATION

	7 years	17 years	27 years	37 years	47 years
(a) Sales price under the bill	$388,000	$728,000	$568,000	$403,000	$248,000
(b) Less basis	200,000	200,000	200,000	200,000	200,000
(c) Gain realized	688,000	528,000	368,000	208,000	48,000
(d) Gain recognized limited to line (a) minus	730,000	597,000	465,000	289,000	91,000
Total	158,000	131,000	103,000	119,000	48,000
Tax [1]	39,500	32,750	25,750	29,750	12,000

[1] Assumes alternative tax at 25 percent.

Note.—This computation assumes that the amount allocated to land remains $200,000 on each of the basis restorations. Perhaps in some circumstances a new allocation in some other ratio might have to be made.

2. Computation of depreciation:

1st 7 years	$800,000
Next 10 years	688,000
Next 10 years	528,000
Next 10 years	208,000
Next 3 years	48,000
Total depreciation	2,640,000

3. COMPUTATION OF TAX BENEFITS TO TAXPAYERS IN FOLLOWING BRACKETS (NOT DISCOUNTED TO PRESENT VALUE)

	70 percent	50 percent	30 percent
Credit	$300,000	$300,000	$300,000
Depreciation	1,848,000	1,320,000	792,000
Total	2,148,000	1,620,000	1,092,000
Less capital gain tax	150,000	150,000	150,000
Total	1,998,000	1,470,000	942,000
These figures are after-tax benefits and over a 50-year period are the equivalent of a before-tax net income of	6,660,000	2,940,000	1,346,000

4. RENTAL INCOME: ANNUAL RENTS (SEE SEC. 107(a)(1) OF THE BILL) $31,500

	1st 20 years	Next 30 years
Net average annual income to—[1]		
70-percent taxpayer	$2,250	$9,450
50-percent taxpayer	3,750	15,750
30-percent taxpayer	5,250	22,050

[1] During the 1st 20 years while amortizing the conventional loan, this assumes an average annual interest cost of $24,000, leaving a $7,500 taxable balance.

5. NET CASH FLOW OVER 50 YEARS TO TAXPAYERS IN FOLLOWING BRACKETS

	70 percent	50 percent	30 percent
Aftertax benefits of tax incentives	$1,998,000	$1,470,000	$942,000
Income after interest and taxes	328,500	547,500	766,500
Total	2,326,500	2,017,500	1,708,500
Less cost of project	1,000,000	1,000,000	1,000,000
Net cash increase	1,326,500	1,017,500	708,500

6. Tax benefits of the bill in excess of present law: The bill's tax benefits in excess of present law can be isolated only if the tax benefits derived in step 3 are reduced by the tax benefits available to a taxpayer who held a project not under the bill for 50 years. Since the credits and the basis restorations would not be available, the ordinary tax benefits would amount only to the benefit of depreciation on $800,000. Hence, the benefits from step 3 are reduced by the tax benefits available under present law:

	70 percent	50 percent	30 percent
From step 3	$1,998,000	$1,470,000	$942,000
Less after-tax benefit of depreciation under present law	560,000	400,000	240,000
After-tax benefits of this bill	1,438,000	1,070,000	702,000
Note: These are after-tax returns and over a 50-year period are the equivalent of a before-tax net income of	4,793,000	2,140,000	1,003,000

II. Benefits Assuming a Sale at the End of Each "Maximum Holding Period" with Immediate Investment in a Used Project as a "Subsequent Holder":

Assumptions:

Same as above.

Sales price on each sale—The amount to which basis would have been restored. This appears to be the effect of the amendments.

Reinvestment—Entire sales proceeds are reinvested in a certified project. This entitles the buyer to credit specified in the bill on all except the last purchase at the 48th year.

1. Net cash return: Net cash increase computed in the case where the building was retained must be modified to add the credits available on each turnover.

	70 percent	50 percent	30 percent
From pt. I, step 5	$1,326,500	$1,107,500	$708,500
Add credits for purchases at beginning of—			
8th year	204,000	204,000	204,000
18th year	167,500	167,500	167,500
28th year	130,500	130,500	130,500
38th year	94,000	94,000	94,000
Total	1,922,500	1,613,500	1,304,500
Note: These are after-tax benefits and over a 50-year period are equal to a before-tax net cash income of	6,408,000	3,229,000	1,864,000

2. Tax benefits in excess of current law: To obtain the tax benefits of this bill over current law the results under the case where the building was retained must be modified by adding the additional credits obtained by reinvestment and subtracting the somewhat higher depreciation which results from each successive owner having a higher basis for the purchased project than for the project just sold. However, that benefit must be reduced by the capital gains taxes paid by a taxpayer not under this bill as compared to the amount paid by one under the bill.[1] The benefits conferred by this bill then are:

	70 percent	50 percent	30 percent
From pt. I, step 6	$1,438,000	$1,070,000	$942,000
Additional credits	596,000	596,000	596,000
Depreciation and capital gain adjustment	75,000	42,000	9,000
Total	1,959,000	1,624,000	1,428,000
These are after-tax benefits and over a 50-year period are the equivalent of a before-tax net income of	[illegible],530,000	3,248,000	2,153,000

III. Sale to Home Management Corporation Two Years after Construction:

Assumptions: Same as above.

1. Financial data:

Depreciation claimed	$305,600
Option price (sec. 101(a)(5)(G))	968,000
Balance on conventional mortgage on sale date	755,200
Payments which were made on conventional mortgage:	
Principal	44,800
Interest	93,800
Balance on a 50 year, 2 percent mortgage for 80 percent of cost assuming all payments were made	780,900

2. Mechanics under the bill: The home management corporation has an option to purchase after 2 years of operation. The price is cost less straight line depreciation. On the assumption above, the price would be $968,000. This amount may not be financed under the 50 year, 2 percent mortgage provisions but may be raised only by 50 year (or less), 6 percent financing which may then be insured under section 235(e) of the National Housing Act as it would be added by the bill. Funds for amortization of this loan would be provided by increasing rents to 105 percent of those otherwise required (§ 102(a)(2) of the bill, p. 11) and the federal subsidy to the home management corporation for this purpose (§ 108(a) of the bill, p. 22).

[1] For this purpose the recapture provisions of § 1250 of the Code which would apply on a sale not under the bill but at the end of the first seven years have been ignored.

3. Deductible tax loss on the project (2 years):

Rents (net of expenses other than depreciation and interest)	$63,000
Expenses:	
Depreciation: See step 1	305,600
Interest: See step 1	93,800
	399,400
Net tax loss	336,400

4. TAX BENEFITS TO TAXPAYERS IN THE FOLLOWING BRACKETS

	70 percent	50 percent	30 percent
Credit	$300,000	$300,000	$300,000
Benefit of tax loss determined under step 3	235,500	168,200	100,900
Total	535,500	468,200	400,900

5. CASH RECEIVED ON SALE

	70 percent	50 percent	30 percent
Option price (see step 1)	....	....	$968,000
Less balance of conventional mortgage (see step 1)	....	....	755,200
Cash received	....	....	212,800

6. CASH FLOW BENEFITS

	70 percent	50 percent	30 percent
Tax benefits from step 4	$535,400	$468,200	$400,900
Rents received	63,000	63,000	63,000
Cash received on sales, see step 5	212,800	212,800	212,800
Total	811,200	744,000	676,700
Less payments on mortgage	138,600	138,600	138,600
Total	672,600	605,400	538,100
Less actual cash provided by taxpayer	200,000	200,000	200,000
Total cash	472,600	405,400	338,100

7. TAX BENEFITS AVAILABLE UNDER THIS BILL WHICH ARE NOT AVAILABLE UNDER PRESENT LAW

	Under the bill	Present law	Difference
Credit	$300,000	....	$300,000
Depreciation (2 years) (200 percent declining balance under present law)	305,600	$78,000	227,600
Exemption of gain assuming same sale price	47,200	....	47,200

These amount to cash benefits over and above present law to taxpayers in the following brackets:

	70 percent	50 percent	30 percent
Credit	$300,000	$300,000	$300,000
Depreciation	159,300	113,800	68,300
Exemption from gain [1]	31,500	22,600	13,700
Total	490,800	436,400	382,000
Thus, in a 2-year period, the tax benefits of the bill, over and above present law tax benefits, would equal a before-tax net income of	1,636,000	872,800	546,000

[1] Under present law, only 4 percent of the depreciation in excess of straight line depreciation would be taxed at capita gain rates. In this case, that is 4 percent of the gain.

Note.—The foregoing does not take into account the ability to depreciate demolition and site improvement costs under the bill. This is not possible under present law.

8. Cost of purchase subsidy to the government: The home management corporation would not be able to obtain financing without the subsidy necessary to assure payment. The cost of that subsidy may be computed as follows:

Net rental income	$31,500
Add 5 percent increase in gross occupancy charges if purchase is made (see sec. 102(a)(2) of the bill)	3,600
Total	35,100

Amount necessary to make annual payments on—

(a) $968,000 loan—20 year, 6 percent	84,500
Subsidy (difference between total rents and payments)	35,100
Annual subsidy	49,400
Annual subsidy multiplied by 20 years	988,000
(b) If the 6% loan is amortized over 50 years, annual payments are	61,400
Less rental income	35,100
Annual subsidy	26,300
$28,300 multiplied by 50 years	1,315,000

The second assumption appears the more likely under the bill.

9. Total cost of a project: Total cost to the government is the tax benefits in excess of those otherwise available plus the cost of the purchase subsidy. Total cost assuming taxpayers in the following brackets are:

	70 percent	50 percent	30 percent
Cost of benefits from step 7	$490,800	$436,400	$382,000
Purchase subsidy. (See step 8.)	1,315,000	1,315,000	1,315,000
Total	1,805,800	1,751,400	1,697,000

10. Total cost of project under an alternative program: Cost if Government bought the project after construction, financed the cost at 4½%, and charged rents permissible:

$1,000,000 amortized over 50 years at 4½ percent	$2,530,100
Less rents ($35,100 by 50 years)	1,755,000
Cost to Government	775,100

II. RATES OF RETURN TO THE INVESTOR

The following analysis is offered as a way of estimating the value to the investor of the provisions of S. 2100.

A. The Loan Terms and the Local Tax Subsidy

The benefits of S. 2100 can be divided between those intended to produce lower rents and those intended to produce a better return to the investor. The benefits of a fifty year, 2 percent interest loan and the subsidy of covering local property taxes are taken into the calculation of rents in such a way that the benefits of these items are passed on to the tenant. It is not clear that an equivalent amount of rent reduction subsidy can be provided under present law. The extension of the advantages of these loan terms and local property tax relief to a larger class of housing projects than those now under rent supplement is a matter of housing policy on which the Treasury Department makes no comment. But it is clear that these benefits could be made a part of housing programs, apart from this bill, if Congress so desired.

B. Return to Investor

1. *Method of Measuring Effects of Tax Benefits.*—It is argued by the supporters of S. 2100 that even if rent is reduced by the local tax subsidy and the interest subsidy the return to the investor under present law is inadequate to

bring about substantial investment in these low-rent projects. S. 2100 goes on to address this second problem by providing additional tax benefits to encourage the investor. The immediate problem is to describe what these benefits are. Whether these benefits are too large or too small is a question which is not discussed here.

To carry out this technical task of describing just the *tax benefits* provided by S. 2100, we will assume that Congress enacts legislation that permits section 221 (d)(3) housing projects to be financed with a fifty-year, 2 percent interest, 80 percent mortgage and provides a subsidy to cover local property taxes. Actually, section 221(d)(3) now permits 90 percent mortgages so that the significance of going from 80 percent to 90 percent mortgages will have to be shown separately. It is necessary to exhibit the section 221(d)(3) arrangement on precisely the same mortgage terms as the S. 2100 arrangements if we are to describe consequences of the tax provisions. Further to keep nontax conditions the same, we assume that the net cash rent allowed under section 221(d)(3) is reduced from 6 percent of the equity to 3 percent of the equity; since the amount of allowable equity under section 221(d)(3) is assumed to be 20 percent instead of 10 percent, this gives the net cash rent computation used on S. 2100. Finally we need to take note of the fact that under section 221(d)(3) an investor must hold the property for 20 years, which is a disadvantage from the investor's standpoint. Our calculations show the rate of return that could be had under section 221(d)(3) if it permitted the same holding period as S. 2100. The return over a longer holding period is also shown. We assume a $1 million project in each case with $800,000 spent for the building and $50,000 spent for site improvement.

2. *Effects of Tax Benefits Provided Under S. 2100—Comparison With Section 221(d)(3).*—The results of our analysis are summarized in Tables 2 and 3 dealing with the first seven, and next ten years, of investment respectively. The tables indicate several calculations for the rate of return under S. 2100 with equity investment of 20+ percent, 50+ percent, and 100 percent and for section 221 (d)(3). The returns are shown on an after-tax basis for taxpayers in the 70 percent bracket, the 50 percent bracket, and the 30 percent bracket. The table follows the language of S. 2100 in treating as "equity" the proceeds of a conventional mortgage.

Column 3 in each table indicates the average rate of return on the equity investment for the period that would be realized by an investor who does not sell the property at the end of the period but continues to hold the property. Column 4 shows the average rate of return after tax for an investor who sells the property at the end of the period. In the S. 2100 examples we assume that the property is sold to a Home Management Corporation (HMC) because HMC always has first option to buy at a price specified in the law. An investor who wants to get out of the investment could not depend upon a better sales price than this.

In the section 221(d)(3) cases we assume that the property is sold at a price below the original purchase price by the amount of mortgage repayment that has taken place. This sales price permits the investor to recover his initial investment, although he will recognize a taxable gain part of which will be capital gain and part ordinary income. This tax reduces the rate of return. To illustrate: we assume that the section 221(d)(3) project costing $1 million is sold after seven years for $935,000 (which would allow a 20 percent equity investor to recover his $200,000 before tax). He would pay a tax on his gain over adjusted basis in the 50 percent bracket of $60,000.

One generalization which suggests itself immediately is that the after-tax rate of return is in all cases better for the 70 percent taxpayer than it is for the 30 percent taxpayer. To take one example, an S. 2100 property with 50 percent equity in the first seven years, assuming sale to HMC, produces a 17 percent rate of return for a 70 percent taxpayer and an 11 percent rate of return for a 30 percent taxpayer. Both of these rates of return are after tax. For the 30 percent taxpayer this return is the equivalent of a 15 percent return before tax. For the 70 percent taxpayer, however, a 17 percent after-tax rate of return is the equivalent of a 56 percent before-tax rate of return. This pattern of after-tax returns is just the opposite of what normally happens under a progressive income tax. If a 70 percent investor and a 30 percent investor each buy a stock with a 10 percent dividend yield, the respective after-tax rates of return are 3 percent (for the 70 percent taxpayer) and 7 percent (for the 30 percent taxpayer). Even with tax exempt bonds the after-tax rate of return is equal for high and low bracket tax-

payers. In real estate investments, however, the after-tax rate of return is perverse; i.e., it is *better* for the high bracket taxpayer than it is for the low bracket taxpayer. This perversity of after-tax rates of return arises because the payoff is in excess depreciation deductions, and it exists under present tax rules on real estate which is reflected in the section 221 (d) (3) calculations. S. 2100 simply carries this pattern out to larger equities.

There is no obvious basis for assuming a particular sales price under section 221 (d) (3). The price assumed here produces the rate of return to the second holder shown in Table 3 which looks rather low in the 20 percent equity case but quite satisfactory in the 10 percent equity case. Thus one could say that the assumed sales price on section 221 (d) (3) 20 percent equity should be somewhat lower than $935,000 which would make the return in the hypothetical 20 percent equity section 221 (d) (3) case still lower. The assumed sales price of $935,000 seems reasonable in the case of a section 221 (d) (3) 10 percent equity case. The fact that it is higher than the assumed S. 2100 sales price is simply a result of the feature of the bill to provide an option to purchase for an HMC. It should also be noted that the seven year holding period was selected because it is the period specified in S. 2100. By holding until year 10, the section 221 (d) (3) investor can avoid ordinary income tax on the gain, and have either a better after-tax return, or this good a return with a lower sales price.

Columns 5 and 6 which were computed for section 221 (d) (3) only indicate how the rate of return would change when the provision for 90 percent mortgages is allowed. Column 5 assumes no sale and is comparable with Column 3. Column 6 assumes sale of the property at the end of the calculation period so that it should be compared to Column 4.

Another generalization that suggests itself is that the tax provisions of S. 2100 result in approximately comparable rates of return for different levels of equity investment. For the very high bracket taxpayer a low equity investment is a bit more attractive, and for the low bracket taxpayer larger equity investment is a bit more attractive; but the differences are not very great. The Treasury testified that the original bill was more favorable for low equity investment. The present comparability results from the amendments introduced by Senator Kennedy at the public hearing.

Another comment on Tables 2 and 3 is that the tax provisions in S. 2100 produce about double the rate of return after tax that would be realized on a section 221 (d) (3) property if they both required 20 percent equity. The rate of return under a section 221 (d) (3) property arises primarily because of the depreciation advantages for real estate built into present law. The provisions of S. 2100, as they apply to a 20 percent equity case, just about double these tax advantages by the speed-up in depreciation and the investment credit. Since section 221 (d) (3) in fact permits these benefits to be realized on just half as much equity, 10 percent, the yield after tax on S. 2100, 20 percent equity, is roughly comparable to the yield on section 221 (d) (3) 10 percent equity.

The additional tax benefits provided by S. 2100 for larger equity investments are structured to further increase the tax benefits in proportion to the increase in equity which is necessary to produce approximately equal rates of return. Thus the value of the tax benefits for a 100 percent equity case is about five times larger than the value of the tax benefits for a 20 percent equity case, which are already two times larger than the tax benefits under present law, giving a total return on a 100 percent equity case ten times larger than present law.

This point can be clarified as follows: If one ignores the depreciation deductions (in excess of mortgage repayments) on a section 221 (d) (3) project with 10 percent equity, the net rent income on a $1 million project is only $6,000 a year or $3,000 a year after tax for a 50 percent investor. The excess depreciation deductions produce the tax savings of about $12,000, making the after-tax return about $15,000 which is 15 percent on an equity of $100,000. S. 2100 as stated earlier is structured to produce roughly comparable rates of return for larger equities that are comparable to those on lower equities. Thus, a $1 million project with 20 percent, or $200,000 equity, would require additional tax benefits of another $15,000 (over the $12,000) so that the combined return will be ($3,000 rent after tax plus $27,000 tax benefits) or $30,000 which is 15 percent of the $200,000 equity. To produce this rate of return for a 100 percent equity, the tax benefits have to be about $147,000 a year which combined with the $3,000 after-tax rent produces $150,000 after-tax benefits which is 15 percent of $1 million.

Where no sale is involved, the rate of return provided by S. 2100 for the first seven years is comparable to the rate of return that could be realized on a section 221(d)(3) property with a 10 percent equity. This can be seen by comparing Column 5 in both tables with Column 3. If we assume a sale at the end of the seventh year, then S. 2100 generally produces better returns than section 221(d)(3) by anywhere from three to five points (compare Columns 6 and 4). In the second holding period, from the eighth to the seventeenth year, a section 221(d)(3) investment, even with sale at the end, produces generally a better return than S. 2100 by 1 or 2 points, but the comparison varies greatly with the equity ratio and the tax rate.

Computation of a rate of return for seven years without a sale may be questioned, so Table 4 has been prepared which combines the results of holding for seven years without sale and holding for an additional ten years with and without sale. It will be seen that the results in this case are very little affected by whether there is a sale in year 17 or not.

Both section 221(d)(3) with a 10 percent equity and S. 2100 present very high after-tax rates of return, especially to high bracket taxpayers where the return is in the range of 17 percent to 20 percent. Typically, after-tax rates of return on corporate equity are about 10 percent.

Another aspect of the rate of return on an S. 2100 project is the benefit from a very fast sellout to an HMC if this can be arranged in a period of two years. The investment credit over a two year basis is three times as valuable as it is in the calculations for a seven year holding period; and the depreciation benefits are about 50 percent better over a two year basis. In the 100 percent equity case, for the 70 percent taxpayer, there are net tax benefits of approximately $470,000 available on a $1 million S. 2100 investment sold to an HMC, after two years that are not available on a section 221(d)(3) investment. These benefits are realized over two years along with the basic tax benefits and net rent provision. They make the after-tax rate of return almost 30 percent a year on the $1 million investment.

TABLE 5.—ANALYSIS OF YEARS 1-7—RATE OF RETURN

[Dollar amounts in thousands; remainder in percent]

Provision and equity	Marginal tax rate of investor	Discounted yield	Equivalent yield after tax: No sale	With sale at end	Adjusted to 10 percent equity: No sale	Sale: 7th year	Sale: 10th year
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
221(d)(3) (20 percent)	70	$87	10.0	6.6	19.4	12.5	15.3
	50	70	8.1	5.7	15.7	10.8	11.9
	30	52	6.0	4.3	11.5	8.1	9.5
S. 2100 (20 percent)	70	171	19.7	17.2			
	50	138	15.9	13.4			
	30	105	12.1	9.6			
S. 2100 (50 percent)	70	398	18.4	16.8			
	50	335	15.4	13.9			
	30	272	12.6	11.0			
S. 2100 (100 percent)	70	727	16.8	15.6			
	50	643	14.8	13.7			
	30	559	12.9	11.8			

NOTES

Col. (1)—Marginal rate means the average rate applicable to the net reduction of taxable income due to the housing project.

Col. (2) equals the sum, discounted at 12 percent, of depreciation, plus investment credit where applicable, plus the net rent and less the mortgage amortization, all after tax.

Col. (3)—Col. (2) multiplied by 1.615 divided by 7 divided by equity ratio, that is, 0.1154, 0.04614, 0.02307.

Cols. (4), (5), (6), and (7) obtained by adjusting col. (2) and repeating operation in col. (3).

The adjustments were:

Col. (4)—221(d)(3) $1 million less mortgage payments, less depreciation, which produces a taxable gain of $177,000 of which $113,000 is capital and $64,000 is ordinary taxable at 25 percent, 25 percent, 15 percent, and 70 percent, 50 percent, 30 percent respectively.

Col. (4)—S. 2100 ($1 million less mortgage payments less $881,000) (0.41).

Col. (5)—Section 221(d)(3) mortgage payment increased 12.5 percent and multiplier for 10 percent equity used.

TABLE 3.—ANALYSIS OF RATES OF RETURN YEARS 8-17

[Dollar amounts in thousands; other columns in percent]

Provision and equity	Marginal tax rate of investor	Discounted yield after tax	Equivalent yield after tax: No sale	Equivalent yield after tax: With sale at end	Adjusted to 10 percent equity: No sale	Adjusted to 10 percent equity: Sale
	(1)	(2)	(3)	(4)	(5)	(6)
221(d)(3) (20 percent)	70	$57	5.4	3.5	9.8	6.0
	50	50	4.7	2.8	8.7	4.9
	30	42	4.0	2.8	7.2	5.3
S. 2100 (20 percent)	70	115	10.9	7.8		
	50	80	7.6	4.5		
	30	61	5.8	2.7		
S. 2100 (50 percent)	70	172	6.5	5.3		
	50	135	5.1	3.2		
	30	113	4.3	2.4		
S. 2100 (100 percent)	70	300	5.7	4.1		
	50	250	4.7	3.2		
	30	215	4.1	2.5		

NOTES

Col. (2) equals the sum, discounted at 12 percent, of depreciation, plus investment credit where applicable, plus the net rent, and less the mortgage amortization, all after tax.

Col (3) Col (2) multiplied by (1 889 divided by 10 divided by equity ratio), that is, 0 9445, 0 3778, 0.1889, respectively.

Cols. (4), (5), and (6) obtained by adjusting col. (2) and repeating operation in col. (3) The adjustments were:

Col. (4) 221(d)(3) ($1,000,000 less mortgage payments and less depreciation) (0 25 or 0 15) (0 28)

Col (4) S 2100 ($1,000,000 less mortgage payments less $711,000) (0 28)

Col (5) -221(d)(3) mortgage payment increased 12½ percent and multiplier for 10-percent equity used.

TABLE 4.—COMBINED ANALYSIS YEARS 1 TO 7

[In percent]

Provision and equity	Marginal tax rate of investor	Equivalent yield after tax: No sale	Equivalent yield after tax: Sale	Adjusted to 10 percent equity: No sale	Adjusted to 10 percent equity: Sale
221(d)(3) (20 percent; 10 percent)	70	8.3	7.6	15.8	14.4
	50	6.8	6.1	13.1	11.7
	30	5.2	4.8	9.9	9.2
S. 2100 (20 percent)	70	16.4	15.3		
	50	12.8	11.7		
	30	9.7	9.6		
S. 2100 (50 percent)	70	13.9	13.6		
	50	11.6	10.8		
	30	9.5	8.8		
S. 2100 (100 percent)	70	12.7	12.1		
	50	11.1	10.5		
	30	9.6	9.0		

III. COST TO THE GOVERNMENT

A. General Analysis

The basic description of the budget cost of S. 2100 (in Table 5) assumes that the average equity investment is 50 percent with one-third at 20 percent, one-third at 50 percent, and one-third at 100 percent. (Equity is used here as in the bill to include the proceeds of a conventional loan.) It assumes also that all of the loan authority, $0.5 billion a year, provided directly under the bill is utilized. This would permit projects with total cost of $1.15 billion. (Actually, the bill appears to permit relending of loan repayments which if taken into

account would slightly increase the scale of these estimates.) The tax cost has been calculated in terms of the cost of depreciation in excess of what would be allowed on an ordinary real estate investment. The local tax subsidy assumes that the local rate would be 2 percent of market value and that one-fourth of the subsidy cost is borne by State and local governments. The "other cost" includes the relocation allowance and the grants to HMC's. These figures are only intended to indicate general magnitudes. They include all expenditures incurred by the bill plus the value of tax benefits in excess of those allowed by present law. They do not involve any comparisons with the costs of alternative housing programs. The table assumes tax benefits are taken against a 50 percent rate.

Table 5 indicates both the National Income Account (NIA) Budget and the Administrative Budget costs. Under the NIA concept a loan by the government is not treated as an expenditure, so it is proper to treat the interest subsidy as an expenditure. This was calculated at 3½ percent. There is a considerable opportunity to argue about how interest rate differentials are to be calculated, and the reader can readily change these figures to suit his predilections.

The case for 4½ percent could be stated briefly by pointing out that if the housing were financed privately with a government guarantee the cost to the borrower would be about 6 percent interest plus a ½ percent insurance premium. The difference between this combined 6½ percent and the 2 percent under S. 2100 is 4½ percent. It is relevant that a section 221(d)(3) loan which is not below market interest rate" would carry a combined interest and insurance premium of about 6½ percent. Thus, 4½ percent is a valid measure of the benefit offered to the borrower under S. 2100.

A lower estimate of interest subsidy of 3½ percent could be described as the cost to the government which would be somewhat less than the value to the borrower. It assumes that the marginal government borrowing rate is 5 percent under current conditions. It also assumes that the risk of non-payment is exactly the same as it would be in a guarantee operation. Thus ½ percent is added as risk premium, but it would show up on this assumption as a loan reserve. The table reflects a 3½ percent assumption. The lower bank of Table 5 shows the Administrative Budget effects if the low interest loan is made by FNMA, as provided by S. 2100. In this situation, since the loan is shown initially as an expenditure, it is inappropriate to add the interest subsidy. Actually, all interest receipts and principal repayments should be shown as negative expenditures (which is why the net expenditure on loans is shown as less than $500 million each year).

As will be seen from Table 5, the NIA Budget cost rises from about $270 million to $550 million in year 6. It then falls back to $270 million and would fall gradually from then on. The Administrative Budget cost rises from about $740 million to about $850 million in year 6. It then falls back to about $75 million and would tend to stay at this level.

In general these costs would be substantially lower (and there would be less housing constructed under the bill since its loan funds would be spread over fewer projects) if all projects were 20 percent equity. If all the projects were at, or near, 100 percent equity, the level of housing investment would be higher and would be limited by the supply of construction facilities, the availability of private investment funds, the availability of sites, etc. The total cost in his case would depend on the amount of projects that could be put up. For any given amount of housing the budget costs would be higher, on an NIA basis. On the administrative budget basis the costs, with all projects near 100 percent equity, would be lower in the short run (because of low loans) but higher in the long run (because no loan repayment).

There is no convenient way to describe the time pattern of these budget costs. The bill creates annual lending authority of $500 million for 6 years and requires these to be loaned out within 15 years. Table 5 assumes that all of this loan authority is used in the 6 years. It also assumes that the tax benefits start when

the loan is made. If the loans are made more gradually and if tax benefits begin with some lag after the loans, then the high costs shown for years 1–6 would be spread over more years but would be lower each year.

The figures would also be changed if sales to HMC's were assumed (which they were not). The tax benefit cost falls when the HMC buys in, but there may be extra costs of financing the HMC purchase. The figures after year 8 would also rise if new investors buy the old projects and qualify for more investment credit. Needless to say, the costs after year 6 would stay relatively high if the program were extended. The decline shown reflects the assumption that after year 6 no additional housing is being produced.

One could estimate a multiplier effect on GNP of these outlays under S. 2100 and then calculate the revenue "feedback" from the higher GNP which could be carried as an offset to the cost. We do not do this for the following reasons:

(a) A multiplier calculation, since it involves the total economy, requires explicit assumptions as to reactions elsewhere in the economic system. If additional expenditures take place at a time when the economy is at full employment, and if the occurrence of these expenditures causes either the monetary or fiscal authorities to take offsetting deflationary action to prevent inflation, then the multiplier effect is zero. Over the near future we expect the U.S. economy to be at full employment so that these are the circumstances in which the multiplier should be estimated at zero.

(b) The immediate discussion appears to be directed at one approach to dealing with the low rent housing program. Even in a dollar spent on an S. 2100 type of program had multipler effects such as to reduce the net budget cost to, say, $.80, then approximately the same multiplier offset could be attached to $1 spent on any other type of housing program, and the technical task of comparing the relative efficiency of the various types of housing programs could be carried out equally well by comparing both costs without multipliers as could be done by comparing both costs with multipliers. Since the Congress generally considers expenditure proposals without multiplier effects, it is useful to describe S. 2100 in comparable terms.

B. A Check on the Estimates

It is possible to indicate on the basis of some independent calculations that the budget cost of S. 2100 should come out at approximately the levels indicated in Table 5 (given the assumption that all the construction occurs in the first 6 years).

Table 5 indicates that the costs of the local tax subsidy and interest subsidy are $40 million a year for each year's projects. After 5 years this cost on all of the outstanding projects will rise to about $200 million. As was noted in the discussion of the rate of return under S. 2100, the local tax subsidy and the interest subsidy are the elements of the bill directed at producing lower rents. Prior calculations by HUD suggest that the effect of the interest and local tax subsidies would be to lower monthly rents on a single housing unit in a project by something like $30. If the average cost of a unit was $12,000, the assumption underlying Table 5, with total project costs of $1,150 million, would imply total monthly expenditures to reduce rents in the neighborhood of $3½ million ($30 times 115,000 units). On an annual basis this produces a cost of $30 million which is approximately the level shown in Table 5. This calculation is only offered as a rough independent check on the general magnitude of Table 5. Small differences in results are due to the precise assumptions used in Table 5.

The other large part of the budget cost has to do with the reduction in Federal tax revenues designed to improve the rate of return. The general assumption underlying Table 5 is that S. 2100 produces housing investments with an average equity of 56 percent. The after-tax rate of return, which S. 2100 attempts to provide, is something like 15 percent. Present law real estate provisions provide about this much benefit on a 10 percent equity. S. 2100, on this description, is designed to produce an additional 46 percent equity investment. Since the tax

benefits must produce something like a 13 percent rate of return on this 46 percent additional equity, it would follow that the approximately $530 million of additional equity required to finance total projects with a cost of $1,150 million would require Federal tax benefits of about $69 million. On this basis the cost of the Federal tax benefits should rise from about $69 million in the first year to about $400 million in the sixth year. This differs somewhat from the pattern shown in Table 5 because S. 2100 is structured to provide a large amount of total tax benefits in the first year. All of the investment credit falls in the first year, and the depreciation is largest in the first year. In general the pattern in Table 5 seems realistic in that the tax benefit costs in the sixth year rise to about $340 million.

The general magnitude of the cost calculations in Table 5 appear, therefore, to be realistic.

TABLE 5.—BUDGET COST—NIA BASIS (I.E., NOT TREATING THE LOAN AS AN EXPENDITURE)

[In millions of dollars]

Year	Tax benefits over present law	Local tax subsidy	Interest subsidy at 3½ percent	Other	Total with interest at 3½ percent
1	211	13	18	30	272
2	247	26	35	30	338
3	276	39	52	30	397
4	300	52	69	30	451
5	318	65	86	30	499
6	336	78	102	30	546
7	143	78	101	0	322
8	90	78	100	0	268

ADMINISTRATIVE BUDGET BASIS (I.E., IN TREATING THE LOAN AS AN EXPENDITURE)

Year	Tax benefits over present law	Local tax subsidy	Other cost	Net expenditure on loan	Total
1	211	13	30	485	739
2	247	26	30	469	772
3	276	39	30	454	799
4	300	52	30	438	820
5	318	65	30	423	836
6	336	78	30	407	851
7	143	78	0	−93	128
8	90	78	0	−93	75

IV. SUMMARY

As can be seen from the foregoing analysis, S. 2100 contains many features requiring some attention. However, the discussion of each separate feature obscures the overall thrust of the bill. The conclusions which follow are an effort to focus upon the most important provisions of the bill and state its general impact on the low income housing problem.

1. Rent Reduction

The rent reduction features of the bill (the interest subsidy, the longer term of the loan, and the local tax abatement) are relatively modest in annual cost, and they could be included in any housing program to produce rent levels comparable to that which would be reached under S. 2100.

2. Tax Benefits

Under the present section 221(d)(3) program "net rent" is limited to 6% on 10% of the project cost; under S. 2100 the "net rent" is limited to 3% on 20% of the project cost. While the "net rent" is the same absolute amount for equal-sized projects under S. 2100 and section 221(d)(3), it is a higher return per dollar of equity under the section 221(d)(3) program. In both cases, net rent is a before-tax return which does not by itself produce an adequate after-tax return. In each case, therefore, the inadequacy of the before-tax return is made up by the value of tax benefits. Under the present section 221(d)(3) program the tax benefits conferred by present law convert the before-tax return rate of 6% on a 10% equity to an after-tax 15% return on 10% equity. (The 15% figure is an average for investors in the 50% and 70% tax brackets who hold for 10 years. This rate declines as the holding period increases, and present regulations prohibit sale during the first twenty years. This prohibition may be waived by FHA.)

S. 2100 would change the before-tax rate of return into an after-tax rate of return more or less comparable to the return under section 221(d)(3) by providing tax benefits that produce two results:

a. The tax benefits raise the after-tax return under the bill to the same relative level as occurs under the section 221(d)(3) program. To accomplish this, the bill must provide tax benefits sufficiently large to overcome the differential in before-tax rate of returns, as stated above.

b. The tax benefits provide this high after-tax rate of return for the whole project cost. In contrast, the present section 221(d)(3) program provides the high after-tax rate of return on only 10% of the project cost—the equity portion—and permits the lower rate that is normally associated with debt financing for the balance of the project cost.

Four principal points may be noted with respect to the amount of the tax benefits that are provided under the bill to produce the above results:

(1) These tax benefits—and the higher after-tax rates of return they provide—do not in any way reduce the level of the rents that must be paid. As indicated above, this function is served by other features of the bill, which could readily be adopted under other programs having a different approach to the rate of return problems.

(2) The after-tax rate of return provided by the tax benefits extends to the entire project cost, and for investors in the 50–70% tax brackets with a 7 year holding period they average about 15%.

(3) The bill treats the proceeds of a conventional mortgage as equity. Even if the borrower on a conventional 70% mortgage incurs some personal liability, which might be extremely contingent, he is in a very different position from what he would be if he had not borrowed at all. He would, however, under the bill obtain after-tax benefits up to 15% on the entire project cost even though he would incur only the lower cost associated with debt on the debt financed portion of the project cost. There is, therefore, a considerable increase in the after-tax rate of return on his *actual equity* investment, which will be far higher than 15%, ranging perhaps as high as 40%.

(4) The bill, by providing a 15% after-tax rate of return on the entire project cost in place of the far lower rates that are usually associated with the debt-financed portion of the cost, does not permit overall costs to the Government to be kept as low as would be possible through reliance on the leverage obtained through debt financing. This, in turn, greatly increases the cost of the project to the Government as against the present section 221(d)(3) program or other programs that are financed largely by debt.

3. Sale to a Home Management Corporation

The bill is designed to encourage sales to tenant organizations called home management corporations. The bill contemplates that the private investor would sell his interest to the tenants at the end of a two-year period of ownership. Pay-

ments by the home management corporation would be subsidized by the Federal Government. These subsidized payments would be large enough to return about 95% of the project cost to the 100% equity private investor. The tax benefits provided during the two-year period would yield about another 45% of the project cost. Both of these are after-tax benefits. Thus, the Federal Government has financed after-tax payments to the investor of about 140% of the project cost. Yet, in effect, the private investor is merely a turnkey project organizer who is required to hold the project only for a minimum two-year period. For this he has, however, in two years received about 140% of the project cost tax free. If 80% of the cost were financed by a conventional mortgage, the after-tax rate of return on the builder's equity is about 100% in each of the two years. If the private investor were also the builder, he would have had a builder's profit in addition.

A Comparison of the Analysis Submitted by Senator Robert Kennedy With the Analysis Submitted by the Department of the Treasury

I. Different Results Shown

At hearings before the Senate Finance Committee on S. 2100, Senator Kennedy submitted a Memorandum[1] analyzing

1. the estimated yields for owners of projects constructed under the bill ("certified projects"), as compared with the estimated yields to be realized by investors constructing projects under the 221(d)(3) "Below Market Interest Rate" (BMIR) loan program or the rent supplement program, and
2. the comparative cost to the Federal Government of a certified project as compared with the cost to the Government of a 221(d)(3) BMIR or rent supplement project.

The Department of the Treasury has now submitted a Memorandum regarding the bill which shows strikingly different results. In order to understand the difference in results between the two Memoranda it is first necessary to summarize the conclusions reached in the Kennedy Supporting Memorandum.

A. Rental Level, Interest and Real Estate Tax Subsidies

Under S. 2100, the rentals for a certified project are considerably below the rentals that would be charged for a comparable 221(d)(3) BMIR or rent supplement project. It was estimated that on a typical certified project of 120 units with an aggregate cost of $1,500,000 the aggregate rentals over 50 years would be:

(1) $2,018,000 (approximately $28 per unit per month) lower than the rentals for units in a comparable project constructed under the 221(d)(3) BMIR program.[2]

(2) $4,032,000 (approximately $56 per unit per month) lower than rentals for units in a comparable project constructed under the rent supplement program.[3]

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[1] The memorandum submitted by the Senator is hereinafter referred to as the "Kennedy Supporting Memorandum."

[2] The 221(d)(3)'s units would have to be lowered to rentals achieved under the bill by a supplement. Under the existing rent supplement program, 5% of all funds may be channeled into 221(d)(3) projects.

[3] The rental figures for projects built under 221(d)(3) BMIR and the rent supplement programs were provided by the Department of Housing and Urban Development.

To produce these low rentals under S. 2100 over a 50-year period—leaving aside any tax incentives—would cost the Federal Government between $415,000, for the certified project with no insured loan, to $1,327,000 for the certified project with an 80% loan. Thus, for a typical project built under S. 2100, the 50-year dollar saving over a comparable project built under the 221(d)(3) BMIR or rent supplement programs would range from $691,000 to over $3,600,000.[4]

B. Tax Incentives

It was pointed out in the Kennedy Supporting Memorandum that, under S. 2100, the Federal Government incurs an additional cost, above that incurred with regard to the 221(d)(3) BMIR or rent supplement programs, as a result of the tax incentives granted to owners of certified projects. This additional cost raises the owner's return on a certified project from the 3% provided directly by rental income to a more adequate level, generally in the range of 12 to 20%.[5] By contrast, the owner of a 221(d)(3) BMIR or rent supplement project may realize a yield of only 8 to 9%—a rate which has proved to be inadequate to bring forth any substantial capital for the rebuilding of our urban ghettoes.

The yield to the owner of a certified project increases, and the cost to the Federal Government in tax incentives decreases, when an early sale is made to a home management corporation ("HMC"). Thus, the owner is given an incentive to do what is best for the Government and what is also best for the residents of our center cities.

In the case of the typical certified project constructed with a 20% equity investment, it was estimated in the Kennedy Supporting Memorandum that the additional tax cost over a 50-year period, as compared with the tax cost for a 221(d)(3) BMIR project, would range anywhere from $248,000 to $603,000. The comparable figures for a certified project constructed with a 100% equity investment would range from between $640,000 to $2,127,000, but in regard to such a project, a $912,000 subsidy on a low-interest mortgage would not be incurred.

The following table—

(1) sets forth, with regard to a typical S. 2100 project, the cost of the interest and real estate tax subsidies necessary o reduce the rent levels and the tax incentives granted to increase the owner's yield, and

(2) compares these costs with the cost of achieving the same rent levels for a 221(d)(3) BMIR or rent supplement project.

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[4] The bill achieves a greater reduction in rentals than the aggregate cost of interest and real estate tax subsidies to the Federal Government because:

(a) the bill provides a 50-year term for amortization of the mortgage as against a 40-year term under 221(d)(3) BMIR and rent supplements, and

(b) the interest rate on mortgages under the bill is 2% as against 3% under 221(d)(3) and at least 6% under the rent supplement program, and

(c) under the bill, the State and localities must provide at least 25% of the reduction in real estate taxes.

[5] The Treasury estimates that the typical rate of return under the bill is from 17–20% as compared to what it alleges to be the 10% typical yield on a corporate equity investment. This additional yield is necessary to attract large scale private investment into our slums. In any event, it certainly does not constitute a "gold mine" or "windfall" return.

COMPARISON OF COST TO GOVERNMENT OVER 50 YEARS [1]

	Certified project						Noncertified project, private sale every 10 years over 50 years	
	20-percent equity investment			100-percent equity investment				
	Sale to HMC, 2 years	Restoration of basis, 50 years	Private sales, end of minimum holding period over 50 years	Sale to HMC, 2 years	Restoration of basis, 50 years	Private sales, end of minimum holding period over 50 years	221(d)(3) BMIR	Rent supplement
Interest subsidy on loan to 1st holder	$912,000	$912,000	$912,000	0	0	0	$459,000	0
Real estate tax subsidy	415,000	415,000	415,000	$415,000	$415,000	$415,000	0	0
Rent supplement (to achieve for 221(d)(3) BMIR) and rent supplement projects same rentals as are achieved under S. 2100	0	0	0	0	0	0	2,018,000	$4,032,000
Total without tax costs	1,327,000	1,327,000	1,327,000	415,000	415,000	415,000	2,477,000	4,032,000
Tax costs:								
Credits	45,000	45,000	[2] 103,000	300,000	300,000	[5] 1,155,000	0	0
Depreciation tax savings	74,000	[4] 444,000	[3] 479,000	211,000	[6] 1,012,000	[6] 1,012,000	[6] 18,000	[6] 18,000
Capital gains, tax paid	0	[7] (42,000)	[2] (108,000)	0	[8] (169,000)	[8] (169,000)	[9] (147,000)	[9] (147,000)
Total tax cost	119,000	447,000	474,000	511,000	1,143,000	1,998,000	(129,000)	(129,000)
Total costs	1,446,000	1,774,000	1,801,000	926,000	1,558,000	2,413,000	2,348,000	3,903,000

[1] All figures not otherwise explained come from the Kennedy supporting memorandum.

[2] See the following table:

Sale at end of year	Presumed sales price	Presumed mortgage	Recognized gain	Capital gains tax	Credit if real sale
10	$1,230,000	$1,045,000	$185,000	$46,250	$24,600
20	960,000	856,000	104,000	26,000	19,200
30	690,000	625,000	65,000	16,250	13,800
40	420,000	344,000	76,000	19,000	
Total				[a] 107,500	57,600
Add credit to 1st holder					45,000
Total					[b] 102,600

[a] Rounded to $108,000.

[b] Rounded to $103,000.

[3] See the following table:

Depreciation years:	
1 to 10	$748,000
11 to 20	554,000
21 to 30	540,000
31 to 40	496,000
41 to 50	270,000
Total	2,608,000
Less:	
Operating income (net)	1,650,000
Tax losses	958,000
X rate (percent)	50
Tax savings	479,000

[4] See the following table:

Depreciation years:	
1 to 20	$1,350,000
21 to 36	810,000
37 to 46	378,000
47 to 50	0
Total	2,538,000
Less:	
Net operating income	1,650,000
Tax loss	888,000
X rate (percent)	50
Tax saving	444,000

[5] See the following table:

Depreciation years:	
1 to 7	$1,350,000
8 to 17	1,161,000
18 to 27	891,000
28 to 37	620,000
38 to 47	351,000
48 to 50	0
Total	4,373,000
Less:	
Net operating income	2,350,000
Tax losses	2,023,000
X rate (percent)	50
Tax saving	[a] 1,011,500

[a] Rounded to $1,012,000.

[6] See the following table:

Depreciation years:	
1 to 10	$501,875
11 to 20	393,225
21 to 30	330,417
31 to 40	440,000
41 to 50	170,000
Total	1,835,517
Less:	
Net operating income	1,800,000
Tax losses	35,517
X tax rate (percent)	50
Tax savings	[a] 17,758

[a] Rounded to $18,000.

[7] See the ollowing table:

Presumed sale at end of year	Sales price	Mortgage	Recognized gain	Capital gains tax
20	$960,000	$858,000	$102,000	$26,000
36	528,000	465,000	63,000	16,000
Total				42,000

[8] See the following:

	Presumed sales price	Presumed mortgage	Recognized gain	Capital gains tax	Credit if real sale
Sale at end of year—					
7	$1,311,000	$1,095,000	$216,000	$54,000	$301,000
17	1,041,000	817,000	224,000	56,000	239,000
27	870,000	700,000	170,000	42,500	200,000
37	501,000	435,000	66,000	16,500	115,000
Total				169,000	855,000
Add credit, 1st holder					300,000
Total					1,155,000

[9] See the following:

Sale at end of year	Sale price	Basis	Recognized gain	Capital gains tax
10	$1,230,000	$998,000	$232,000	$58,000
20	950,000	837,000	123,000	31,000
30	690,000	630,000	60,000	15,000
40	420,000	250,000	170,000	42,500
Total				[a] 146,500

[a] Rounded to $147,000.

The above table shows that in virtually all cases the cost to the Federal Government of achieving the same rent levels is lower under S. 2100 than under the 221(d)(3) BMIR or rent supplement programs by an amount which is *greater* than the added tax incentives provided to the owner of an S. 2100 project. Thus, it may be fairly stated that the aggregate cost of producing a specified rent level project is lower under S. 2100 than under either of the other two programs. Moreover, the yields to owners of certified projects are significantly higher than under either of the other two programs. (*E.g.* 12%–20% as compared to 8–9%.)

C. Treasury Analysis

In contrast to the above results, the Department of the Treasury Memorandum contends that:

(1) In certain cases, the owner's return with regard to a certified project is not significantly better than that achieved with regard to a 221(d)(3) BMIR or rent supplement project. (Note should be taken, however, that the Treasury Memorandum is not consistent and, in certain places, the argument is made that the owner of a certified project realizes an astronomical yield compared to the owner of a typical housing project.)

(2) The aggregate cost to the Federal Government of providing for the construction and operation of a certified project is substantially greater than the aggregate cost to the Government of providing for the construction and operation of a 221(d)(3) BMIR or rent supplement project.

The reasons for these conflicting results are hereinafter discussed.

II. GENERAL PRESENTATION OF TREASURY ANALYSIS

The Kennedy Supporting Analysis estimated aggregate costs to be incurred by the Federal Government under S. 2100 over the entire life of all the certified projects which it is estimated may be constructed under the legislation. Each one of these aggregate figures is tied to a specific "one building" example which may be analyzed in detail.

In contrast, in the Treasury Memorandum, aggregate cost figures are given without clearly relating them to a single building example. As a consequence, it is impossible, on the basis of the information furnished, to check the accuracy of certain questionable figures in the Treasury analysis.

The need for closely scrutinizing all figures and assumptions becomes more apparent after certain computations in the Treasury Memorandum concerning yields and per building costs are examined. For example, at one point, the Treasury Memorandum compares the 50-year tax cost to the government of a certified project with the 50-year tax cost of a 221(d)(3) BMIR project constructed under existing laws. In this example, the Treasury Memorandum assumes, for the certified project, either a restoration of basis by a single owner over 50 years, or private sales over 50 years at the end of each owner's minimum holding period.

These assumptions are clearly justified since they are the courses which will maximize the holder's return in the absence of a sale to a HMC. By contrast, in computing the tax cost of the 221(d)(3) BMIR project, the Treasury Memorandum assumes that one person will hold the project over the entire 50 years. This, of course, minimizes the tax cost to the Government of the 221(d)(3) BMIR project since only one dollar amount (the original investment) is depreciated. If the project were sold frequently, each investment would produce additional depreciation.

The Treasury Memorandum's "one owner" assumption for the 221(d)(3) BMIR project is unjustifiable. If one person held a project over 50 years, his yield would be lower than 6%. On the other hand, if the project were sold every ten years—as would be likely—at the prices used by the Treasury in its *yield* computations, the tax cost of the project would rise from $560,000 to about $922,000 or a difference of approximately 65%.

Moreover, at another point, the Treasury Memorandum gives a somewhat one-sided estimate of the amount of Federal subsidy which a HMC will require in order to enable it to purchase a certified project.

The Treasury Memorandum estimates this cost only in the case in which the original owner made a 100% equity investment. Since there is no existing Government-insured mortgage on the project in such a case, the private loan that the HMC will be required to make to finance the purchase will be at its maximum—

as will the subsidy from the Government necessary to enable the HMC to meet the payments on such a mortgage.[6]

By contrast, in the case in which the HMC purchase is made from an owner who originally made only a 20% equity investment, there will be no subsidy at all—or at most only a nominal subsidy.

III. METHOD OF MEASURING YIELD IN THE TREASURY ANALYSIS

A. Yield Without Sale

In one strange set of computations—which the Treasury concedes "may be questioned"—The Treasury sets forth yield figures for the owners of 221(d)(3) BMIR and rent supplement projects as high as the yield figures for the owners of certified projects. Examination of the yields for non-certified projects reveals that they were computed without regard to the price at which the owners of such projects may eventually have to sell. These computations may be likened to a case in which an individual receives a $5 dividend each year over a 10 year period on a share of stock which he purchased for $100. The Treasury Memorandum would conclude that the individual's yield over this period is 5%, notwithstanding the fact that, at the end of the period, the market value of his share of stock may have fallen to only $30.

B. Yield With Sale

In a second set of computations which do assume sales, the Treasury analysis compares yield figures for the owners of certified projects with yields for the owners of 221(d)(3) BMIR and rent supplement projects. Once again, the yields for the owners of non-certified projects are raised through some unusual calculations. With regard to 221(d)(3) BMIR projects, the Treasury Memorandum assumes that the sales price (before a capital gains tax is assessed) will be sufficient to return the builder's full initial investment. Although it uses these inflated sales prices in computing yields for 221(d)(3) BMIR projects the Treasury Memorandum assumes sales prices for certified projects on the conservative basis used in the Kennedy Supporting Memorandum, i.e., a price based on the initial cost of the land plus the cost of the building as depreciated on a level basis over 50 years. As set forth in the Kennedy Supporting Memorandum and the annexed schedules, a buyer of a certified project at such a price would realize a satisfactory yield. In contrast, the buyer of a 221(d)(3) BMIR project, even at this conservative price, would realize a low return. His return at the price utilized in the Treasury Analysis is exceptionally low—below 6%. It seems somewhat ludicrous to hypothesize sales at prices which no investor would be willing to pay. And yet, this is precisely the hypothesis put forth in the Treasury Memorandum.

Interestingly enough, the Treasury Memorandum does state—although without supplying any background figures—that a purchaser of a 221(d)(3) BMIR project after seven years will achieve higher returns during the next holding period than the comparable owner of an S. 2100 project. The system of recurrent credits and accelerated depreciation periods established by S. 2100 is designed to maintain high yields for purchasers of certified projects over a 50-year period. Similar high yields cannot be maintained for purchasers of 221(d)(3) BMIR projects. Thus, in virtually all cases, the purchaser of a certified project will realize a substantially higher yield than a comparable purchaser of a 221(d)(3) BMIR project.[7]

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[6] It is not possible to check the accuracy of the Treasury's estimate even in the case presented. Before a HMC can apply for a subsidy to purchase the building, it must increase its rents by 5%. The Treasury's Memorandum shows a figure for this increase which appears quite low. Since the Treasury's Memorandum nowhere shows the gross rental income and estimated expense of the building upon which its example is based, there is no way of checking the computation.

[7] The Treasury Memorandum computes yields differently from the Kennedy Supporting Memorandum. The Treasury Memorandum discounts all future returns or investment at an arbitrary rate of 12% and then determines yields from the discounted figures. No explanation for the use of a 12% discount rate is given. In contrast, the Kennedy Supporting Memorandum computes yields as the actual percentage rate at which the present value of all future receipts will equal the amount of the owner's investment. In other words, the Kennedy Supporting Memorandum determines yields by calculating what percentage return on original investment at regular intervals would produce the same result to the investor as the anticipated future returns. This method does not require the use of a predetermined discount rate. The Treasury method in many instances tends to narrow the differentials between the higher yields on certified projects and lower yields on 221(d)(3) BMIR projects.

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C. Windfall Yields

In one section of the Treasury Memorandum, an attempt is made to demonstrate that the return under S. 2100 is astronomical for an initial owner making a 100% equity investment and holding the property for a 50-year period, while continually restoring its basis. The Treasury Analysis shows an aggregate profit of $2,326,500 on an original investment of only $1,000,000.

On first glance, it appears that the owner has received a windfall. But it must be remembered that these receipts are being realized gradually over a period of 50 years. Even in a savings bank, money doubles itself over a period of less than 20 years. When the actual rate of return is computed in a restoration of basis situation, it is found to be 10% or lower. This is far less than the yield which the initial owner could have realized if he had made an immediate sale to a HMC.[8]

CERTIFIED PROJECT

[In percent]

	20-percent equity	100-percent equity	221(d)(3) BMIR or rent supplement
Sale after 2 years to HMC	19.1	25.2	1.4
Sale 10 years or 7 years for 100-percent equity investor to HMC	12.5	13.1	[1] 8.2 [2] 5.5
Private sale at end of 10 years (or 7 years for 100-percent equity investment)	11.3	12.7	[1] 8.2
Restoration of basis over 50 years	12.7	7.0	....

[1] 10 years.
[2] 7 years.

D. Private Mortgages and Yield

In several instances, the Treasury Memorandum indicates that the initial owner of a certified project would have a very high yield if he financed part of his cost by a private mortgage loan. Since any such loan is treated as part of the owner's equity for purposes of 2100, it would supposedly enable him to achieve the highest credit and depreciation rates with a very low commitment of personal funds.

This proposition is founded on a series of very weak building blocks. To begin with, it would be virtually impossible to obtain a private mortgage loan on an S. 2100 project without the owner providing his personal endorsement. No bank or insurance company would be likely to make a nonrecourse mortgage loan at a 6% or higher interest rate on a project which—apart from the owner's tax savings—yields only three percent. Once the owner personally signs for the loan, he has committed his own resources and the loan must be included within his equity investment.[9]

Once it is understood that conventional financing will necessitate personal endorsement and liability, such seemingly startling Treasury statements as "conventional financing not only reduces the risk but also increases the return on the actual equity" must be viewed as fallacious conclusions based upon inaccurate assumptions. An investor who is personally liable on a private loan risks losing the entire principal of the loan—not just the interest on it—and the more an investor borrows on his personal signature, the greater is his risk of loss.

E. Omissions Regarding Yield

The Treasury Memorandum is further marred by statements which, perhaps unintentionally, have a misleading effect. For example, the Treasury Memoran-

[8] At another point in its analysis, the Treasury Memorandum concedes that this declining yield curve will arise. It fails to state, however, that this curve gives the owner the motivation to make an early sale to a HMC and that such a sale results in a substantial reduction in tax costs to the Federal Government.

[9] At one point, the Treasury Memorandum seems to concede that this loan does necessitate a commitment of personal resources. It notes that the argument can be made "with . . . some merit" that "personal liability on the mortgage is the equivalent of a cash investment since the ability to raise funds has been depleted to the extent of personal liability." This is followed, however, by a statement that despite this argument's merits, "it overlooks the substantial benefits accruing to the investors . . . [constituting] a fund to which the lender can look for repayment. These benefits are not overlooked in the Kennedy Supporting Memorandum, but they are not raised to the status of constituting the sole basis on which a mortgage would be granted.

dum states that the after tax yield to the owner of a tax free municipal bond—as contrasted with the owner of a certified project—is the same for an individual in a 30% tax bracket as for an individual in a 70% tax bracket. Literally, of course, this is true, but as a realistic appraisal, it is clear that the benefits from a tax exempt bond are far greater to the individual in the 70% tax bracket. In short, the depreciation provisions of S. 2100, like any deduction or tax free gain, provide a far greater incentive to an upper bracket taxpayer than to a lower bracket taxpayer.

Again, the Treasury Memorandum states that the total return for an owner with a 100% equity investment is over five times as great as that for a 20% investor. This is, of course, true, but since the latter owner is making a 5 times greater investment, his net percentage yield is only slightly higher.

IV. MEASUREMENT OF S. 2100'S COST TO THE FEDERAL GOVERNMENT AS COMPARED WITH THE 221(d)(3) BMIR AND RENT SUPPLEMENT PROGRAMS

A. Real Estate Tax Subsidy

The Treasury Memorandum apparently assumes that the local real estate taxes subsidized under the bill would normally amount to about 2% of the original cost of the property. By contrast, earlier Department of Housing and Urban Development memoranda concerning S. 2100 estimated local taxes at 14% of gross rental income. It is difficult to see how real estate taxes could bear any sort of a constant relationship to the original cost of the project as the Department of Treasury has hypothesized. Clearly the project's value will decline as the building gets older and the decline in value will be taken into account by local taxing authorities. It is normal to assume that local property taxes will bear a relationship to gross rental income which, for a low rental project, may be in the area of 14% to 18%. Once this percentage of gross rental is substituted for the Treasury Memorandum's constant percentage of cost, the 50-year revenue loss to the Federal Government decreases substantially.

B. Interest Subsidy

In computing the cost of mortgage loans under S. 2100, the Treasury Memorandum assumes an interest subsidy of 3½% based on the difference between a 5% government borrowing rate plus a ½% loss reserve on one hand, and a 2% lending rate to the owner of a certified project on the other hand. In contrast, when the Treasury Memorandum deals with the hypothetical cost to the Federal Government of buying the project, it assumes a 4½% borrowing rate. (Table 1) There is no explanation given for this change in rates.

And it should be made clear that any change in Government borrowing rates which affects certified projects under S. 2100 will also affect 221(d)(3) BMIR and rent supplement projects. If the interest subsidy goes up under S. 2100, it must go up commensurately for a 221(d)(3) BMIR project. Moreover, if the Government borrowing rate should begin to increase, the interest rate to the private builder of a rent supplement project will increase even faster. To the extent that the private borrowing rate increases, the rentals to be subsidized by the rent supplement program will constantly outstrip the increased cost of Government borrowing.

Again, the Treasury Memorandum states that the per unit rentals achieved under S. 2100 are $30 a month "lower." By lower, in this context, the Treasury apparently means lower than the rental on units in a 221(d)(3) BMIR project, since the $30 is approximately the gap which the Department of Housing and Urban Development referred to in its earlier memoranda. In the same paragraph, the Treasury Memorandum estimates aggregate interest subsidy cost to the Federal Government in regard to the certified project. What is not made clear is that in order to bring the rent differential down to only $30, under the 221(d)(3) BMIR program, the Federal Government has already incurred a substantial part of the interest subsidy cost which would be incurred in financing a certified project. Nor is it mentioned that the gap in per month rental is far higher (i.e., about $56 per month) under the rent supplement program where there is no interest subsidy.

V. MEASUREMENT OF ABSOLUTE COST

In terms of measuring the absolute cost of a certified project (as oppposed to its comparative cost in relation to a 221(d)(3) BMIR or rent supplement project) certain factors disregarded by the Treasury Memorandum became important. For example,

(A) The Treasury Memorandum treats as an absolute tax cost an amount determined by multiplying the owner's marginal tax rate by the full amount of depreciation taken on the certified project. This amount is treated as a subsidy to the extent that it exceeds the comparable figure for a noncertified project. But, in fact, the only net cost to the Federal Government from the depreciation deductions is the tax saving realized by the owner when he applies his tax loss from the project against his other income. The cost is, in short, the owner's tax rate on the *excess* of the depreciation deductions over the net operating income produced by the building. To the extent that the owner offsets the depreciation deductions against the net operating income arising from the project, there is no cost to the Federal Government, since, in the absence of S. 2100, the project would have never been constructed in the first place.

(B) The Treasury Memorandum also states in some places (but not others) that when S. 2100 reduces the capital gains tax payable on the sale of a certified project below the amount payable under existing rules, a further tax cost is incurred by the Federal Government. But since the tax savings from depreciation have already been charged as a revenue loss, it is fallacious to increase this cost by adding to it the capital gains not paid. The Treasury Memorandum's conclusion can be likened to the case of a person who lends $10 for a promise that he will be repaid $5 in a year and then concludes that he has suffered a $15 loss when the borrower reneges on his promise. Clearly, the lender has an out-of-pocket loss of only $10—not $15.

(C) In computing aggregate tax cost, the Treasury Memorandum explicitly refuses to take into account the additional tax revenues that the Federal Government will realize on the income generated by the construction of the project. This is a rejection of the multiplier effect which both this Administration and the previous Administration took into account when computing the effect of the original investment credit and the restoration of the investment credit. (See, e.g., H.R. Rep. No. 131, 90th Cong., 1st Session (1967)—U.S. Code Cong. and Administration News, p. 1073 (1967); Testimony of Secretary Dillon, Hearings before the Senate Finance Committee on the Revenue Act of 1962, pp. 373-76 (1962).) Moreover, the primary reason given for ignoring the multiplier effect is that the United States economy will be at full employment "over the near future." We would suggest that the Treasury Department peruse with some care recent studies made by the Department of Labor concerning employment in urban poverty areas. The conclusion of that Department is that the unemployment problem is getting worse. There is no indication that this nation's unemployment problem will be eliminated in the near or distant future.

As a secondary reason for rejecting the multiplier, the Treasury Memorandum states that any type of Federal program would have the same multiplier as S. 2100 so there is no reason to attach a multiplier to that bill. Obviously, any *new* housing program calling for approximately $4 billion in new investment in poverty area housing will have the same multiplier effect. But the Kennedy Supporting Memorandum did not use the multiplier in discussing comparative costs to the Federal Government. It utilized it only when dealing with *absolute* costs. Thus, when the Treasury discusses the absolute cost to the Federal Government of S. 2100, it should take the multiplier into account—as it has when supporting the adoption of other incentive legislation.

(D) In computing aggregate cost, the Treasury Memorandum implies that aggregate costs over the long term can be grounded on an analysis of costs over the first six years. This implication is misleading. Costs would of course be high during the first six years since the major credits provided by S. 2100 would all be utilized during this period, depreciation deduction would be at their peak, and the interest subsidy would be at its highest because the maximum amounts of mortgage loans would be outstanding. After six years, the costs of S. 2100 would fall off. This decline in cost is not clearly set forth in the Treasury Memorandum.

VI. DEBT AS AGAINST EQUITY FINANCING

At one point, the Treasury Memorandum points out that the cost of obtaining equity capital under S. 2100 is concededly 12% to 20%. This return is being provided by the Government through tax incentives. In contrast, the Memorandum notes, debt financing traditionally costs only 4½ to 6%. Is it not cheaper, the Treasury Memorandum asks, to rely upon debt financing?

If the Treasury is talking about debt financing undertaken by the Federal Government the proceeds of which are used to finance public housing, then a

question of social policy is raised. Do we desire further public housing in the ghetto areas, or, for the first time, are we seeking major construction efforts by private enterprise? A fundamental premise upon which S. 2100 rests is that it is desirable to promote private construction in the ghetto areas and to promote eventual sales by the private owners to the tenants of the building. Moreover, if only a limited pool of Federal mortgage money exists in the short-run then it would seem necessary to pay higher long-run costs in order to obtain the needed private capital for the rebuilding of our urban ghettos.

VII. THE EXAMPLE PRESENTED BY SENATOR WILLIAMS AT THE HEARINGS

At the hearings, Senator Williams and the Treasury Department utilized an example to show what the revenue costs might be in a particular case under S. 2100. Certain reservations were raised at this time to the mechanics of various sections of S. 2100 as originally submitted. Although some of the technical flaws raised at that time were based on erroneous assumptions, many of the technical problems detected by Senator Williams did exist and it was helpful to have them isolated. Both Senator Smathers and I had also found these flaws, however, and we had introduced a series of corrective amendments to ensure against them.

These Amendments had been mentioned in my testimony before the Committee earlier that day and had also been introduced in the Senate. They—

1. clarified that a capital gains tax is *always* payable on a restoration of certified project's basis;
2. clarified that a capital gains forgiveness could be achieved only if the seller of a project invested in the construction of a new low-cost housing project rather than in an existing building; and
3. stipulated that the price at which the HMC might purchase the certified project would constantly decline on a level basis as the project aged, and would be the same declining price regardless of the prior owner's equity investment.

It seems useless to prolong the debate over these flaws which did not go to the main purposes of the bill and which were corrected prior to the time at which they became the focal point of Committee debate. At the same time, Senator Williams' efforts in detecting these mistakes in the bill should be recognized as a definite contribution to the perfection of a smoothly working bill.

The testimony at the Hearings before the Senate Finance Committee from eminent economists, investment bankers, tax experts, builders, businessmen, and representatives of the urban poor showed that S. 2100 was a logical and efficient approach to the problem of providing adequate moderate income housing for the residents of our center cities. It was the feeling of all of these witnesses that it is time for our Federal Government to break with the status quo built on old watchwords and slogans and to propose new solutions to meet the pressing problems of today.

In short, we believe that S. 2100 represents a feasible solution to the urban housing problem faced by this nation. If there are flaws in it, however, we welcome constructive suggestions. If there are ways to improve the bill and achieve the goals of rebuilding our supply of housing more efficiently and effectively, we think that they should be put forward now. Our aim has been to stimulate imaginative and immediate solutions for our urban problems, for the crisis of our cities will not wait.

Mr. ZIEGLER. One further statement. Under the bill as submitted, and even more clearly under the amendments, nobody would get a tax credit, an extra tax incentive, just by selling it to his brother, trading it back and forth every couple of years. Nobody can say, "I am selling to myself" and all of a sudden get a tax-free sale. This is clear under the bill as submitted. If it is not, I am confident that an amendment will be submitted making it even more clear.

One further point. There has been a good deal of talk about how a man can restore his basis. If a man wants to restore his basis at the end of his holding period he has to pay a capital gains tax just as if he sold it to a stranger. So the result is really no different than if the builder had sold the project to a stranger at that point. The whole point

of the provision was to allow the same tax results to be achieved but to allow continuity in management.

Thank you.

Senator TALMADGE. Thank you very much, Mr. Ziegler.

Thank you, Mr. Secretary.

Mr. BARR. Thank you, Mr. Chairman.

Senator TALMADGE. The next witness is the distinguished mayor of the city of Atlanta, Ivan Allen, Jr.

It is a pleasure to welcome a friend and constituent to the committee. Atlanta has pioneered in housing and is still doing an outstanding job. We are delighted to have you before us, Mr. Mayor, and you may proceed as you see fit.

STATEMENT OF MAYOR IVAN ALLEN, JR., CITY OF ATLANTA, GA.

Mayor ALLEN. Thank you very much, Mr. Chairman, and distinguished members of the Senate Finance Committee.

I am grateful for the opportunity to present my views to you today on the bills introduced by Senator Kennedy of New York and Senators Smathers and Pearson which seek to encourage investment by private enterprise in the development of housing and industrial opportunities in urban poverty areas.

It is especially pleasing to me that I can appear at this time as the chief elected official of a great Southern city which has consistently made a determined effort to utilize Federal programs of national import in the past for the purpose of eliminating shameful urban slums and providing a decent environment for all our people to live and be gainfully and adequately employed.

May I specifically bring to your attention Atlanta's two major efforts along these lines.

First, in the mid 1930's, the city of Atlanta successfully completed the first public housing uints in this country, the Techwood Homes.

Since that time we have continued, out of recognized necessity to build additional public housing so that today nearly 10,000 units provide decent, comfortable, and safe housing to 40,000 citizens at rents they can afford to pay. Eight percent of the population in the corporate limits of Atlanta now live in public housing.

In addition to taking major advantage of the federally assisted housing programs passed by the Congress to help cities meet this vital need, as early as 1956 we also began to make plans for the full utilization of urban renewal legislation in our efforts to eliminate slums and improve the lives of those persons trapped in them.

To date, we have cleared more than 3,000 acres of intolerable slums, revitalized large sections of the community, and I can say without hesitation, carried out forceful and successful programs of both public housing and urban renewal.

Senator TALMADGE. Will you yield at that point? I can certainly vouch for the statement you have just made. I have seen some slums in the heart of the city, particularly that have been cleared out, as you know, within the last several years the skyline of Atlanta has completely changed and it is a dynamic growing area that just a few short years ago was slums. I congratulate you.

Mayor ALLEN. Thank you, Senator. I am glad to have those nice words from you.

To those men of vision and courage in this body who conceived and who have supported continuation and improvement of these programs over the years go the blessings and thanks of many thousands of less fortunate citizens of my city and many millions throughout our Nation.

In spite of the best efforts of my city and the Federal establishments and all that has been done in the past, we are still confronted with depressing slum conditions on a large scale in Atlanta. So is nearly every other major city of America.

As we have moved forward in public housing and urban renewal, the continuing mass migration of untrained, uneducated, rural poor to the cities, automation, and the establishment of higher and better standards of minimum living conditions have raced ahead of our best efforts in slum removal. Realistically, while we have moved forward one step, we have slipped back in many instances two steps.

The tragic conditions of the American summer should be evidence enough that we must do more than we have ever done before and that we have to incorporate all resources available in the private community to share in this task.

Probably for the first time in our history, the private sector of American free enterprise has developed a deep and acute social consciousness. The vast resources of brain power, energy, and corporate wealth are now available to help in the task of rebuilding our cities and eliminating the slums.

There is no physical task which the American free enterprise system cannot overcome when there is a reasonable profit motive involved. The Government should recognize this motive and utilize tax exemptions and depreciation allowances to the fullest in order to put the free enterprise to work saving our cities.

Senator TALMADGE. I share your view and I think it is your view that private enterprise with the proper incentive and encouragement can do a better job of providing adequate housing than the Government can. Is that your thesis?

Mayor ALLEN. I think that it can certainly materially step up the present efforts that we are making. The limitations of these efforts mean they are not going to solve the problem quickly enough which demands that we bring into the forefront of the war against poverty other able segments of the community—primarily the free enterprise system.

Senator TALMADGE. There is a further point that if it is built by private enterprise it will pay ad valorem taxes to the city, will it not?

Mayor ALLEN. These bills, Senator, provide for a dimunition in the amount of taxes that are paid at a local level because this is one of the things that increases rent. But it provides for a rebate to the cities through the Federal Government program and also for the State and the Federal Government to make up additional sources of income at the tax level in case——

Senator TALMADGE. They would make some contribution.

Mayor ALLEN. Yes, sir; it would make some contribution.

Senator TALMADGE. One of the big problems now in city government as I understand it is the limited source of revenue and the increased and

growing demand for services. So you have a vastly compressed tax base. Is that not true?

Mayor ALLEN. That is quite correct.

Senator TALMADGE. Would this not make a greater contribution to your revenue to encourage private enterprise to build the housing facilities than if you have Government owned and operated homes?

Mayor ALLEN. I think it would make a material increase in income; yes, sir.

Senator TALMADGE. Thank you, sir.

Mayor ALLEN. Last year our city planning department presented to me figures from a study on housing resource needs in Atlanta. This study showed a critical need for substantial new low- and moderate-income housing units to house families being displaced by various governmental and private improvements.

We called the builders, bankers, developers, and civic leaders together at city hall, along with local and Federal Government housing experts and political leaders and launched a crash effort to build 9,800 new low-income units by the end of 1968 and 16,800 units in a 5-year period.

The expressions of support and cooperation from all segments of the business community were terrific. Our program produced some quick and positive results in the moderate-income sector. Some progress has been made by the Atlanta Housing Authority and private developers in the turnkey construction of public housing for low-income families.

However, virtually all attempts by private interests in the development of private market housing have met with totally negative results.

Necessary building requirements and land costs in central cities make it impossible for private enterprise to develop low-income housing in America today.

I am convinced that the answer to this problem will provide the keys to decent housing for millions of deserving citizens in this country. And it is for this reason that I heartily endorse the concept embodied in the two bills under consideration.

I am further convinced that once the profit motive of the free enterprise system is injected into the low-income housing program, we can accomplish feats in Atlanta which would take us years to accomplish utilizing only the previously established avenues of governmental assistance.

It also is a source of gratification to me to report to you that during the summer just past my city was selected by a great national corporation, the Celotex Corp., as the site of this company's entrance into the field of developing low- and moderate-income housing.

The Celotex Corp., out of a competition of seven excellent proposals, was awarded the contract to develop 208 housing units in one of our urban renewal projects.

The main motivation for entry into the local housing field of corporations like U.S. Gypsum and Celotex has not been as a result of any anticipation of profit or as a result of any tax incentives but because of the great possibilities which exist for finding new markets for building materials which these companies produce. Nevertheless, it demonstrates a high sense of social responsibility on the part of a large private enterprise.

Also along this encouraging line has been the activity of U.S. Gypsum in New York and other cities.

Senator Kennedy's bills provide for special tax assistance and allowances for work where it is needed most—in the slums of our cities. They further provide for these special allowances to be used in those fields in the slums where most needed—housing and employment.

Those of us who live closest to these problems have long recognized that America must put a minimum house over every citizen in this country. Our program in Atlanta calls for 9,800 new low-income housing units during the next 2 years. The success in reaching our objectives can be materially improved with the approval by you of additional tools of this type.

Creative, productive programs such as those proposed in these bills are probably the least expensive, but most positive way that the Federal Government can provide help to our cities in their fight for survival over the slums.

Gentlemen, I hope that you will give these bills your favorable consideration.

Thank you very much.

Senator TALMADGE. Thank you, Mayor Allen. I congratulate you on your statement.

Are there any questions?

Senator KENNEDY. Just a couple of questions.

What is the shortage in Atlanta at the moment as far as low-income housing units are concerned?

Mayor ALLEN. We have 17,000 units that have been declared under city zoning requirements and code enforcement as actually unfit for human habitation in which people are still living. We art trying to enforce the code and trying to move them out of them. We have 17,000 units that are really not fit for people to live in. We have an additional 6,000 or 7,000 units that are badly in need of repair. This is far beyond the yearly capabilities of replacement that we have been going through.

Senator KENNEDY. How much public housing do you have?

Mayor ALLEN. We actually have 9,000 units in operation now and an additional amount being built that will bring it up to around 10,000 units.

Senator KENNEDY. Whatever the prospects are in Atlanta, it does not seem to me that there are any Federal programs at the moment which can deal in a major way with the problem you have.

Mayor ALLEN. With the crash program that we are in to build these 17,000 units it appears to me that with all the figures that can be put behind it and with the great assistance that we are getting from HUD in public housing, turnkey jobs, low-income housing units, it probably is only going to fill 50 percent of the need during that 5-year period and we are not taking into consideration the 187,000 other housing units in the city that are deteriorating at an annual rate, let us say, of 2 percent a year and that is an additional 3,000 units that will go out of existence.

Senator KENNEDY. Is the situation getting more serious?

Mayor ALLEN. I think, based on the standards of today which are higher than they were 5 years ago and much higher than they were 10

years ago and with increasingly higher standards coming, that we are actually slipping behind faster than we are catching up.

Senator KENNEDY. Thank you very much, Mayor Allen.

Mayor ALLEN. Thank you, Senator.

Senator TALMADGE. The next witness is Mr. J. Stanley Purnell, president and chairman of the board of Action-Housing, Pittsburgh, Pa.

You may proceed as you see fit.

We will insert your statement in the record in full and if you wish to highlight it you may do so or proceed as you see fit.

STATEMENT OF J. STANLEY PURNELL, CHAIRMAN OF THE BOARD AND PRESIDENT, ACTION-HOUSING, INC.

Mr. PURNELL. Mr. Chairman, my name is J. Stanley Purnell. In business life I am assistant to the president of T. Mellon & Sons, in Pittsburgh, and I also participate actively in civic affairs. In addition to being chairman of the board and president of Action-Housing, Inc., a private, nonprofit civic organization actively engaged in the housing field, I am on the executive committee of the Allegheny Conference on Community Development, the Pittsburgh Regional Planning Association, the National Urban America, Inc., the Pittsburgh area's regional industrial development corporation, and chairman of the board of the housing agency of the Commonwealth of Pennsylvania. I am also secretary of the United Fund of Allegheny County, chairman of the United Health Foundation, and a vice president of the mayor's committee on human resources, the antipoverty organization in Pittsburgh.

Accompanying me are the executive director of Action-Housing, Bernard E. Loshbough, and Seymour Baskin, our general counsel, both of whom are considered authorities on housing. With your permission, they will be glad to participate in the question-and-answer period.

It is a pleasure to accept Senator Kennedy's invitation to me to appear before the committee to tell about Action-Housing's experience in providing new and rehabilitated housing for families of moderate income in the Pittsburgh area; the broad support our organization has received from the private sector in Pittsburgh; our plans for large-scale rehabilitation of old housing in our aging neighborhoods; and to provide whatever experience we can to assist you in your consideration of bill S. 2100 now before you.

My statement will relate only to S. 2100—the proposed Urban Housing Development Act of 1967. It is beyond our competency to testify on S. 2088—the Urban Employment Opportunities Development Act of 1967.

Our impression of the S. 2100 bill is that its aim is twofold: First, to induce large corporations to invest in housing; second, to provide lower cost housing for the lower, but still not the lowest, income families in poverty areas.

We are of the opinion that the bill has been the result of thoroughly conducted research and that highly professional skills have been brought to bear in its preparation. In other words, it is an excellent job of drafting.

In addition to our new housing program, Action-Housing has recently completed a 221(d)(3) demonstration program of rehabilitating a group of 22 deteriorated but basically sound 60-year-old houses in a designated poverty area in Pittsburgh. Our testimony on S. 2100 will be based, in large part, on that experience which, in turn, has led to a proposal for the establishment of a limited-profitmaking corporation to be funded and operated by a number of private companies. This corporation would undertake housing rehabilitation on a major scale through an organization known as AHRCO—the Allegheny Housing Rehabilitation Corp.

AHRCO SUMMARIZATION

This proposal recommends the formation of a new corporation, capitalized at $3 million to $4 million, to engage in the rehabilitation of structurally sound but deteriorating housing in the Pittsburgh metropolitan area on a profit-motivated basis, in cooperation with the local, State, and Federal agencies.

The Pittsburgh demonstration by the proposed Allegheny Housing Rehabilitation Corp. would, when experience has proven it successful, constitute a prototype which could be repeated in many cities throughout the Nation.

Participating companies would commit to purchase common stock or debentures. Policy will be established by a board of their selection. Professional staff and management personnel will be provided by the newly created company (AHRCO).

To date we have written commitments from 14 major corporations for more than $1 million of equity investment and loan participation in the proposed corporation. We anticipate at least an equal amount from other corporations within the next few weeks and ultimate attainment of our goal of $3,100,000. The companies which so far have agreed in writing to participate when the corporation is established are: Aluminum Co. of America; Blaw-Knox Co.; Crane Co.; Dravo Corp.; Duquesne Light Co.; Jones & Laughlin Steel Corp.; Koppers Co., Inc.; Limbach Co.; Peoples Natural Gas Co.; PPG Industries, Rockwell Manufacturing Co.; United States Steel Corp.; Westinghouse Electric Corp.

Our experience in developing the AHRCO proposal suggests that private enterprise is willing but cautious in becoming involved in this type of activity. The private sector is cautious because this is an activity not directly related to its regular course of business. It involes a financial relationship generally beyond the private enterprise purpose for being; that of making a profit. The private sector is concerned with the nature and scope of involvement with government, labor, and race, as these affect its ability to perform in this field efficiently and effectively. It is also concerned with the lack of manpower sufficiently qualified in the complexities of housing rehabilitation to bring about a successful end product for the consumer.

In reviewing S. 2100, we can summarize our comments generally in two classifications: those elements which might seem attractive to private enterprise, and those factors which might cause concern within the private sector.

On the favorable side, there are at least three major plusses:

(1) The objectives of S. 2100 of providing housing for lower income families, and the mechanics prescribed to achieve these objectives, are good, if economically feasible within the framework of the national economy. I refer to 2-percent mortgage money; 50-year term and tax abatement.

(2) S. 2100 presumes profits motivation for the producer—a prime requisite to attract private enterprise.

(3) Tax incentives generally appeal to the private sector.

S. 2100 encourages large corporate entities to enter the housing field on a major scale. Thus, it could increase housing supply for low- and moderate-income families. If its objectives are successfully reached, S. 2100 could effect a major change in the social and economic environments of our urban centers. Consequently, it could provide great benefits to the people living in cities, which, incidentally, would also assist the business community generally.

However, there are some concerns and questions relating to S. 2100:

(1) We believe that major industry is not anxious to hold for long-term investment purposes the type of real estate development anticipated in this bill. A freeze of such investment locks in the investor and removes flexibility.

(2) Private enterprise would also be concerned with management of such properties, since this will affect the ultimate return and disposition potential. In my belief, large corporations are not now prepared to involve themselves in the field of housing operation and management for low- and moderate-income families. This smacks of the unpopular connotation of "company housing."

(3) Practical problems relating to public relations may also provide resistance to involvement by the private sector.

(4) The tax inducements proposed provide a possible, but not certain, profit result. The tax benefits depend upon circumstances which may or may not be achieved or achievable after the investor has made a substantial equity investment. It should be noted here that the AHRCO proposal requires an equity investment for working capital, to be turned over in production, as opposed to S. 2100's required equity investment in real estate for a 10-year period.

(5) Restriction to urban poverty areas, with no exceptions, is too rigid. There are pockets of poverty in many otherwise substantial neighborhoods.

(6) The provision for tax abatement is an economic recognition of a major stumbling block in providing low-cost housing, both new and rehabilitated. However, and without discussing its other merits or deficiencies, most States, Pennsylvania included, do not constitutionally permit tax abatement. As far as we are able to determine, tax abatement for certain types of housing is constitutionally permitted in New York, New Jersey, Missouri, and Wisconsin. There is also some question as to the practicality of local, State, and Federal relationships; also of the procedure for the reimbursement of abated taxes from excess tenant income.

(7) There is the question of whether big corporate entities can be induced to become involved, in a major way, in a new production activity designed to serve a social need.

(8) This proposal promises, but does not assure, a profit. It provides market insurance against operating losses, but none against equity losses.

(9) The requirement that the "builder-owner" build or rehabilitate at least 100 units is not practical and is unfair to the otherwise qualified small builder.

(10) The limitation of a 3-percent rate of return to the developer should not be considered as an inducement to the private sector to enter or continue in the housing field.

The foregoing touches on some highlights of S. 2100, mainly in areas where the Action-Housing experience may be relevant to the discussion. My statement in no way purports to be an analysis of the bill in all its detailed aspects.

RECOMMENDATION

We suggest that consideration be given to determine if inducements, in addition to potential tax benefits, are required. Perhaps this should include some assurance to private enterprise against the loss of the original equity investment in consideration of its entering a new and difficult field as a challenge to its civic responsibility in addition to the profit motive.

For example, if this proposal is considered as a borrowing, in effect, of equity from private enterprise, without interest, then with some assurance of its repayment, if not recaptured in tax benefits, the tax incentives provide a "plus" factor. With a continuing rise in our economy, normal appreciation should approximate or exceed amortization in the early years of a long-term loan and justify repayment of original equity if not otherwise recaptured. Neither the return of original equity nor the "plus" factor would adversely affect the consumer.

In closing, I would like to express my conviction that, if we are to rebuild the slums and deteriorating areas of the cities of this Nation, we must find innovative ways to encourage the large corporate entities to enter this field, whether through a profit incentive or a civic motivation, or both, using all the Federal tools now available and to be made available.

The problem has been defined and redefined for generations, but this generation has the resources, the skills, and the energies to solve it, if it has the will to do so.

Senator SMATHERS. Thank you very much.

I understand that while I was gone Secretary Barr testified after some questioning from Senator Williams that there was an opportunity for businessmen to make considerable money in a program such as this. Would you not agree that actually one of the purposes of this legislation is to get businessmen interested and that the best way to get them interested is to hold out to them an opportunity to make some money?

Mr. PURNELL. That is exactly what we have done in AHRCO.

Senator SMATHERS. Is that not the reason why businessmen to this day have not gone into the low-income housing field, because they could not make any money?

Mr. PURNELL. I believe that is so.

Senator SMATHERS. Is it not a fact that the greater the amount of money you hold out in front of them the more likelihood there is of their going into it?

Mr. PURNELL. No question about that.

Senator SMATHERS. So the fact that somebody can make some money out of it seems to me to be necessary. We want them to make money out of it because that is the only way we can get them interested in it. You agree with that philosophy, don't you?

Mr. PURNELL. We certainly do.

Senator SMATHERS. How do you think Congress encouraged the hunt for oil? With 27½-percent depletion. Isn't that correct?

Mr. PURNELL. Yes, sir.

Senator SMATHERS. Thank you very much for your testimony.

Senator KENNEDY. May I express my appreciation for your coming here? I think that some of the reservations that you have mentioned are now covered by the amendments that I talked about today. I think your criticism of the restrictions which limit the bill to urban poverty areas with no exceptions is also a good point and one that perhaps should be studied by the committee. It has a good deal of merit to it. Also, your suggestion that a builder be able to construct a number of units less than 100 is worth exploring. The purpose of the 100-unit limitation is to insure that small groups do not receive great benefits for limited efforts. I know of the fine job you have done in Pittsburgh and the fact that you have come here to testify is very very helpful to us.

Thank you for your suggestion.

Senator SMATHERS. Thank you, sir.

Mr. PURNELL. Thank you, Mr. Chairman.

Senator SMATHERS. The next witness is James W. Rouse, president of the Rouse Co., Columbia, Md.

STATEMENT OF JAMES W. ROUSE, PRESIDENT, THE ROUSE CO., BALTIMORE, MD.

Mr. ROUSE. Thank you for giving me that change of address.

Senator SMATHERS. You have changed your address?

Mr. ROUSE. You stated it as Columbia. It actually is Baltimore. We do have a small interest in the city of Columbia.

Senator SMATHERS. They have you down here as a resident of Columbia.

Mr. ROUSE. Very sensible.

Senator SMATHERS. All right, sir. You may proceed, Mr. Rouse.

Mr. ROUSE. My name is James W. Rouse, president of the Rouse Co., a mortgage banking and development firm.

It is becoming clear at long last that the task of making the American city into a fit place to grow our people is the No. 1 priority of our civilization. Now that poverty, protest, and, finally, riots have brought us to face the task, it is imperative that we not misunderstand it, not oversimplify it, not confuse symptoms with causes.

Out of our impatience for quick and easy answers, there is always the danger that we will try to settle for "solutions" that are incomplete and inadequate.

We have had too much of this for too long. For over 40 years we have been making giant thrusts at little pieces of the urban problem, and, yet, in all this time we have not, in one single American city, mounted a program seriously constructed to make that city into a fit place to live and work and raise a family.

The problem of the American city is not just congestion, pollution, deterioration—nor crime, disease, and rats; nor housing; nor unemployment. It is all of these things, and, even more important, it is: "How did they happen?" What has caused our cities to rot away physically and socially?

It would not be enough to rebuild our cities brand new—exactly as they are. The same causes that dragged them down in the first place would drag them down again.

Why don't our cities consist of neighborhoods and communities that are socially and economically dynamic, with the capacity to maintain and renew themselves physically, and to provide an environment that supports and nourishes the growth of the people who live there?

That is the task we face in the American city: to build environment that supports and nourishes the growth of the people who live there.

And these are not just big, round, idle words. We can have no smaller target and be serious about our task. That must be our purpose—to remake our cities into places in which a man, his wife, and family—of whatever race or income level—can grow in productivity, dignity, and love of his fellow man.

Is it possible?

I happen to believe that it is not only possible, but actually easier, cheaper, quicker, to make over an American city into an effective place for the growth of its people than it is to shore it up, patch it up, put out the fires of crime, ignorance, and unemployment, as we are now trying to do.

We must begin by thinking about a single family—about what it takes to make the husband and father into a productive person—what it takes to educate the mother in child rearing, personal hygiene, and nutrition, budgeting, and buying—what it takes to provide for the education of the children from where they are into what they might become.

Then, we add more families to our thinking. What are their common needs? In what kinds of places might they meet one another easily, unself-consciously—share problems, give help? What kinds of institutions might they bring into being, if they had the opportunity? What kinds of churches, schools, health facilities?

How can we produce more winners—fewer losers? What kinds of stores will the people need? Where might they work, and how might they get there?

We must keep on thinking about how these families, their houses, schools, churches, stores, working places, might be arranged to give the greatest joy, dignity, beauty, convenience—and then there might emerge the scheme for a healthy neighborhood.

We add to it another neighborhood—and another. We introduce bigger facilities, like high schools, bigger parks, major employment

shopping and education centers that might serve a whole set of neighborhoods.

But the family remains paramount in our thinking and planning. No one can be allowed to get lost in a massive scaleless, impersonal mesh of buildings, streets, and people.

There must be physical separation of neighborhoods. They must become places that people can comprehend, be a part of, feel important in, feel responsible for.

Lay this kind of scheme across a city. Close streets--widen others; create open spaces to give shape and definition to the communities. Save all the buildings that can be saved and rehabilitated, and build new buildings as needed.

Create a physical environment that works for its people, educate workers, provide places for business and industry to come. Values will be strengthened. The assessable base will grow. Tax revenues will increase.

They will increase so much that they will prove it to be a better financial investment to make a city really fit than it is to pay the heavy cost of endless patching and repairing that never is able to stimulate new dynamics for the city's life.

And how does all this relate to the legislation before this committee? Clearly, no single bill will produce the program our cities need, but every bill should be judged in relation to the real task we face in our cities, and should be shaped to further the completion of that task.

It is clear that, although programs to provide employment and housing will not alone solve the problems of our cities, they can be important tools in a comprehensive planning and development program. These bills introduce an important new force with a high potential for effective work.

I am not qualified to speak on the impact of the bills on Government tax and financial policy. I must limit my observations to my role as a mortgage banker and real estate developer.

From that viewpoint, I can report to your committee that I believe the bills will accomplish the important purposes they have set. They will stimulate new business and employment in neglected areas. They will attract new capital, new developers to the low-income housing field, and are likely to result in a higher quality of low-income housing than we have yet seen in America.

The tax incentives seem to me to be ingeniously rigged to encourage a maximum equity investment in low-cost housing. This would be an important achievement, as it would automatically mean the attraction to this market of larger corporate institutions with greater capital resources, greater investment patience, a longer view of the market, and potentially a more responsible attitude toward housing ownership.

The escalating benefits for increasing equity work to strengthen the soundness of the project, and, at the same time, to reduce the requirement for Federal funds.

The emphasis on private participation removes the heavy hand of Government control and operation, and encourages competitive innovation in design and construction.

The provisions of the bill encourage early transfer of the property to the individual occupants as owners under circumstances that are likely to be favorable to successful continuance of that ownership.

It assures a testing and settling down period in the hands of the original developer, with transfer to the occupants not likely to occur until the project has been soundly established.

I really believe that this legislation could stimulate some large and exciting new projects in the low-cost field, that it creates an environment uniquely favorable to creative exploration with new materials, new building techniques, and new housing design.

It should attract new corporate entrepreneurs into the housing field with resources that could permit greater research and bolder experimentation.

This is an extremely thoughtful piece of legislation. Its provisions are complex, and I cannot claim to understand their full impact. As it is studied by the committee, I would urge your consideration of the following questions or suggestions:

(1) Does the bill focus attention adequately on the special needs and special opportunities for very large-scale rehabilitation projects?

The existing housing inventory is enormous. Much of it is susceptible to rehabilitation, which can result in significant economy, maintenance of charm and scale, and minimum dislocation of families now living in the area.

Rehabilitation has largely failed because it has been impossible to undertake it on sufficiently large scale to average out the risk of individual buildings, and to permit imaginative redesign of units, blocks, and particularly of neighborhoods.

We need really large-scale projects involving areas big enough to take in a dozen blocks or more, and to permit creative planning of whole new neighborhoods.

Is it not possible to provide special inducements in this area?

(2) The bill contemplates either "equity" or 2-percent, 50-year FHA loans.

In many cities, the tax incentives alone are sufficient to make possible low-rent housing, without the credit subsidy. Private financing has supported an enormous rental housing program in the middle and upper income markets over recent years. Such financing should be encouraged and specifically contemplated or induced by the tax incentive program. It will save time, tax dollars, and redtape.

(3) There is great danger that piecemeal use of these programs—particularly in industrial development—will tend to impede comprehensive, large-scale community planning, by proliferating small, unrelated projects through wornout areas that need extensive re anning and redevelopment.

It would be a disaster to encourage the rebuilding of the old inner city, without reshaping it to produce the essential ingredients of a good urban environment.

Except in rare instances, this requires planning and programing over a large land area. It is not apparent to me that the bill requires the projects to be a part of any comprehensive development program.

With respect to industry, this raises another danger. It could encourage a scatteration of small industries throughout residential areas, with little regard for their impact on the residental communities they are intended to serve.

These plants are likely to be small. It seems unlikely that they will be beautiful. They may even have a temporary quality which could become an erosive force in their neighborhood.

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It would seem vital that such development be hitched to larger scale planning and development programing.

I thank you for inviting me to appear before your committee. You have the opportunity, through these bills, to add important new tools for the task of remaking our cities into places that will support and nourish the growth of our people.

Senator SMATHERS. Thank you very much, Mr. Rouse. That was an excellent statement.

Mr. ROUSE. Thank you.

Senator KENNEDY. Do you think that if legislation along these lines were passed that it would induce major investments by companies and corporations which previously had not taken an active interest in ghetto housing for the poor?

Mr. ROUSE. I think very definitely it would, Senator.

I think anyone who observes what has been happening in the corporate relationship to the urban center over the past half dozen years has to see that this relationship is puckering for some bigger position than there has been.

GE is flirting with large-scale community development. Westinghouse is obviously engaged in bits and pieces of the city. Other industries are talking a lot. Litton Industries has talked about its potential involvement in city development.

The best of this thinking is looking for very large-scale operations. They want to move in, if at all, in a big way.

Furthermore, there are hopeful signs in housing technology. I do not think anybody can look at what is happening in the mobile-house field and not observe that we are now manufacturing houses in America.

They may not be the houses we want them to be, but if we can manufacture kitchens and baths and living rooms and dining rooms in the form of a trailer, we can manufacture them in other forms.

Thus there is the prospect of big industrial corporations putting their industrial manufacturing capacity to manufacture housing components, that could be hung on structures or supported by structures in the manner of habitat at Expo '67.

You can see wholly different kinds of housing in America, an entirely different relationship of large corporate and industrial enterprise to the problems of the city than we have ever seen before.

I think this prospect tends to be missing from the questions and answers about existing programs.

This is a potentially dynamic moment in time for this kind of legislation. I think it could release forces that are ready to be released for new roles in housing in the inner city.

Senator KENNEDY. It seems to me that, no matter how good some of the programs that we have at the present time are, the fact is that we are not going to unleash that innovation, that imagination, that expertise which has made the private enterprise successful and effective in this country, unless there is some incentive of some kind for a private enterprise system to become involved in urban redevelopment.

Do you agree with that?

Mr. ROUSE. I think there are adequate incentives to bring people into housing now. I think they will come into housing, but once they have

gone into housing, there is the question of what place in the housing field.

It is extremely tight and difficult—unreasonably so—to reach down into the bottom of the market.

I do not believe normally in special inducements or special incentives or special advantages to business. I have more anxiety than praise about forces that distort the market.

I do, nevertheless, feel that there is strong justification for a special set of incentives to get people into the low-cost, low-rent housing field.

To put those incentives in the tax area, it seems to me, is to make them most understandable to business. It would be difficult to find an incentive more inducive to corporate enterprise than a tax incentive.

I can understand what Mr. Barr was saying, and it is hypothetically true, a buck is a buck, but it is the psychological impact of a buck, too.

The fact is that receiving subsidy dollars from the Government in direct grants is not acceptable to business, whereas business is already and naturally extensively involved in negotiating its position through the tax laws, not in the sense of tax evasion, but in finding a way to arrange its operations in more judicious response to the laws that exist.

Therefore, what this does is to open up certain streets along which business and industry would move. It would produce the result intended.

Senator KENNEDY. I think tax benefits leave the incentive element present and entice businessman. Paying a flat figure to business to do something is unattractive.

Moreover, subsidies take out some of the incentives where you have the imagination and initiative to do the construction in a different way, and therefore save more money. Our tax-incentive system can lead to a cutting of costs.

Mr. ROUSE. I don't think anybody knowing anything about the building business would question for a minute that, if you starter out with the Government to build a million dollars worth of housing that it was going to rent under the public housing program, or it was going to provide tax inducement to business to make $1 million worth of housing, that more and better housing would be produced by this route than with the expenditure of a million dollars of Government money.

This can induce competitive innovation and the use of new mateials, design, and techniques. There will be industrial corporate pride at stake in this.

Westinghouse or General Electric or Litton or Alcoa, or whoever it is, would not want to produce an unworthy project. As a matter of fact, to the extent they have been involved so far, the results produced by big industry have been pretty darn good. They made a quality contribution where they have been involved in the housing field.

Projects like Society Hill in Philadelphia and Century City in Los Angeles—these are outstanding projects—and not very profitable.

Senator SMATHERS. Thank you very much, Mr. Rouse, for that excellent statement.

Mr. ROUSE. Thank you.

Senator SMATHERS. Our next witness is Philip M. Klutznick, president of Klutznick Enterprises, Chicago, Ill.

Is that correct?

STATEMENT OF PHILIP M. KLUTZNICK, PRESIDENT, KLUTZNICK ENTERPRISES, CHICAGO, ILL.

Mr. KLUTZNICK. I intend to identify myself more adequately and immodestly in a moment, sir, but I would like to have leave to enter my statement in the record later. I had written one, but most of it has been covered.

I should merely like to make some general observations after having identified myself.

Senator SMATHERS. Fine.

Mr. KLUTZNICK. My name is Philip M. Klutznick, of Chicago, Ill.

At various times in my life I have helped to organize local housing authorities, served on the State Housing Board of the State of Illinois, and was at one time Federal Public Housing Commissioner here in Washington.

In my private life, Klutznick Enterprises and its related companies are engaged in community development. We have built and completed one of the few postwar cities in Illinois, and we are presently engaged in operations in Chicago, Denver, and on the west coast.

Now, Mr. Chairman, with respect to the legislation that is before the committee, I should like to make a few limited observations.

The method of using the tax-incentive route is not new. As a matter of fact, it was said here today, and properly, that in the real estate field tax incentives are a very common thing, as they are in many other areas.

Nor is it unique to use below-market interest rates in stimulating housing.

Yet I find that this bill has certain attractions which existing legislation does not have.

What are they? First and foremost, in my judgment, the bill opens up an area for resources which present legislation and laws do not.

I think the thing that should be stressed most in considering housing problems is not the failure of the programs we have. They have not been failures. Some have succeeded a little more than others.

The simple fact is that we have not had enough resources for either public or private programs to produce the results that we asked of them.

For example, the public programs generally ask for too little, and get even less in terms of resources.

Discussions here today, including those by the Treasury, suggest that private resources are unlimited, as far as home construction is concerned. This is not true.

The simple fact is that the normal, traditional resources available for housing construction are extremely limited, as a portion of the gross national product. The best evidence of that was in 1966; with the slight shift in the interest rates, projects had to drop out by the dozens and dozens because money was not available for them.

It has never been true in postwar America that there has been enough money available through institutions, savings and loan associations, to meet the housing need as we define it here today, being the need of all the people, and not just those who can afford to pay conventional rents.

Therefore, any legislation which opens up a new avenue is pertinent and desirable.

In my judgment, the proposed legislation makes it possible for aggregates of capital which are not presently concerned or interested in the housing scene to utilize their capital productively, reasonably, and profitably, and thereby become attracted to the housing production field.

Now, there is another aspect of the bill that I believe is very important. I don't think it has been commented on today.

S. 2100 proposes the establishment of a new Division in the Department of Housing and Urban Development.

I think this is much more important than at first blush it may appear.

The President yesterday in discussing the allocation of the $1 billion by the insurance firms of America toward work in the slums said to them in effect: "Now, don't wait until developers come to you. Go out and proselytize them, sell them, do anything you have to to get them to do this job."

We need that in the Government, Senator. We need a department that is fresh and young, with no inhibitions, a division that can take a new idea and make it live by selling it.

We are accepting what is happening today as a norm, when we need to create new norms, if we intend to solve this problem.

This is not a criticism of the Federal Housing Administration. In 1940 I had serious doubts whether the title VI program for defense housing, and later war housing, should have been lodged in the Federal Housing Administration.

The Federal Housing Administration has a mortgage-insurance job to do. This is a painstaking job. It is a difficult job. It relates itself to long-term patterns.

The FHA has done a very fine job in that area. I am not certain that the same personnel, having that kind of burden, can move into a new area and become excited by it, and excite others by it.

Therefore, I consider this phase of the legislation quite important.

Senator SMATHERS. I think that is a very good point.

Mr. KLUTZNICK. Yes.

Finally, Senator, assuming that the legislation is adopted and the new unit is created, and aside from some of the technical questions that were raised earlier that I shall comment on in my statement which I will file for the record, there are two things which it seems to me the Department, and certainly the new unit if it is created, should be considering.

In 1966, with the lowest housing production in many years, with the exception of a few places, in New York City, for the moment, and the west coast, our construction labor force was overused in many places.

We have a severe shortage in a number of places of the skills that are needed at the present rate of construction in this country.

Some will deny it. We who live through this problem every day know that the recruiting program, the apprentice training program, and the jurisdictional questions that have arisen from time to time have made it impossible to build the kind of force that is needed to deliver a few hundred thousand units a year more—forget 1 million units a year more.

This is a very delicate question. I am fully aware of the problems that the construction trades have had in the past. In my new construction, I have no problems with them. Jurisdictions work adequately. But when you come to massive rehabilitation programs, maybe the time has come to ask whether there is not enough construction work in America to take the underemployed and the unemployed, and create a new skill force that works in the slum at adequate wages and becomes the labor force to rehabilitate the slums. Additions to the construction labor force and a new labor approach to rehabilitation need major consideration. Money alone will not solve this problem.

In conclusion I would observe that, while I agree entirely with Mr. Purnell's suggestion that there should not be a limitation of the benefits to slum areas, on the other hand, I think it is very vital that we recognize that not this year, or next year, will the new America be born, housingwise, for the 10 to 20 percent of the people who are living in the slums. Therefore, anything that we can do to make present slum areas better by fixing them up, making them livable, making them less the traps that they are today—even though some of our friends disagree with that approach—those who live there will forever bless the people who give them that chance.

Thank you.

Senator KENNEDY. That is very, very good, Mr. Klutznick. I think that all of the points you have made are valuable.

Do you think that if we take an approach along these lines, and pass legislation, that it will attract the private enterprise system to become involved? Will it attract those corporations that have not been involved before?

Mr. KLUTZNICK. My answer to that is very simple. We tend to oversell all legislation on housing. I do not want to see this oversold.

If you get a new, hard-hitting division concerned with this, that goes out and sells it, yes; it will. Because I think private enterprise, that sector of it which has been out of touch with this program, is, as Jim Rouse has said, ready. But, it is going to have to be taken by the hand.

Many of them do not have the equipment. Many of them do not have the understanding. That is why I emphasize the importance of having the new unit.

It may not be very acceptable in Congress to say that you must sell a public program. I used to get bawled out by Congressmen in the old days over the same thought. But this program has to be sold, and if it is, private enterprise will buy it.

Senator KENNEDY. Thank you.

I appreciate your coming before this committee. You have had a distinguished career. Your testimony will be very helpful.

Mr. KLUTZNICK. Thank you.

(The prepared statement of Mr. Klutznick follows:)

PREPARED STATEMENT OF PHILIP M. KLUTZNICK

My name is Philip M. Klutznick. My office address is 401 North Michigan Avenue, Chicago, Illinois. My principal business activities are: Senior Partner, Klutznick Enterprises; Managing Partner, KLC Venture, Ltd.; President of Old Orchard, Oakbrook, and River Oaks regional shopping centers; and President of Oak Brooks Utility Company, all of Metropolitan Chicago; and Chairman

of the Board of the American Bank and Trust Company, of New York City. I was the president of the company that planned and developed the post-war Village of Park Forest, Illinois (30,000 people) and a principal in the company that planned and developed the port city of Ashdod in Israel. I participate as an investor, officer, or consultant to other ventures, including the new town, Montbello, Denver, Colorado, and University Village in Santa Barbara, California.

It has been my privilege to serve in public life in two major spheres: housing and international affairs. In the former my work dates back to 1933, as counsel to the Mayor's Housing Committee of Omaha, Nebraska, which later resulted in the creation of the Omaha Housing Authority which I represented for some time. I served in the Federal Government in a number of part-time and full-time housing posts, most notably during World War II, as Assistant Administrator of the National Housing Agency in charge of war housing and as a Commissioner of the F.P.H.A., which was charged with construction and management of public war-time housing, as well as the conventional public housing program. I also served as Vice-Chairman of the Illinois Housing Board during Adlai E. Stevenson's term as Governor of our state.

In International affairs, my main interest has been the United Nations, where I have served in one capacity or another by appointment of the past three presidents. My longest full-time service in this connection was as U.S. Representative to the Economic and Social Council, with rank of Ambassador and as assistant to Governor Stevenson at the U.S. Mission, in economic, social and financial matters. I headed missions to other lands to investigate and recommend on matters involving urban and housing affairs. So much for my background.

I have examined the proposed legislation that is before this Committee. Subject to more careful analysis of certain of the details, some of which I shall mention, I would heartily recommend enactment.

This proposed legislation involves a constantly confusing question of governmental policy. There has been an ongoing struggle between the Treasury and various proponents of plans and laws involving tax incentives. The Congress has not been of one mind on the utilization of this route to stimulate and achieve social and other ends. There are ample precedents for the use of tax incentives in other areas with which this Committee is amply conversant. I have long felt that development and real estate operations have been treated rather badly, on occasions, by the Treasury and particularly the Bureau of Internal Revenue. Whether or not this is attributable to shifting governmental attitudes or a failure of statesmanship on the part of the industry, is a moot question. Certainly, the time is ripe for re-examination of this matter.

In this instance, the incentives have a special role since they are addressed to meeting, in part, the long-standing challenge of slums and ghettos. There would seem to be no cogent argument against the utilization of either direct subsidy or tax incentives, whichever achieves the most desirable end. The government has intervened in the development and housing market through subsidy, both open and disguised. Yet, it is generally agreed that in spite of all that has been tried since the early 1930's, we are still faced with a problem of such proportions that we must find new methods and more resources to tackle it effectively. While we can be proud of our achievements in the economic housing market, our progress in meeting uneconomic needs has been meager and slow.

On one thing, I want to make my position very clear. There is an unfortunate tendency to blame existing programs for the failure to eliminate slums or to substantially improve them. I am conversant with most of these programs. I have been actively involved in the public housing program in its beginning, and for a considerable period, in the Federal government. The history should be set right before we take on new ventures, with new hopes. When the public housing program was formulated in this country, it had a facility not unlike that which we now encourage in fighting poverty. It had an important social and educational aspect. There was a feeling then, not altogether gone today, that social planning was somehow, "communistic," even if it were done by free people, in a free environment. Between congressional attitudes and administrative timidity, the public housing program became more and more just another set of buildings, not all of them good looking.

Even more importantly, at no time did these programs receive the resources which could have produced substantial results. At the very heart of our problem must be the simple realization that we have not been persistent or determined nor have we induced a sufficient share of our gross national product into this activity to produce great results.

Therefore, I welcome *any* program which provides additional resources and taps new avenues of capital. It is difficult to predict with accuracy, what will happen under the proposed legislation. Economists and statisticians make estimates, but there are certain elements in any program which remain hidden until they are put into field operation. We always tend to over-sell programs, with the result that fustration follows in its wake. I shall not be guilty of this in recommending the legislation before the Committee.

Looking for new resources and new types of capital is the only hope for the ultimate solution of our housing problem. We need only look back to 1966 to realize what happens to housing production when there is a change in the money market. This was not a unique year. Not only does money dry up, but in terms of the kind of programs that are projected for the future, it has never been in abundant supply. If it had been, there would have been no necessity for F.N.M.A. Any reasonable examination of the past and the immediate present, will demonstrate conclusively that the part of our gross national product which gets allocated to housing and slum remedies is woefully short. Furthermore, it comes through sources that are, by now, traditional. The few large companies with huge capital who have entered the field, with one or two exceptions, did so under adverse circumstances. Therefore, the attempt in this legislation to make capital investment attractive to large companies is worthy of experimentation. Its adverse effect on tax revenue should be minimal, if any. Properly handled, this program could provide the kind of housing production which would otherwise not have appeared on the horizon in any event. Some collateral tax revenues would be inevitable.

The endorsement of the general principal does not necessarily suggest that I agree with all of the details. I have doubt about the 3% return rate. Maybe it should be 4% or 5%. It is not that one or two percent make a great difference, but the psychological effect of asking business men to invest their capital at 3%, irrespective of tax benefits, may be a deterrent.

Nor am I certain, from such calculations as I have made, that there are enough inducements in the original bill for 100% investment in any single project. My present opinion would be that the average entrepreneur would get more advantage out of investing 20% in five (5) separate projects than he would from investing 100% in a project which would produce ⅕ the aggregate of the units otherwise produced. If I am correct, much more of the federal authorization will be used up than, I believe, the proponents estimate.

Nor am I fully convinced that attempting to shorten the period of ownership by the original developer makes too much sense. While ultimate ownership by the tenants is extremely desirablo, reducing the period of investor ownership could present obstacles.

There may be certain developers who deliberately create projects with the view of selling in a hurry. In the main, those who look at rental housing as a desirable objective, do not do so with that aim. Furthermore, the objective of this legislation is to interest those who would be content with keeping their funds invested and reinvested in rental housing. The pain and difficulty, even with short-cuts envisioned by this bill, in the creation of a housing development is not easily compensated for in a matter of two years.

There is a tendency to consider that the developer who invests only his time, and none or little of his money, has really no investment in the property. In our business, I insist that our people examine the choice of alternative development proposals, in terms of where we can best supply the scarce resource of trained manpower. The fact that a project may involve no money investment, as against one which may include capital investment, is not the determining factor. We consider our time, energy, and know-how as capital investment. Looked upon in this fashion, the holding of a project for two (2) years hardly provides the compensation for the energy that produced the project. These things do not get done by themselves.

The proposed assistance for local real estate tax abatement will not operate universally. Some localities are prohibited by state constitution or law from extending special tax benefits to private corporations.

There is another aspect of this legislation which, I am sure, will be broadly debated. The suggestion that a new division be established in H.U.D. may be looked upon as a criticism of the F.H.A. Some may intend it as such. Too many people enjoy criticising the Department of Housing and Urban Development, the F.H.A., and all of the other complex of agencies. This is a great American game that ought to be recognized as just that.

I had great doubts in the early 1940's, that the defense housing and later, war housing programs, under Title VI, could or should have been executed by the F.H.A. So my present attitude is not new. The F.H.A. was established to do a certain job which requires painstaking effort. It has generally executed its basic task with great merit. I am not certain that it is wise to burden the F.H.A. with programs that have objectives other than sound mortgage insurance. Therefore, it is no criticism of the F.H.A., if a new type of program is originated and, at least at the outset, it is put into operation by new faces, with no inhibitions and no conflicts arising out of a past history and a large present program. There is an an old rule in government that if you have a new idea, it is best to get some new people and a new agency, to at least get it off the ground. What happens later, remains to be seen.

When the President received the billion dollar announcement of the Insurance Companies on September 13, he urged them not to wait for developers, but to go out and sell the idea. It is not always wise to suggest that the government do a selling job and it is especially unwise in the halls of Congress, but it needs saying. Most new housing programs are complicated and this is no exception. It was not easy to get F.H.A. accepted in the 1930's and it was even more difficult to keep the public housing program afloat. What is more, these days any new idea for involvement of capital complete with many other ideas that abound all over the national scene in these days of enormous economic activity. A new unit is needed to sell the idea and to develop the fervor demanded by the seriousness of the problem we seek to solve. Tools are not enough. Fiscal tools, such as proposed in this instance, need to be explained, understood, promoted and pushed into use. There are too many other ways to keep money working. In the absence of a real effort, the inertia of choosing the known will set in.

If the Congress decides to take this step, I would hope that that new unit would consider the feasibility for this program, to use cost instead of a valuation basis. Let me amplify: The F.H.A., in its long term program, looks as it should at the value of a project when completed, rather than in terms of its cost. This has created some problems in the past and it continues to create others. Yet, I believe it to be sound where programs for the long term economic markets are involved. It is this approach that helped produce the famous "WINDFALL SCANDAL" and it is this approach which makes developers become prematurely gray, when someone in F.H.A. second-guesses their honest estimates and their actual costs.

Perhaps in the program that is envisioned here it would be worthwhile, especially if the proposed sponsors of projects are established, well-known firms, to proceed on the theory that whatever their commitment, their investment should not exceed 20% or 30% of whatever it might be; they would be expected to use certain procedures and whatever the end result in rents would be, that would be its own best answer. These are subsidized rents which cannot be adversely affected too much. Local communities, where these projects are to be built, demand certain building densities and code requirements. It would be worth a test to see if the end product might not be just as good and the early processing accelerated, with much time saved.

Some emphasis is put on rehabilitation. I believe, with the proponents, that it is high time to face up to the music. Open occupancy laws are desperately needed, but they will provide very little housing in absolute terms for the uneconomic market. Dispersal, to create integrated neighborhoods and suburbs, is likewise needed. But this will not solve the problem of the slums today or tomorrow. Consequently, it makes sense, irrespective of opposition, even from Civil Rights advocates, to do the best job we can in fixing up, cleaning up, and making the slums livable. There is much that can be done. It does not all involve the house, whether new or the product of rehabilitation.

But let us address ourselves to the problem of rehabilitation, itself. I would hope that a new agency might be able to face the real bottlenecks in a large scale rehabilitation program. There is a general opinion that good rehabilitation will save money. I am not certain that this is always possible. In some instances, it will. In other instances, good rehabilitation will cost as much, or nearly as much, as a new unit. Certainly, when the acquisition cost of the old property is added, in some instances, it may even exceed the cost of a new unit. This program contemplates an accelerated rate of production of both rehabilitated and new units in the slums. There are other suggestions that abound, at least in the newspapers, that we should add at least a million units in a year to our present scale of housing production. I wish we could! We are not prepared for such figures.

In 1966, when housing production was down, and except for spotty areas like temporarily in New York or on the West Coast, our construction manpower pool

was substantially used or over utilized in most cities. In Chicago, there was a shortage.

Construction includes not only housing and public facilities, but industrial and commercial establishments, which provide the employment for people who live in houses and in cities. If all the money we needed were made available today, we could not build several hundred thousand or a million more units and maintain the remainder of our construction effort at its present level. Certainly such a sudden increase would induce a real inflationary spiral with no more units, at higher cost. While I believe that the materials problem can be solved rather quickly, I am certain that the manpower problem cannot be solved without some rather revolutionary steps.

I am fully sympathetic to the problems faced by the construction trades in the past. While they have enjoyed relatively high hourly rates, there has been substantial seasonal unemployment. I have never found any difficulties in working with the construction trades. And, I can understand the reasons for some of the practices. But, there is and has been a rather meager apprenticeship program and there are restrictions on the admission of certain people. We get so excited about this with unions, but, forsooth these practices also exist in business and elsewhere.

However, the scene is changing. We are projecting large increases in construction. We are also placing a great emphasis on rehabilitation. This poses two (2) problems:

(1) A large addition to our annual construction volume requires a substantial addition to our work force. Fortunately, there are enough unemployed and under-employed in ghetto areas who have been discriminated against to conclude that the people are available, if only the programs can be put into effect and the unions can cooperate to train the people quickly.

(2) The second problem has to do with rehabilitation. Here, I tread on delicate ground. While the jurisdiction system which prevails in the construction trades presents no great problem in large-scale new development, it becomes excessively burdensome in rehabilitation. It is time that the unions, the government, and employers face up to certain questions: Does rehabilitation require a different type of union? Does it require an industrial type union? Does it require a certain number of people who are really able, advanced, handyman types? These questions do not involve wage rates which are less important than method and training.

From my experience in and about the construction industry, I would suggest that unless there is a somewhat revolutionary approach to this problem, rehabilitation will always be too costly and will take too long to produce.

There are many other aspects of this problem which only technicians can handle, once the broad legislation is enacted. I am convinced that the tax incentive approach is one that has been under-explored and under-utilized in the treatment of this major problem of our day. I am convinced that any program that undertakes it must recognize that there will be problems and that it will not work to perfection; but, in its success, we may help solve another problem by augmenting capital available in the housing field. If we travel along the present pathway, housing produced at least at the private level, will continue to have periods of starvation and periods of relative plenty; but, at no time, will enough capital have been induced into the overall sector to assure the provision of a decent house, in a decent environment, within our lifetime. What is true of the economic housing market is even more true of the housing needs of the disadvantaged, which can only be met by subsidy—direct, indirect, or through the method contemplated here.

Senator KENNEDY. Mr. Barlow.

I apologize for keeping you for such a long period of time. I appreciate your patience.

STATEMENT OF JOEL BARLOW

Mr. BARLOW. That is quite all right.

My name is Joel Barlow. I am a member of the Washington law firm of Covington & Burling. I am appearing as a tax lawyer interested in legislation, and for no one else.

The necessity for bringing immediate solutions to the critical problems of the slum areas of our cities is recognized by every thoughtful citizen. We are all anxious to find some way that this can be done quickly and more effectively.

Massive Government spending programs have made some progress, but the evidence of their limitations has been graphically presented by Senator Kennedy and others at this hearing. With a $29 billion deficit in prospect, it seems to me we have reached the limits of Government spending.

The evidence is also clear that the private sector must do more, and that in many ways and in many areas it has been and can be more effective than public spending.

Business has shown a great interest in moving into the slums and dealing with the problems there. The example of the Warner & Swasey Co. in renovating an apartment building in the Hough district of Cleveland, and the efforts of Smith Kline & French in Philadelphia's Spring Garden area, are two notable examples.

The efforts of U.S. Gypsum in developing low-cost housing construction techniques are still another example of the solutions business can bring to this problem.

Business is clearly ready to move ahead both in the national interest and its own interest. But these efforts will continue to be isolated and sporadic until something is done to put slum investment on a realistic competitive basis with investment in other areas.

S. 2088 and S. 2100 offer the promise of large-scale participation by the private sector.

The immediate question presented by these bills is whether a deliberate use should be made of the tax structure to help solve these pressing social and economic problems. I shall deal principally with this question.

In my testimony before this committee in the past, I have opposed those who would regularly use the tax structure in an effort to remedy all of our social and economic ills. I have repeatedly agreed with the well-known views of the Treasury, expressed again today by Assistant Secretary Barr, and of Chairman Wilbur Mills of the Ways and Means Committee, that we must exercise great restraint in turning to the tax structure for solutions to all of our problems, social and economic. I am greatly concerned, as they are, about the threatened proliferation of tax credits. But it is the Treasury's introduction and sponsorship of the credit device that has created the risk of proliferation in all the areas Assistant Secretary Barr referred to today.

In my opinion, only in the most critical situations, amounting in effect to national emergencies, should we resort to the deliberate use of specific tax provisions or the tax-rate structure to solve problems wholly unrelated to revenue requirements.

However, we have learned from our experience in three wars that in national emergencies we must adopt accelerated tax amortization of industrial facilities not only to stimulate expansion and production, but also to recognize the taxpayer's abnormal risk in that expansion and production.

Sixty-month tax amortization was thus clearly justified in World War II and again during the Korean war.

Faced as we were in 1960 with a chronically dragging economy, a critical imbalance in international payments, and a ridiculously outmoded tax-depreciation structure, the adoption of an investment tax credit was clearly necessary and justified, not only as a stimulus to badly needed investment, but, once again, as a recognition of the unusual risk in making this investment.

Today we again face a national emergency—this time in our slums—that calls for unusual investment by the private sector.

Once again it would appear to be necessary to provide, through the tax structure, the stimulus for this investment and the recognition of the unusual risk in this investment.

The significance of this latter point—the necessity for recognizing the risk—must not be overlooked. It is this consideration, grounded in basic tax concepts, that warrants the use of the tax structure, and keeps the investment credit and depreciation proposals of S. 2088 and S. 2100 from carrying the labels of outright subsidies.

For the reasons just stated, I have concluded that I can support the tax concepts in these bills.

I think the use of credit and accelerated depreciation to solve these kinds of problems is inevitable, for a variety of reasons.

I have some reservations about the complexity of the bills, certain technical aspects, and in a number of instances the precise percentages and figures employed which may create unintended benefits.

I should mention that later amendments to the original draft of S. 2100, which I have discussed with members of the staff, appear to take care of the principal problems of multiple rollovers and multiple credits referred to by Senator Williams.

If the unintended benefits that Senator Williams referred to were in this bill, I would not be in favor of it.

And I could not support any provision that would give a taxpayer a credit or a deduction in excess of actual cost and expenditure.

I am still of the opinion that there should be an adjustment to basis for the investment credit now in the law. There may still be those who remember that when the investment credit was first proposed, in 1961, I favored an equivalent depreciation deduction, instead of the credit.

I was concerned then, as I am now, about the proliferation of credit, and about the distortion of net income when it is computed by subtracting arbitrary credits instead of deducting actual cost, but the Government decided to go the credit route. We have crossed the bridge, and the credit is now an accepted and established part and concept of our tax structure.

The kind of investment risk we are talking about today is now measured both by the investment credit and by depreciation. This is also the pattern of the bills before us.

I want to emphasize that I find myself supporting these bills also because the only alternative is more direct Government spending.

This, in my opinion, will not only be less effective, but it has already reached prohibitory limits.

The proposed legislation before us will result in some short-term loss of revenue.

I should be very much interested in seeing the Treasury estimates on the amended bill.

But on the basis of present estimates, it seems clear that the long-term gain from the multiplier effect, just as Secretary Fowler and Secretary Dillon have pointed out in the past, can be expected to far outweigh this short-term loss.

Certainly the loss will be far less than it would be if we were to follow the alternative of a massive new Government spending program.

In the 1950's and 1960's, the Government was repeatedly faced with the choice between tax relief incentives and spending to provide a stimulus for investment and economic expansion. In the spring of 1958, the Eisenhower administration considered various proposals designed to stimulate the economy and eliminate the persistent recession pressures.

Many of us at that time urged tax relief, and this was seriously discussed, but in the end the administration turned instead to a $6 billion increase in Government expenditures. This, in my opinion, was a mistake.

In the early 1960's, the Kennedy administration was confronted with the same problem, and chose the tax relief route. The decision was made to reduce the tax drag on the private sector, and to let the latent strength of private capital generate the economic growth which Government expenditure had not been able to stimulate.

The results, as we all know, have been impressive, both in terms of creating a sustained pattern of national growth and in stimulating an absolute increase in the rate of growth beyond that of many of our foreign competitors.

The tax stimulus to investment in productive facilities to reduce costs and make us more competitive in the markets of the world has greatly increased exports and made a real start on solving our balance-of-payments problem.

When I testified before this committee on behalf of the Chamber of Commerce of the United States in support of the Kennedy administration's tax-reduction program, I referred to the necessity of a shift away from Government spending, and observed that the administration's bill presented a "choice * * * between relying on the private sector or on the public 'pump.' "

The same observation seems to me to be appropriate today.

Since the New Deal days of the great depression, we have been attempting, principally through Government spending and public charity, to help those who are ill clothed, ill fed, and ill housed. We have made some progress, often wastefully, but we all agree that we have not made enough.

Even the progress that has been made might well be attributed more to the growth in the private economy than to Government programs.

Thus, it seems clear that to solve this pressing problem we must now rely more on the private sector than on public spending, just as we did in 1964.

We achieved the desired results in 1964 by reducing taxes across the board because the entire economy was stagnating. This time we are dealing with a limited area of the economy which is stagnant, and the logical cure is a localized application of the medicine which produced such excellent results in the general dose: the elimination of tax deterrents.

Let me emphasize once again that this is not a call for Government subsidies, any more than a call for the tax cut and related measures in 1961 and 1963 was a call for subsidies.

It is a call for recognition of the fact that a businessman operating in the slums has greatly increased risks, costs, and problems which make it difficult or impossible for him to proceed under the existing tax structure.

Industrial corporations cannot under the law be eleemosynary institutions. Most of them are discharging their responsibilities to charity and education, sometimes over the protests of shareholders, to whom they have a legal responsibility to try to operate at a profit.

They cannot assume unreasonable risks, or incur substantial losses, or overpay their taxes.

The businessman going into the slums often cannot get insurance at all, and when he does, the premiums are very high. He must pay higher taxes and higher construction costs. His labor force may be poorly trained and unreliable. He has all the risks which make his business life less certain.

Dan Thoop Smith of the Harvard Business School has observed that:

Taxation by itself is repressive rather than stimulating. To a greater or lesser extent, both work and investment are undertaken for pecuniary rewards, and when the rewards are reduced directly or indirectly by taxation, the balance is tipped to some extent against work and investment. The speed and the extent of the reaction will vary with individuals and with all the attending circumstances. (Federal Tax Reform 23 (1961).)

In America's urban slums, the attending circumstances are such that the reaction against investment is triggered much more readily by the repressive effect of taxation.

If the fact is accepted, as it must be, that increased investment in the slums is necessary and desirable, a more reasonable tax burden is obviously necessary to enable private capital to operate effectively.

The problems which create increased risks in the slums are not the fault of any particular segment of our society, and the businessman cannot be expected to assume general responsibility for eliminating them. They are general social problems for which the whole society must assume responsibility.

However, the performance of the businessman's normal functions could have the effect of solving many of these problems, if only he could find a way to do so as a business project.

Private business regularly builds the houses and provides the jobs that are so desperately needed in the slums.

Until now, the approach of the Government to this dilemma has been to rush in where business fears to tread, and institute Government spending programs. Too often the result has been charity, with its debilitating effect on the recipient, and with its tendency to whitewash rather than find solutions.

Too often welfare is dispensed in a way that destroys the home and family, instead of rehabilitating them. People are trained and then there are no jobs for them. New slums are built to replace the old. Great areas are torn down, only to remain vacant for years, while redtape and political controversy tie up renewal plans.

Just in the nature of things, and our system, the businessman will be more efficient. He will, of necessity, plan ahead. He will not be po-

litical. He will not be handicapped by the uncertainties of legislation or appropriations.

He will have continuity of organization and personnel. He will train people in the skills that are needed. He will maintain the properties and utilize the land in a productive way, so that his investment is protected. And he will pay taxes, and so will the newly trained employees.

It is my understanding that the efficiency of private investment has recently been demonstrated to the Department of Housing and Urban Development, which found that years could be saved in the time taken to complete public housing projects if private developers were permitted to plan and construct the projects and turn them over to HUD when completed.

The developers of Puerto Rico also know what private investment can do, and that Government spending failed to produce comparable results.

Congress has always recognized the advantages of enlisting private capital in construction and development efforts. The Housing Act of 1949, for example, declared that:

The policy to be followed in attaining the national housing objective shall be: (1) private enterprise shall be encouraged to serve as large a part of the total need as it can; (2) governmental assistance shall be utilized where feasible to enable private enterprise to serve more of the total need.

However, the encouragement provided thus far to corporations has simply not been enough to justify this use of stockholders' money.

The failure of the section 221(d)(3) below-market-rate-of-interest program is a good example of what happens when a program attempts to enlist private capital in the slums, without providing a reasonable return on investment.

S. 2088 and S. 2100 accept the fact that a solution to slum problems may be evolved as a byproduct of business activity, and they attempt to provide adequate measures to stimulate, instead of discourage, that business activity.

In conclusion, I would simply say that these bills place principal reliance on tried and proven tax measures to eliminate the tax deterrents that have prevented businessmen from making large-scale expenditures in the slums.

A tax credit for new investment has worked out successfully in practice and, since the temporary and unsuccessful suspension of the credit last year, the Government has committed itself to make the credit a permanent and integral part of the tax structure.

Businessmen have learned to utilize the credit as a means of minimizing the risk of large and unanticipated capital investments such as those to be incurred in renovating, reconstructing, and industrializing slum areas.

Improved and more realistic tax depreciation is also well known to businessmen as a proper means of minimizing risks and tax costs in justifying expenditures. Further liberalization of depreciation is an entirely appropriate measure for recognizing the uncertainties of business life in the slums.

The provisions of S. 2100 which permit an investor to roll over investment from one project to a new one without payment of capital gains tax is likewise consistent with traditional nonrecognition of gain provisions, when mobility of capital must be encouraged.

As Senator Kennedy and the other sponsors of these bills recognize, they are not yet in final form. Further refinements in drafting are underway, and already in these hearings changes and amendments have been suggested that must be studied carefully.

However, the kind of tax approach proposed in the bills is warranted by the emergency that confronts us, and I am hopeful that the distinguished members of the Finance Committee will give S. 2088 and S. 2100 favorable consideration.

I have attached a memorandum to my statement which makes some comments more or less technical on the provisions of the bill, but because of the lateness of the hour, I will not refer to them.

Senator SMATHERS. We will make them part of the record, Mr. Barlow.

(The memorandum follows:)

SUMMARY MEMORANDUM TO ACCOMPANY STATEMENT OF JOEL BARLOW

TAX ASPECTS OF KENNEDY PROPOSALS

This memorandum briefly describes with my brief comments the tax aspects of the proposals introduced by Senator Kennedy on July 12 and 13. The first of these, S. 2088, is entitled the "Urban Employment Opportunities Development Act of 1967" and provides incentives for investment in depreciable property in an urban poverty area poverty area and for the hiring of low-income individuals who had resided in the urban poverty area for at least six months or had been unemployed. S. 2100, the "Urban Housing Development Act of 1967" provides incentives for investment in new and rehabilitated housing in an urban poverty area.

S. 2088

The principal tax provisions in this bill are the following:

1. 7 percent investment credit with respect to qualifying real property;

2. 10 percent investment credit with respect to qualifying personal property (in lieu of the 7 percent credit otherwise allowable);

3. Depreciation deductions with respect to qualifying property of 150 percent of the amount otherwise allowable;

4. Salary deductions in the case of qualifying salaries equal to 125 percent of the amount otherwise allowable. (This provides a deduction in excess of actual expenditure.);

5. Investment credit carryback and carryover with respect to qualifying property of three and ten years respectively (in lieu of the otherwise applicable three and seven year periods);

6. Net operating loss carryback and carryover with respect to qualifying losses of three and ten years respectively (in lieu of the otherwise generally applicable three and five year periods).

S. 2100

The principal tax provisions in this bill are the following:

1. An investment credit with respect to qualifying housing ranging from 3 to 22 percent in the case of an initial owner and 2 to 22 percent in the case of a subsequent owner, such credit to depend on the percentage of the owner's equity in the project;

2. Depreciable lives with respect to qualifying housing equal to a percentage of the lives that otherwise would have been allowable, such percentage to vary inversely with the percentage of the owner's equity in the project;

3. Salvage values on qualifying housing disregarded;

4. Treatment of demolition and site-improvement costs with respect to land on which qualifying housing is to be built as part of the building cost subject to depreciation. (Under existing law, such costs frequently must be added to the basis of the land.)

5. If the qualifying housing is held for a certain minimum period and then disposed of, the owner can avoid the recognition of gain by reinvesting the

proceeds in other qualifying housing with certain time limits (usually one year). If the qualifying housing is held for a certain maximium period and then disposed of, the amount of gain subject to tax is limited to the excess of the amount realized from the sale over the principal balance of the mortgage on the property at that time. (There is thus no tax on the difference between the depreciation previously claimed and the mortgage principal amortization.) If the qualifying housing is held for the maximum period and the owner decides to continue to operate it, he is treated as having sold the property to himself and is given a stepped-up basis and permitted to redepreciate the property.

1. The bills do not provide for statutory depreciation allowances. The depreciation allowable under the bills depends upon the amount of depreciation that would have been allowed under existing law. Consequently, it will be necessary to establish useful life, within the meaning of section 167, before applying the acceleration provisions of the legislation. This leaves much to be desired from the administrative standpoint since taxpayers will be forced to justify their depreciation either under the guidelines or on the basis of the facts and circumstances. Revenue Agents thus could, in effect, limit the benefits provided for in the bills by insisting upon unusually long section 167 lives.

2. The tax aspects of the bills are extremely complex principally because so many different tax incentives are offered. It should be possible to provide the same overall tax benefits and incentives with fewer different provisions. For example, the percentage credits could be increased and the depreciation provisions eliminated, or a credit (in lieu of a deduction) could be provided for a portion of the qualifying salaries paid, and the additional 25 percent deduction could be eliminated. This would avoid the criticism of a deduction in excess of actual expenditure.

3. The most disturbing of the proposals from the tax standpoint is the extra 25 percent deduction provided for qualifying salary payments. While it is possible to justify the depreciation proposals on the ground that the present depreciation structure is inadequate, no similar justification can be made for the salaries. There is great value in imposing a tax on the basis of net income (at least before the allowance of credits), and we should be extremely hesistant to encroach upon the net income concept through the allowance of a fictional deduction.

4. The proposals are, of course, subject to the "Pandora's box" argument—that if these bills are enacted, others will be proposed which will similarly make direct use of the tax structure to achieve social ends. There is considerable risk of this, but certainly if the risk is to be taken at all, there would seem to be no better place to take it than in legislation dealing with, perhaps, our most critical domestic problem.

Senator SMATHERS. Senator Kennedy.

Senator KENNEDY. I think your testimony is very helpful.

I think that, because you have had so much experience in the tax field, you know the problems of amending the code perhaps as well as anyone else in the country.

We are glad to have the benefit of your ideas, and suggestions of how the legislation may be refined and improved. I think they will be particularly useful.

I will just say that I agree with what you have said—that it is a national crisis that we are facing, and that people from all political persuasions must agree to the fact that what we have done in the past is not sufficient. There are things that we can do now to improve the situation.

And it seems to me it is time that we started seeing action in the executive branch of the Government, in the legislative branch of the Government, and in the private sector. We must try to rectify a very dangerous situation within our country.

Mr. BARLOW. I think that is very true, Senator.

One of the things that I think has not been emphasized by those who oppose these measures is the urgency of the situation. I think

that is one reason why tax incentives should be used. I think they will have an immediate effect, and they will have a very helpful multiplier effect.

Senator SMATHERS. You have testified before this committee many times, have you not?

I know in recent years I have seen you up here often. Don't you usually speak for the chamber of commerce?

Mr. BARLOW. Yes, I do. I was chairman of the taxation committee of the chamber of commerce for 10 years. I resigned this year.

I am not speaking for the chamber today.

I might add, Senator, I am not speaking for the National Association of Manufacturers, which I understand from the clerk was a typographical error on the agenda.

I am simply speaking because I am interested in the bill. I think it is an imaginative and very thoughtful approach to this problem.

As I said earlier, I have great reluctance in going to the tax structure every time we need some social change or economic change, but I think this is the time to do it.

Senator SMATHERS. I thoroughly agree with you.

Thank you very much.

Our next and last witness for today is Mr. Richard Hatch, executive director of the Architects' Renewal Committee in Harlem, Inc.

Is Mr. Hatch here? If he is, will he identify himself?

Mr. Hatch is not here, so the committee will stand in recess until 10 o'clock tomorrow morning, when we will hear the former Secretary of the Treasury, Mr. Dillon.

(Whereupon, at 4:45 p.m., the committee recessed, to reconvene at 10 a.m., Friday, September 15, 1967.)

TAX INCENTIVES TO ENCOURAGE HOUSING IN URBAN POVERTY AREAS

FRIDAY, SEPTEMBER 15, 1967

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 2221, New Senate Office Building, Hon. George A. Smathers presiding.

Present: Senators Smathers, Williams, Carlson, and Bennett.

Also present: Senator Robert F. Kennedy of New York.

Senator SMATHERS. The committee will be in order.

This is the Finance Committee's second day of hearings on Senate bill 2100, offered by the distinguished junior Senator from New York, the Senator from Kansas, the Senator from Connecticut, and myself.

Our first witness today is the former Secretary of the U.S. Treasury, the distinguished Douglas Dillon.

We are delighted to have you as our witness, Mr. Secretary. You may proceed as you like.

STATEMENT OF C. DOUGLAS DILLON, FORMER SECRETARY OF THE TREASURY

Mr. DILLON. Thank you, Mr. Chairman. It is a pleasure for me to appear before you again.

Since leaving the Treasury, I moved to New Jersey and am engaged in the investment business there and in New York City. I am president of United States & Foreign Securities Corp., a registered, closed-end investment company.

I am also a director of the Chase Manhattan Bank and of the American Telephone & Telegraph Co.

In addition to these business connections, I am chairman of the board of the Bedford-Stuyvesant Development & Service Corp., a nonprofit corporation organized for the purpose of stimulating the redevelopment of the Bedford-Stuyvesant area in Brooklyn.

During my years at the Treasury, many important tax measures were passed upon by this committee. Of these, none was more important than the investment credit included in the Revenue Act of 1962. A stimulus to encourage the rebuilding and heighten the productivity of our industrial plant was urgently needed at that time.

The investment credit was proposed only after careful analysis of all the many alternatives that could have been used as a means for achieving this goal. It was chosen because our studies convinced us that it would provide the most powerful stimulant at the lowest cost in revenues for a given incentive effect.

There can be no doubt that the credit has proved to be a powerful influence on investment decisions and has played a major role in enabling our economy to enjoy an unprecedented period of uninterrupted expansion.

I begin my testimony by talking about the investment credit because it demonstrates the important uses that can be made of tax policy. I am not one who believes that our tax system should be used to solve every national problem we encounter. In the interest of uniformity, special incentives should be held to an absolute minimum.

But as President Kennedy stated in connection with the investment credit:

> Some departures from uniformity are needed to promote desirable social or economic objectives or overriding importance which can be achieved most effectively through the tax mechanism.

In 1962, the importance of stimulating modernization and capital expansion justified the enactment of the investment credit. Today, the crisis we face in our cities—in insuring that all our citizens have a fair opportunity to obtain decent housing and meaningful jobs—is no less urgent than the state of our economy was in 1962.

We are faced with a problem of the highest priority which so far as defied solution. Under such circumstances we cannot turn our backs on the use of tax policy or of any other policy that might help us to reach a successful solution.

Although I understand that the question of industrial development within our urban poverty areas is not as yet before the committee, I would like to say a few words in support of the principles contained in S. 2088 before turning to the subject of housing.

The creation of new jobs for the unemployed in our slum areas must have first priority in any attacks on the urban ghetto. Without the prospect of a job, there is little or no incentive for a young person to improve his education.

Better education and better training are central to the problem of our cities, but additional funds spent in this area will be largely wasted if there are too few job opportunities at the end of the road.

Better housing is unlikely to be maintained or to change the character of a community if there are no jobs for those who live in the improved quarters. And today the plain fact is that there are nowhere nearly enough jobs for those who live in urban poverty areas. In such areas, less than half the young adult men can find jobs at which they can earn wages sufficient to carry themselves and their families across the poverty line.

The best answer to this unemployment problem is to create jobs right in the areas where these people live. Such jobs can only be created in adequate numbers by the operations of private business on a large scale. I do not refer simply to major investments by big business, although these are important and very welcome. What is more likely to do the job is the large-scale investment of funds by a multitude of small- and medium-sized enterprises.

But investment of this nature will require special inducements that only Government can provide. Without such inducements, the risk are just too great and the anticipated profits too low to permit businessmen who are responsible to their shareholders or to their families to commit funds to the urban ghetto.

We no longer have the time to go case by case and determine the exact incentives needed to attract a particular business to a particular area. Instead, we needed incentives that will apply automatically to encourage a rapid increase in new businesses in poverty areas without substantial redtape and delays.

It is for this reason that I support the principles embodied in S. 2088. Through the use of a number of tax incentives, it would encourage broad categories of private business to play an important role in reducing our unemployment problem. And I cannot see any other practical means to induce the large-scale private investment that is required.

I am particularly impressed by the provision for the deduction of 125 percent of the payroll cost of employees from poverty areas. This is an imaginative suggestion that strikes at the heart of the problem. In effect, it directly subsidizes the training and employment of the unemployed, not just the use of machinery, but the training and employment of the unemployed. It gets them off the streets and into jobs with decent pay.

I can think of no better weapon to avert the kind of rioting that swept our land this past summer.

Turning to S. 2100, I feel less competent to speak since I am no expert in the extremely complex field of housing. However, I am convinced that the problem is a deadly serious one.

Although it has been recognized for many years, progress to date has been sadly inadequate to the crying needs. New approaches are clearly needed and every possible tool should be considered, including the use of tax incentives.

The basis question is how can we get the job done? If it cannot be done without special tax incentives and can be done with them, then by all means let us have tax incentives, even though we recognize the undesirability of creating new tax privileges.

This year has seen a number of exciting new proposals designed to meet the housing problem. Along with S. 2100 which you are considering today, there has been the home ownership plan developed by Senator Charles Percy, and the recent $1 billion commitment of the life insurance industry to ghetto housing.

And we still have not given a full trial or adequate scope to the promising rent supplement program. It is fortunate that so much intelligent thought and effort is being put into this matter, since there is not likely to be any single answer. The problem is so stupendous and so crucial that we should attack it in every possible way, instead of trying to find one perfect solution to cover all the various needs for action in the housing area.

I am particularly struck by the ingenious suggestion in S. 2100 for municipal tax abatement in order to achieve lower cost housing. In Bedford-Stuyvesant we have found a reluctance on the part of many homeowners to undertake the rehabilitation of their homes, even if heavily subsidized, for fear of tax increases.

The provision of S. 2100 for the abatement of local real estate taxes seems particularly helpful in this connection and could well be an important part of any slum housing program.

On the other hand, I must admit to being troubled by the wording of the provision in S. 2100 for 50-year loans at 2 percent. This is clearly an unrealistic rate of interest.

While I was in the Treasury, I chaired an interdepartmental task force set up by President Kennedy to look at the problem of subsidized interest rates. Our report, while recommending that existing programs be left undisturbed, found that the establishment of new programs dependent on interest rate subsidies would not be in the public interest unless specific provision was made for the annual appropriation of funds to cover the difference between the newly subsidized rate and the cost of money to the Treasury.

This finding was approved by President Kennedy and still appears to me to be good policy. It does not prevent the use of 2-percent loans if they are found necessary, but, rather, specifies that the cost of the subsidy be clearly shown as an expenses on an annual basis. I am concerned because I was unable to find any such provision in S. 2100 as presently drafted.

In conclusion, I am firmly of the opinion that we cannot solve the urgent problem of our cities unless we tap the huge resources of our private enterprise economy and harness its ingenuity and energy in pursuit of a solution.

So I favor any and all approaches that are designed to accomplish this end. Specifically, in spite of the arguments of general tax policy against the creation of new and special exemptions, and they are valid arguments, I would favor the use of tax policy wherever other tools cannot do the job. This seems to be clearly the case in the field of job creation covered by S. 2088 and may well prove to be the case in the housing area as well.

Therefore, while fully supporting the principles embodied in S. 2088, I also feel that S. 2100 merits your most careful and sympathetic consideration as one of the promising new approaches to the housing problems of our urban poverty areas.

Thank you.

Senator SMATHERS. Thank you very much, Mr. Secretary.

Senator Williams, have you any questions?

Senator WILLIAMS. I have just a couple of questions.

Mr. Secretary—and we still address you as "Secretary," respecting you as such—do I understand that you are endorsing the proposal for 30-percent tax credit on this type of building property?

Mr. DILLON. I don't mean to endorse any specific provision for tax credit. What I am trying to say is that I believe the use of tax credits is a proper thing, and I do endorse their use if there are not other readily available means to accomplish an objective that is of overriding importance.

I think our cities, rebuilding our urban poverty areas, is of overriding importance. I think the rebuilding of housing, the building of new housing in those areas, clearly has been completely inadequate under all the programs we have had so far.

We have been successful in the suburbs but not in these urban poverty areas. I don't see any reason to expect present programs to be adequate. I think new approaches are needed and it seems to me that one of these, getting private industry in and getting the funds

is the use of tax incentives. The exact form of the tax incentive I don't feel able to comment upon because I don't have enough knowledge or information about the housing business.

Senator WILLIAMS. I think you underestimate your knowledge and ability. Having known your background, I have such tremendous respect for you, that is the reason I am interested in your answer.

Of course, a bill passed with just the flowery language for tax incentive with no figures involved is zero.

Mr. DILLON. No, there has to be a figure involved.

Senator WILLIAMS. That is correct. What figure would you recommend?

Mr. DILLON. As I say, I don't want to make a particular recommendation there, not for lack of knowledge of taxes generally, but from lack of detailed knowledge of the housing industry to know what is necessary.

I think the way to find that out is to ask the people who would be required to put up the money what they would need. I have seen this bill. I would think the idea that after taxes there would be profits available on equity money of something like 12, 15, or 16 percent would seem to be an adequate incentive to me. Six or 7 or 8 percent would not.

I think the way this package works out is probably about right, but there may be other ways of writing the incentive than the ways in this bill.

Senator WILLIAMS. Then basically you do endorse the package as it is recommended with the 30 percent. Is that what I understand you to say?

Mr. DILLON. No, I don't want to be put in the position of endorsing a specific incentive. It is just the net result of allowing a profit of roughly, say, from 12 to 15 percent.

Senator WILLIAMS. The bill as it was originally drafted, in effect, mathematically would allow a rollover at the end of every 10 years and set it up for depreciation again for an amount minus the amount of the tax credit, which in this instance would be 30 percent.

For example, a $1 million building, at the end of 7 years, could be set up on your books again and depreciate that $700,000 over for the next 7-year period, and then follow that same line each 7 years. In other words, for the 35-year life of the building, you could depreciate it five times.

Would you endorse that?

Mr. DILLON. That seems a little extreme. The way you paint it it sounds a little extreme.

Senator WILLIAMS. I am not painting it. That is the way the bill is drafted.

Mr. DILLON. That is why I say I don't want to endorse any one particular thing.

Senator WILLIAMS. Then you are speaking more or less in favor of doing something in this immediate area without at the same time endorsing the principles of the bill now before us?

Mr. DILLON. Not the details.

Senator WILLIAMS. You are just endorsing the principle and not the details of the bill?

Mr. DILLON. That is right.

Senator WILLIAMS. Then you are not endorsing either the tax rapid writeoff or the tax credit provisions of the bill? They are not being endorsed by you at this time?

Mr. DILLON. Not in detail, but I do endorse the use of tax policy and tax credits for this purpose.

Senator WILLIAMS. You realize if we enact the bill as it is drafted and eliminate these features and just endorse it in principle, and say we are for it, we wouldn't have anything. You understand that?

Mr. DILLON. I understand that.

Senator WILLIAMS. I would appreciate, because I have such tremendous respect for your knowledge of the tax law and your soundness in this area, knowing just what you would recommend in this area as to both the extent of the writeoff that would be advisable and the extent of the tax credit, if you would see fit to give it to us at this time.

Mr. DILLON. I am not prepared to go into detail on that at this time. I am sorry, Senator. But I do endorse the use of tax credits that would lead to a profit potential of 12 to 15 percent.

Senator WILLIAMS. Thank you.

Senator SMATHERS. Mr. Secretary, let me ask you this question: You are familiar, of course, with the legislative process.

Did you ever see a bill brought before any of the committees of Congress that was not amended if it needed to be amended?

Mr. DILLON. Certainly not; not any that I had anything to do with.

Senator SMATHERS. Have you ever seen one in your experience that was perfect in every detail from the outset, even though it was sound in its concepts?

Mr. DILLON. No, not even those that were prepared in the Treasury Department.

Senator SMATHERS. So if it were true, as the Senator from Delaware suggests, that there was in the bill a mechanism by which some very alert, astute, and particularly technical mind could obtain some unwarranted compensation, that ought to be repaired; you would recommend it and we would recommend it. That has been your experience, has it not?

Mr. DILLON. That is right. That is the purpose of having these hearings.

Senator SMATHERS. But you do agree that there is something that needs to be done in this field of eliminating slum housing and ghettos in the bigger cities?

Mr. DILLON. Most certainly. You can't look at an area such as I am somewhat familiar with—the Bedford-Stuyvesant area in Brooklyn—you can't look at that without seeing how much remains to be done and how little these programs in the past have accomplished toward meeting the great need.

Senator SMATHERS. And you do agree that because of this very urgent need we must provide some tax incentive and that otherwise private business, with its great technical knowledge and capital, will not move into this area.

Mr. DILLON. Basically, I think the most important thought I had to give was in the sentence where I said that if tax incentives are needed to get the job done and if it can't be done without them, then by all means let us have tax incentives.

Senator SMATHERS. As a former Secretary of the Treasury and a man who has had great experience in private business, a man of considerable distinction in the business field, do you believe that private business men—have they given you any indication—would go into this field if there were not considerable opportunity to make money for their companies and themselves?

Mr. DILLON. Well, they will, even without that opportunity, to a considerable extent, because they are getting more public welfare minded. I think the action the other day of the insurance companies in agreeing to put up $1 billion for this type of investment in ghetto areas shows that.

While that is a good-sized sum, it is not anywhere near enough to do the job. I don't think the mere desire to carry out their public welfare duties will lead them to make investments that are anywhere near large enough to fulfill the needs. To do something of that size they will need to do it profitably in competing with other investments. As these companies said, this $1 billion was only a small part of their investment pool.

Senator SMATHERS. You said, did you not, that you felt they did need an incentive, a minimum return on their money of around 12 to 16 percent?

Mr. DILLON. Something in that area. I wouldn't be an absolute expert and say that 11 percent wasn't enough. But certainly 8 or 9 percent has been proved, with the risks involved, not enough to cause them to do it.

Senator SMATHERS. So we have to go to that figure which will finally bring private enterprise, with its brains and ability, into the field, whatever that particular figure may be.

Mr. DILLON. Yes, if you are going to get private enterprise in, and I am convinced that you have to.

Senator SMATHERS. It is like going fishing. You have to get the right kind of a lure. We have to lure these people into doing what needs to be done. We are not exactly certain at what level it is, but if we have at the moment erred on the side of generosity, that will be demonstrated and we should then change it. But we must do what is needed in order to get them in.

Do you agree with that?

Mr. DILLON. Yes. It is probably a good idea to have a specific provision that the workings of any such scheme be reviewed at periodic intervals, with that in mind.

Senator SMATHERS. I might say to you, and to my distinguished friend from Delaware, that frankly, I felt he did us a great service yesterday by talking about how much opportunity there was in this bill for businessmen to make money. It may have excited their imagination.

When we finish perfecting this bill legislatively, if what he says is the case, that, of course, would be too big.

As the distinguished Senator from New York said when he testified in favor of the bill yesterday, in introducing it he recognized that it would have to be amended in some respects and he would want the committee to work its will.

Thank you, Mr. Secretary. I will yield to the Senator from Delaware.

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Senator WILLIAMS. The Senator from Florida, as one of the authors of the bill, certainly knows what is in his bill, I am sure of that, both he and the Senator from New York. However, he refers to the analysis of the bill by the Senator from Delaware.

I point out that this is not my analysis. This is the analysis of the Treasury Department, for which we both have a tremendous respect. I think you do, too.

Mr. DILLON. Certainly.

Senator WILLIAMS. I won't ask that it be printed in the record again as it is in yesterday's record, but there is very short colloquy, my colloquy with the Under Secretary of the Treasury, Secretary Barr, pages 135 to 148 of yesterday's hearings, which sets forth very clearly not what the Senator from Delaware says can happen under this bill, but that which the Secretary of the Treasury Department says can happen.

We can approach a solution to this much better to admit what is in the bill rather than defend it on the basis that it is unintentional or that maybe I am wrong and this is just some fairly tale.

I would say this: that perhaps it is somewhat of a fairy tale because, as was pointed out in the colloquy yesterday, by transferring this property on a $1 million investment, two gentlemen, by exchanging it over a period of the life of the property every 7 years, which is permitted under this, could draw $300,000 tax credit, 30-percent tax credit, seven times, or $2,100,000 tax credit on an initial $1 million investment, and, in addition to that, they could depreciate this property on the basis of $1 million seven times during this same period.

I don't think anyone would say that that is not at least a generous proposal and one which I think both you and I would agree would attract a lot of investment even from New York banking industries.

Mr. DILLON. I would think so.

Senator SMATHERS. In fishing they chum the waters a little bit. That might be chumming up.

Senator WILLIAMS. That is correct. In fishing, I am reminded that one of the most likely fish caught sometimes are suckers.

Senator SMATHERS. From what you say, if they go into this, they wouldn't be suckers.

Senator WILLIAMS. No, I would say the suckers would be on this end, who are financing it and voting it.

I won't continue the colloquy, but I just want to emphasize this is not my analysis of the bill, although I had analyzed it to that extent, too. But the Treasury Department confirmed it exactly as I have said, which I am sure you are aware of.

I have one further question along another line.

I was glad to hear you mention the fact that the banking industry and the insurance industry got together and are going to put $1 billion into this particular investment field. I think this is a step in the right direction.

However, to get the record straight, and these are high-risk loans, nevertheless, as the insurance companies and the banking industry underwrites this, they are underwriting it with 100-percent Government guarantees in back of it; is that not correct?

Mr. DILLON. FHA guarantees; yes.

Senator WILLIAMS. So while these are described as high-risk loans, and they are high-risk loans originally, as the insurance companies

and the banking industry take these over under this $1 billion venture, they are taking them over with a Government guarantee 100 percent in back of the repayment and interest both; is that not true?

Mr. DILLON. FHA guarantees; yes.

Senator WILLIAMS. Thank you.

Senator SMATHERS. Senator Carlson.

Senator CARLSON. Mr. Secretary, I just wish to state that I, too, am delighted to have you appear before this committee. You have appeared before us on many occasions in the past and have always been helpful in regard to financial problems of our Government.

You appear here today interested in the expansion of industry and housing as a whole.

I was interested in your suggestion that you thought it might be well to use tax incentives. This deals with housing, but what other tax incentives do you have in mind in view of the situation confronting the Nation?

Mr. DILLON. I am only talking about this problem of urban ghettos. I talked earlier about the bill, S. 2088, which I think is highly important in handling this problem.

It is particularly important since very little has been done in this area, how to get jobs created in ghetto areas. I am quite convinced that the best way to do it and the way it will be done eventually, is by medium-scale private investments in light industry.

I am convinced the only way you can do that is through tax incentives. I think this particular incentive that has been suggested in this bill, of a 125-percent deduction for the wages paid to people who are hired from these areas, from the unemployed ghetto areas, is a very imaginative suggestion because it does strike at the problem of getting people employed at decent wages, and from that flows, of course, multiplier effects. If they get employed, they are able to buy more in the stores, and so on and so forth.

I think it is a highly important and significant suggestion.

Senator CARLSON. I have noticed that in very recent years there has been a great expansion in the use of tax-exempt industrial revenue bonds. I think possibly it has reached such a stage at the present time that the Treasury is greatly concerned about the revenue.

Mr. DILLON. Personally, when I was in the Treasury, I was opposed to that process. I though it would be self-defeating, eventually. It is maybe moving in that direction since so many States are beginning to use it. This is a question of raiding; of getting the business away from one place to come and settle some other place by the use of this tax incentive on revenue bonds.

Of course, if one State wants to counter it, it just starts doing the same thing itself. So you have a race to do this and nobody loses but the Federal Government in revenues.

It doesn't seem to me to be a wise procedure. I would agree with the Treasury and hope that something can be done to limit it or end it.

Senator CARLSON. Of course, these industrial revenue bonds are a tax incentive.

Mr. DILLON. They are; yes.

Senator CARLSON. It does cost the Treasury revenue. The situation confronting this committee in the piece of legislation before us now,

which deals with an investment credit, would also cause a revenue loss, would it not?

Mr. DILLON. Yes. I wouldn't worry only about the revenue loss if this accomplished something that was a nationally desirable goal that cannot be accomplished any other way. The way revenue bonds are presently being used, they do not meet that objective. They simply lure a plant away from one area to a different area where labor costs may be lower or something of that nature.

I don't think what they are accomplishing is an overriding national goal. On the other hand, the results of last summer show that the amelioration of conditions in our urban poverty areas has to be an overriding national goal.

Senator CARLSON. As one member of this committee, I heartily favored and supported the 7-percent investment tax credit. I thought it was a mistake when we suspended it and then later had to come back and restore it. I was in favor of restoring it.

But we run into one problem after another when we begin to increase this from 7 percent to any other percent.

Mr. DILLON. That is another reason why I didn't want to specifically endorse any one of these specific provisions. All I endorse is something that will lead to the end result. I think you can have very good arguments against a number of these specific provisions.

Senator CARLSON. I don't like to use the term "loopholes," but sometimes the Treasury comes up here and complains about loopholes, and many of our citizens do. Instead of adding another, maybe we should be taking care of some that we already have.

I appreciate very much your appearance.

Mr. DILLON. Thank you.

Senator SMATHERS. Senator Kennedy.

Senator KENNEDY. Mr. Secretary, the question has been raised whether it would be equally effective to seek industrial investment in the ghettos through an appropriation or a payment to a businessman to invest in the ghetto, to build housing in the ghetto, or build a factory in the ghetto. This would be in place of a tax incentive.

Would you comment on that?

Mr. DILLON. Of course, if he actually received the same amount of funds, the result would be the same. But there is a great difference. I think our national position is very heavily against subsidies to business of that nature, and I don't think business people like them, or they don't believe they would be able to count on them. They could be voted one year and they might not be voted the next year.

Therefore, there is no certainty that they would continue. There is more certainty that a tax incentive would be allowed to continue because people would make the investment with that in mind. It wouldn't be so likely that it would be drastically changed in midstream.

Of course, your bill on investment to create jobs is limited. The credits are only available for 10 years. I think, therefore, that payment of a subsidy is impractical because it is not in our tradition and business would not accept it in any event as a permanent thing.

Senator KENNEDY. The Tax Investment Credit Act of 1962 which you had so much to do with, was that a success in stimulating business activity?

Mr. DILLON. Yes, I think it was, though it was very hard to prove how much it stimulated business as opposed to something else. But certainly the way the business community feels about it after operating under it is interesting. When it was first proposed, they weren't so certain it would be the stimulus we hoped it would be.

Gradually as it was being discussed, business opinion changed. I think it was remarkable last year, the unanimity of business opinion, that this had proved to be a very important tool and very helpful in stimultaing investments. It clearly has been. The people who were supposed to have been affected by it say so.

Senator KENNEDY. Is it your feeling that a tax credit now to stimulate industry and the construction of housing would have the same effect in the ghetto?

Mr. DILLON. There is no reason why it wouldn't. I think it would.

Senator KENNEDY. Do you think that, from your experience in the financial field and the tax field, business would be attracted by tax incentive to make investments in the ghetto which they have avoided up to the present time?

Mr. DILLON. I think so. It is a high-risk problem, but other means are being used to take care of some of these risks. They can be basically countered by the opportunity of adequate profits. I am sure they would be.

Senator KENNEDY. There was opposition from the Treasury Department yesterday on the basis that this established a precedent. Would you comment on that?

Mr. DILLON. Anything we do establishes a precedent. That is a valid argument, but there also have to be exceptions when matters of overriding importance are faced. I think that is the real decision and I can't really make it. But this is something that the wisdom of Congress has to decide: whether amelioration of the problems in our urban poverty areas, which brought on the sort of situations we saw in many cities this summer, is a crisis that deserves high national priority or not. I personally think it is.

If it is such a crisis, then it deserves the use of all possible ways of putting an end to it, including tax incentives.

Senator KENNEDY. Thank you very much, Mr. Secretary.

Senator SMATHERS. Senator Bennett?

Senator BENNETT. Mr. Chairman, I came in after the witness' statement was made. He indicated that he thought the deduction of 125 percent of payroll was an imaginative approach.

I am not sure he is the one that can answer this question.

If the basis of this very unusual deduction is the area from which the employee came, then some imaginative businesses will discharge all of their employees except the people from those areas, or as many of their employees as they can get rid of, because this is a real windfall. Perhaps they would say to the employees, "Get an apartment in that area so I can justify the 125-percent deduction."

Isn't this a risk in this particular type of an approach?

Mr. DILLON. I think it is, but I think it probably has been answered in the way the bill has been drafted, as I understand it, which says that this is applicable for a period of no more than 10 years and only to those new industries that move into a ghetto area and are approved

by the city involved. So the local authorities would have to approve the establishment of a new industry which would then have to be established in the ghetto area, and it would presumably not have any employees to discharge because it was new and it would hire new employees.

The incentive is to hire as many as possible of the employees from the ghetto area rather than bringing in people from oustide to do the job in that area.

What we are trying to do is to provide jobs for these unemployed people in the ghetto areas. They are not as well trained. It costs more to use them. Therefore, this tax incentive seems particularly appropriate for that sort of thing.

If this applied to going businesses, I think what you have said would be true.

Senator BENNETT. It seems to me that if I were the manager of a business in another city, to which I had no particular and special reason to be attached, it would be a terrible temptation to become a new business in the ghetto area.

Mr. DILLON. There is a provision in here to prevent movement of runaway businesses of that nature because there also has to be a certification from, I understand, Washington, from the Secretary of the Treasury.

Senator BENNETT. In other words, it presents an opportunity for political determination as to which businesses are going to be given that particular privilege?

Mr. DILLON. No, I think not. I think it is spelled out clearly that they cannot be runaway businesses. They have to actually be the establishment of new industry. I think those provisions should be very carefully drafted and looked at to make certain it works that way.

Senator BENNETT. I remember our experience with ARA. There was to be no movement there. But there was a lot of it. The opportunity to offer this incentive is there. Cities will take advantage of it. Political pressures will be exerted. This is a great emotional situation. Here is an industry that will employ 500 people. We can bring it into our ghetto area. They don't have any unemployment problem in this other city, and so on.

I have grave misgiving about any situation in which you permit the deduction of more than the actual expense involved. Now we only have two, the investment credit and the mineral depletion allowances. We have had trouble with both of those.

I think this is even more dangerous because it attaches to so common a thing as wages. It seems to me there is a prospect this proposal would create the problems to which I refer.

Mr. DILLON. I think what you say agrees with my feeling. You agree that this incentive would work very well. You are afraid it would work too well. I think certainly that is a very reasonable and very important fear. It is a question of drafting a bill of this nature so that wouldn't happen. If that can't be done, then maybe you shouldn't do it.

I assume from reading the bill that it has been done and could be done, and Congress could find ways of doing it. If they can't, then I would tend to agree with you. Certainly we don't want to have a bill that would just promote a lot of movement of plants from one place to another. That is not the purpose of the bill.

Senator BENNETT. I have no further questions, Mr. Chairman.

Senator SMATHERS. Mr. Secretary, I have just three quick questions.

As former Secretary and as an experienced businessman, you do recognize that there is a need to provide housing in the ghettos?

Mr. DILLON. Certainly I recognize it. I don't see how any reasonable person could not recognize it.

Senator SMATHERS. You do believe that one of the answers, if not the only answer, is to get the wealth of knowledge and the wealth of capital that is included in what we would call free enterprise interested in the solution of that problem?

Mr. DILLON. Yes, and get it interested on a large scale and not just on a welfare basis.

Senator SMATHERS. And you do further agree that the only way to get them into this area is by giving them some tax incentive?

Mr. DILLON. I think it is one of the best ways. I think it is a very important way, possibly an essential way.

Senator SMATHERS. Thank you very much, Mr. Secretary.

Senator WILLIAMS. I have just one further question.

However, as I understand it, you are not endorsing the tax incentives or the depreciation provision in this bill?

Senator SMATHERS. I think we know he is not supporting the particular amounts. He is supporting the tax-incentive concept.

Senator WILLIAMS. The language without the formula, which means nothing, as I understand it, because you have to have a figure in there to get any benefits.

Mr. DILLON. You can decide whatever way you want, Senator. I am delighted to see you supporting the Treasury so strongly these days.

Senator SMATHERS. Thank you very much.

Our next witness is Mr. William Warren, the dean of the Columbia University Law School, from the great State of New York.

Dean Warren, we are delighted to have you and you may proceed as you like.

STATEMENT OF WILLIAM C. WARREN, DEAN, COLUMBIA UNIVERSITY LAW SCHOOL, NEW YORK

Mr. WARREN. Thank you, sir.

I am William C. Warren, dean of the faculty of law of Columbia University. I have worked in the field of taxation for the past 30 years, and I have taught taxation in law school for a period of over 25 years.

I have published many articles, books, and reports on taxation, and, in addition, I have served as a tax consultant to the Secretary of the Treasury.

I was a member of the mission that went to Japan under Gen. Douglas MacArthur and set up the tax system in Japan. Then I went to the Far East with General Van Fleet on one of his military and economic missions.

This gives you some background as to what expertise I might have.

I want to say that I appreciate the privilege of appearing before this committee, particularly to discuss the tax incentives for investment in urban poverty areas, Senate bills 2100 and 2088.

The use of the tax laws to provide incentives in these areas of our national development is now well established by previous tax laws en-

acted by Congress. We all know that a tax proposal can no longer be considered only in its efficacy as a revenue-raising measure. Any tax law necessarily has its effects on both the economic and social well being of the Nation.

Congress has recognized in the past that these effects include incentives for the vigorous development of our economic life.

What comes to mind is, of course, the investment credit enacted into law not too long ago.

I might say that this type of law is not peculiar to the United States because we find its counterparts in many parts of the world where other systems of Government have used the same technique.

The use of such a measure is an obvious and effective way of encouraging economic growth and development. The Internal Revenue Code bristles with provisions that affect our social policy. Additional exemptions on the income tax return for the blind and the aged are obvious ones.

The deduction of medical and dental expenses, and of contributions to charities and educational institutions, are others in a long list of the use of the tax laws to favor desired social results.

Today I don't think anyone should quarrel with the principle of providing a tax incentive to achieve a desired result. We are concerned, rather, with, first, the policy question of what do we want to do, and, secondly, the best method of going about it. The answer to the policy question seems relatively simple. Obviously, something must be done about our city slums. Slums no longer are a local urban problem. They are a national problem which vitally affects every citizen of this country. The problems of the city slums are not abating. Each summer sees an increase in the number of riots and violent disturbances, and there is nothing on the horizon that I see that indicates that these disturbances will decrease.

We can no longer wait until the vigor and extent of these riots reach an intolerable point beyond which control is no longer possible.

I turn now to the method of seeking a solution to the decay of our cities. Why select a tax incentive rather than a direct Federal grant? The members of this committee know all too well the many Federal programs that are directly involved in the problems of this area. At times, massive financial aid has been channeled into the slums. City, State, and Federal programs have worked for a solution of the problems of our cities for two decades.

Unhappily, these programs, welfare assistance, unemployment payments, training programs, job counseling, small loans and others, just to name some, have been overwhelmed by the magnitude of the problem to be solved.

What has not been tried is the most efficient industrial complex that the world has ever seen, American private industry. To date there seems to be no problem too big or too difficult for our modern American industry to solve. Once private industry directs its energies to the needs of the moment, it reaches a solution.

Our present space program is a vivid example of private industry providing the solution to incredibly difficult technical problems. It is certainly not too optimistic to hope that the incursion of private capital and private industry, encouraged by this bill into our city slums,

will materially and perhaps decisively make our cities a desired place in which to live.

Moreover, a tax incentive will not be the only operative factor in the field. There are other factors operating vigorously in this area. There has been a striking surge of interest in attracting private capital to the slums.

Many forward-looking companies have made tentative steps in that direction in recognition of the vast market potential which exists.

The broad sponsorship of this legislation by Senators and Congressmen of differing political persuasions and the range of favorable opinion represented at these hearings is further convincing evidence that this concept of incentives for private investment is the most powerful of all things—an idea whose time has come.

The support for this concept is readily understandable. Private capital is controlled by many different businesses and, therefore, has a degree of flexibility and individual creativity which Government programs can never have and do not have.

The investment of private capital in a project would release Government funds for other projects. The need for profitable return on private investment is a powerful incentive for efficient operations. A tax incentive is one that appeals directly and powerfully to the private investor. It is a factor that enlivens and multiplies economic growth.

More often than not, the economic activity generated by a tax incentive more than offsets any tax loss incurred as a result of the incentive. Experience with the Investment Credit Act has amply demonstrated this happy result.

However, the right area of activity and the right means of interesting the private sector must be found. There is reason to believe that this hearing is addressing itself to the right means and the right area of activity.

This points up the two general criteria that a desirable tax benefit proposal should satisfy. The proposal should further the public interest in a broad way and not in a narrow or specialized way, and it should reflect an efficient means of advancing that interest.

There are, in addition, several other standards for assessing the effectiveness of incentives for investments in the area of added or high risk. These standards provide a useful basis for making a specific evaluation of Senate bill 2100 and Senate bill 2088.

In the case of encouraging slum investment, the best incentive is probably one which goes directly to the act of investment, as do the tax credit and accelerated depreciation aspects of Senate bill 2100 and Senate bill 2088. Senate bill 2100 also contains provisions which give favorable tax treatment to the proceeds on sale of a project if certain conditions are met. This, too, is a rationally designed method to bring about desired results.

Senate bill 2088 contains an unusual tax incentive in the form of an additional 25-percent tax deduction for compensation paid to previously unemployed persons. Here, again, the incentive is rational.

Senate bill 2088 is designed to encourage not only capital investment, but also the creation of jobs for the unemployed. If the only incentives were based on capital investment, labor intensive projects would suffer unreasonably. Hence, the desirability of the 25-percent extra de-

duction to provide an incentive for the businessman who is concentrating on creating the needed jobs.

The incentive should also be highly selective. A scattergun approach offers too much opportunity for windfall and does not attract investments to projects of the very highest priority. The selectivity of Senate bill 2100 and Senate bill 2088 is assured by the local and Federal governmental controls on certified projects. This is the right area of activity for drawing in private capital because it involves ordinary profitmaking projects.

The construction and rental of housing, and the creation of jobs, are traditional functions of the private sector. These programs, unlike a pollution control program, do not ask a private investor to spend his money on public projects. They offer him the opportunity to earn a return on his capital, on his know-how, and on his experience.

The direction of the businessman's knowledge and experience to the solution of slum problems is clearly a resource that cannot be ignored. The Investment Credit Act is a tax-incentive program that encourages capital investment in plant and equipment. Here are bills that literally encourage an investment in human life and in human decency.

In urging the enactment of this legislation, I would like, however, to add that past experience with our tax laws show that a continuing study of their effect is desirable and indeed required. We want to encourage private industry to commit itself to the improvement of our cities by reducing the impact of taxes on its operations. We know that private industry requires a fair return for its risks and efforts. We also know that conditions change and that a small tax savings today may in a few years, or in other areas, result in an inflated profit.

For this reason, safeguards should be enacted in the law to insure that it operates fairly and effectively.

In addition, its operation should be closely monitored to insure the timely correction of any defect that subsequent experience may disclose.

Thank you.

Senator SMATHERS. Thank you very much, Dean.

Senator Williams, have you any questions?

Senator WILLIAMS. Just a couple of questions, Mr. Warren.

The existing bill, S. 2100, which you have just endorsed, proposes, in the instance where it is all private money or conventionally financed, a 22-percent tax credit, and the minimum rollover or amortization period of 10 years.

Yesterday, the sponsor of the bill changed that provision to 30-percent tax credit and a 7-year period. Would you endorse that second liberalization?

Mr. WARREN. Senator, when you come to figures you are in the political area and the economic area. I say "political" because we must prepare certain economic data. I know some committee of Congress must be working on the economic data here so that they will know what should be the right percentage.

But let's go back to the oil-depletion thing for a minute. If you know the history, and I am sure you do, in the House the percentage figure was 25 percent and in the Senate it was 30 percent.

They had lunch, and in the afternoon it came out 27½ percent.

Senator WILLIAMS. I thank you for that, because I have always said there was nothing sacred about it. Maybe we better have another lunch in that area.

Mr. WARREN. When you come to this, I am not prepared, because I have not seen the economic data. But you are in the high-risk area, and I speak here in controlling some property right in the ghetto area.

Therefore, if you are going to do something, you are going to have to give some incentive. I don't know what the right amount is, but I think there can be economic studies made that will determine what it should be.

If you notice, at the end of my statement I said I thought you should have some kind of mechanism in the bill that was constantly reviewing it to see that there weren't windfalls.

Senator WILLIAMS. I understand that. I think you underestimate your own ability. I have such a tremendous respect for the dean of the Columbia Law School that I know you can give us a lot of information in this connection. That is the reason I want to direct a couple of questions to you.

We will proceed on the premise of the new formula, the 30 percent and 7 years, assuming that is correct.

Under this bill, even though this project was built as a separate corporate entity, they do have the advantage of subchapter S, which means that they could commingle the results and carry them over on their personal tax returns.

You understand that, do you?

Mr. WARREN. Yes.

Senator WILLIAMS. We will proceed with the hypothetical case that the individual is well in the 70-percent bracket. He forms this corporation and he builds one of these projects. To make it easier, he puts all of his own money. He builds this $1 million project under this proposal. He would get $300,000 tax credit which he could carry over against his personal return.

Mr. WARREN. That is right.

Senator WILLIAMS. Following that, he would be able to depreciate this full $1 million cost in the next 7 years under this proposal. Is that not correct? Ten years under the bill or 7 years under the most recent change.

Mr. WARREN. As I understand it, at each of these periods he has to pay a capital gains tax.

Senator WILLIAMS. I haven't reached the end of the period yet. I am in the first 7 years right now.

Mr. WARREN. You are correct on the first 7 years. That is my understanding.

Senator WILLIAMS. He can depreciate it the full $1 million. If this individual is in the 70-percent bracket——

Mr. WARREN. Of course, this is only the building, not the land.

Senator WILLIAMS. That is correct, but we are speaking of the building; just the building.

Mr. WARREN. And land represents a fairly substantial part of the cost.

Senator WILLIAMS. That is correct but we are speaking of the building. He doesn't get a tax credit on the land. The building costs $1 mil-

lion. He gets $300,000 tax credit. In the next 7 years he can depreciate this building in its entirety, which is a $1 million depreciation. For a man in the 70-percent tax bracket, it is worth $700,000. Is that correct?

Mr. WARREN. Yes.

Senator WILLIAMS. At the end of 7 years he has depreciated his building to zero but he has recovered, by tax benefit, the full $1 million cost; is that correct?

Mr. WARREN. That is right.

Senator WILLIAMS. At the end of the 7 years he could roll it over on a new basis and the base would be reduced by the amount of the tax credit but he could set it on his books again at $700,000 for depreciation purposes for the next 7 years; is that not correct?

Mr. WARREN. I don't believe that is correct, Senator.

Senator WILLIAMS. I refer you to page——

Mr. WARREN. Excuse me. Again, I don't profess to be an expert on this bill.

Senator WILLIAMS. I recognize you as an expert. I refer you to page 40 of this bill.

Mr. WARREN. I think what happens is this: He can set it up on his books at that point by paying the capital gains tax.

Senator WILLIAMS. That is correct.

Mr. WARREN. He has to pay a tax. All of that $1 million that you just talked about, some of it has to go. He has to pay a tax. In addition, he sets it up on his books at what it would have been if he had taken straight line depreciation.

Senator SMATHERS. He recognizes you as an expert, and I think you are right.

Senator WILLIAMS. All right, a straight line. The bill provides that you can depreciate it in 10 years.

Mr. WARREN. That is right. But when he comes to the rollover, as you call it, then there is another gimmick there to protect the Government.

Of course, Senator, if you think $1 million is too much of an incentive, then if this is the wisdom of Congress, the Congress would say it ought not be that much. I can only support the principle.

Senator WILLIAMS. I am just trying to find out what could happen. We have established at the end of the first 7-year period he has $1 million. You say that it can be computed on what it would be at straight line. If it is straight line, 7 years, it would be $12\frac{2}{7}$ percent per year straight line and it would come out to zero seven times, or if you accelerated the depreciation you would come out to zero by changing over, anyway.

So any way you get to it, at the end of the 7 years, if that is the life of it, and that is what is set up, you are back to zero. You are back to the zero. The Under Secretary of the Treasury confirmed that. I think, as dean of the law school, you know that seven times $14\frac{2}{7}$ is a hundred percent on straight line.

Mr. WARREN. Yes.

Senator WILLIAMS. I would ask, Mr. Chairman, that we put section 1394(a)(1), sections 1 and (a), which sets up this plan that he can roll this over with his equity investment in such property less the amount of any credits that were allowed under section 41.

The equity amount is $1 million, less a $300,000 credit, which is $700,000, and that is what he sets it up at. He depreciates that the second 7 years, and he is in the 70 percent bracket, and he has a tax benefit of $490,000 at the end of the second 7 years.

Mr. WARREN. I am told that the witness who is to follow me has addressed himself particularly to these provisions and studied them very carefully. I have a feeling, Senator, that inasmuch as I have not, it would be wiser if you addressed that same question to him instead of to me.

Senator WILLIAMS. If I can be here, I will. It is so seldom that I get a chance to get educated a little bit by the dean of a law school that I would like to have your answers, too. I have such a tremendous respect for your knowledge in this field.

Now we have this property at the end of 14 years. It has been depreciated twice, down to zero. Under this bill, under section 1394(a), he could set it up again at the amount of $700,000, which is $1 million, less the $300,000.

Mr. WARREN. My understanding—and, again, I would prefer to let someone who studied it carefully answer you—I thought it was only one 7-year period and after that it was in 10-year periods.

I didn't come prepared, really, to discuss the intricate technical provisions.

Senator WILLIAMS. Under the bill, they were all 10-year periods. Under the proposal yesterday, that 10-year period was reduced to 7.

Mr. WARREN. I understood in talking with someone this morning that that only applied to one period. You got one bite.

Senator KENNEDY. That is correct.

Mr. WARREN. And after that it is 10 years.

Senator WILLIAMS. All right, with that slight change.

We will proceed on that premise and see how we come out.

Mr. WARREN. Don't forget every time you do this to put a capital gains tax on that fellow, will you?

Senator WILLIAMS. You pay $175,000 for each $700,000 you get. That isn't too bad.

Mr. WARREN. If they don't put it here, Senator, they will put it in oil and they will get percentage depletion and writeoffs for intangibles. There are a lot of other things that people can put money in, in the 70-percent bracket besides this. We don't have to list them. You know them. You list them all the time. We are not dealing with anything here that is uncommon to the 70-percent taxpayer.

Senator WILLIAMS. Perhaps not. Perhaps this may be an incentive for some of us to try to get to the 70. I would like to pursue this because I recognize your great knowledge in this field.

We have it set up and we agree that in the first 7 years he will recover——

Senator SMATHERS. Excuse me. We will have Mr. Mortimer Caplin, the former Commissioner of Internal Revenue, who has addressed himself to this particular problem and who is prepared to answer it.

I know, as the Senator from Delaware said, he has great respect for expertise on the part of everybody. You, Dean—and certainly he would recognize the Commissioner of Internal Revenue as one who is qualified, and who at this moment happens to be prepared, which the dean has stated he is not, on these particular specifics.

Rather than have the dean, who has stated over and over again that he is not prepared on the specifics of it, that he is merely supporting the concept, would the Senator not be willing to have us bring Mr. Caplin up at this time, when the dean has concluded, and we can go into all of these figures?

Senator WILLIAMS. I would agree except for one thing. I would hate very much for this hearing to be recessed and leave the impression that the members of this Finance Committee don't think that the dean of the law school has the qualifications to answer the questions. I disagree completely.

I recognize him as one of the best qualified witnesses we have had. He has just endorsed this principle. I shall also be interested in Mr. Caplin's opinion, because I would like to to get as much information as we can on this. I will proceed on the 10 years. I would like to get this correct.

You have endorsed this principle. After all, a principle doesn't mean anything if we don't understand the mechanics of how it works.

In the first 7-year period—and I will be very brief on this—this individual in the 70-percent bracket would have obtained $1 million in tax credit. Now we will proceed with the understanding that it is 10 years. This is a 7-year-old building. For the next 7 years he can set that up at $700,000 and depreciate that, we will say, for the next 10 years, which means he could get $490,000 tax benefit for the next 10 years, would he not? Do you agree with that?

Mr. WARREN. Yes. He has to pay a capital gains tax, though.

Senator WILLIAMS. Capital gains tax on $700,000, $175,000 for each $700,000 he gets. At the end of that period, the building is 17 years old. He can set it up again for $700,000 and depreciate it all over again, and by paying capital gains tax on the $700,000, and get another $490,000, could he not?

Mr. WARREN. That is right.

Senator WILLIAMS. He could do that over and over again for the life of the building; is that correct?

Mr. WARREN. That is right.

Senator WILLIAMS. Do you think that is a good proposal in the law? That is, in the tax law.

Mr. WARREN. I think that some incentive along this line has to come. Whether the figures are right is in your wisdom, not mine, because this is a congressional decision, a political decision. I can't make that because this is what has to come out of the legislative process.

Senator WILIAMS. I understand it is our responsibility.

Mr. WARREN. But the principle here, Senator, is right. That I won't back away from 1 inch. The principle of providing a tax incentive to private industry to move into the slums and to do something for human beings is right.

Senator WILLIAMS. I understand it is our responsibility. you said it. But to get back again to what I am speaking of, so that I will get it clear because as one member of the committee I value your recommendations so highly, you endorse the principle that he get this 30-percent tax credit and then be permitted to depreciate——

Mr. WARREN. It was 22½ yesterday. Now it has gone to 30. Maybe it ought to be 18. I am sure that you committees are going to have

studies made. You are going to have economic data to show what is needed. Industry is going to come in and tell you that they are prepared to do this if you have certain kinds of incentives.

The insurance companies, as you know the other day, said they were prepared to put up $1 billion. There is a lot of money that can flow into this. I hope and I know that you will be sure to review that economic data and to know that that percentage ought not to be 30 if that is too high, but that it ought to be 16 percent if that is right.

I don't know what it ought to be. But someone with a computer feeding into it what people will or will not do, will let you come up with an answer.

Senator WILLIAMS. I would still like to finish my question.

Senator SMATHERS. You are asking questions and then giving the answers and wanting him to agree.

Senator WILLIAMS. I haven't had the chance to ask the question yet.

My question: Under this bill, it proposes a 30-percent tax credit and then, in addition to this tax credit, the man that builds this property will be allowed to depreciate this same property at least five times during the life of the property.

Do you agree with that principle in our tax law?

Mr. WARREN. I agree with the principle. I am not sure that it may not be too generous. I agree fully with the principle, but the generosity is something else. I don't want to give private industry any more than you have to give. If you can do it with a 4-percent tax credit, then do it, as far as I am concerned. But if it takes 22, we will have to give 22. But this is a problem we must meet.

I am convinced in my own mind, at least, that you will never do it by the appropriation route. You will never do it by the appropriation route. It is going to have to be done so that business can move in and be assured of something.

When business people get a tax credit, they know they can depend on it. I don't agree with the Secretary that just spoke earlier. I have great respect for him, but when he says credits are never changed, they are changed. You changed the investment credit before and took it away from people, and then you put it back on. You can do the same thing here.

You want to get the slums moving, and the slums are getting worse. There are more people in the slums today than there were 6 months ago, and there will be more 6 months from now. There is no sign of improvement. In fact, there is every sign that it is going the other way.

Briefly, when you can harness this private sector of the economy through some means to step in and help, then we are going to be doing something. I am trying in the educational field, Senator, to educate a number from the slums. I have people who are given special scholarships to try to educate them, to provide leadership. But we have to do more than that. That is too long a process.

Senator WILLIAMS. I agree we need something in this area but we still get back to the point that we have a proposal that a man can recover 100 percent of his investment in the first 7 years and depreciate it five times thereafter in recovering it several more times.

It seems rather liberal.

Mr. WARREN. There are other provisions in the tax law that you permit to be there, that a fellow can make an investment and get it all

back in 1 year. He can get it all back in 1 year. And then he can continue to take deductions thereafter.

Senator WILLIAMS. Would you give us an example of that? I would like to have your support in that direction.

Mr. WARREN. Depletion.

Senator WILLIAMS. The oil depletion?

Mr. WARREN. Yes.

Senator WILLIAMS. You would endorse that being reduced?

Mr. WARREN. I think it ought to be studied, yes. I think all of these percentages ought to be studied. I think they ought to be under continuous study.

Senator WILLIAMS. I welcome your support. I have been trying for years to get more than a study, but to get action.

Mr. WARREN. You have had my support for a long time in that.

Senator SMATHERS. Now you all agree.

Senator Bennett.

Senator BENNETT. The bill recommendations, as far as I know for the first time, that we move into a situation where we allow an overdeduction of an out-of-pocket cash operating expense, in other words, 125-percent deduction for wages, based on location of a business.

Does that disturb you?

Mr. WARREN. No, it doesn't disturb me one bit. It wouldn't disturb me, Senator, if you decided that you wanted to subsidize that employee by giving 25 percent more than what the employer was paying him.

Frankly, we are dealing with people who have very few skills. If you don't do something for them, they are not going to be hired.

Senator BENNETT. This doesn't limit it, as I understand it, to people who have few skills. It limits it to people who live in an area.

Mr. WARREN. And have been unemployed, and the people who are unemployed are the people who don't have the skills. Anybody with skills today can have a job. I don't care what color he is.

Senator BENNETT. How long do you have to be unemployed to qualify as unemployed?

Mr. WARREN. I forget the exact detail.

Senator BENNETT. So do I.

Since my little visit with the former Secretary, it seems to me it is a beautiful setup. I operate a business in city A, and here is a chance to get 125-percent deduction of my salaries in city B, so I open a branch in city B and let it run along for a few months. Then I gradually transfer all of the manufacturing operations from city A to city B as fast as I can get Government-trained employees, employees trained with Government money, to be prepared to operate my various functions. Pretty soon I discover that I didn't need city A any more. I may keep it for a headquarters office or something.

You have a setup under which I can get the advantage of 125-percent deduction of out-of-pocket expenses. It is a beautiful setup.

Mr. WARREN. Senator, I would like to answer that on two levels. First, I don't think anything would be more wonderful than it happened what you say happened because you are training people and giving them skills that they did not previously have, and the people you are leaving behind in city A have skills and they will get jobs. They will get jobs with another person because there is still business in the other city.

All of these people that we now have brought up with skills, who are wage earners now, are going to be paying taxes. They are not going to be taking welfare payments. But I am going to go further with you, Senator, if I may. I am going to say to you that business doesn't move this way.

There are a few who will do what you say, but a very few. Business is determined on other bases, rather than by tax laws. We have done enough investigation in the tax field, empirical studies, to know that businesses don't move like you seem to think they do.

Senator BENNETT. I made the point that they could move and there are those that do.

Mr. WARREN. There are a few that move to Puerto Rico, yes. There are a few. But you haven't seen all of American industry go down to Puerto Rico because there is a tax incentive in Puerto Rico, have you?

Senator BENNETT. No. But the opportunity for American industry to get a tax deduction or a tax relief of 25 percent of its out-of-pocket wage cost has not been available.

You are referring to going to Puerto Rico, but the proposal would apply to moves to very attractive cities within the States, provided you locate your plant within a designated geographical area within the city.

Mr. WARREN. Did you ever think about the secretaries who have to work in that factory? Would they go into the ghetto? You can lose more money by moving a business from here to there than you realize, I am afraid.

Senator BENNETT. I have been in business and you haven't.

Mr. WARREN. I have, sir.

Senator BENNETT. Have you?

Mr. WARREN. Yes, sir. I am chairman of the board of a company right now.

Senator BENNETT. I have been an operating manager of a business that has branches and which has had to move those branches.

Mr. WARREN. We have moved them, too, but we have moved them for business reasons and not for tax reasons.

Senator BENNETT. We are reaching the point in this country where tax reasons are becoming important. The whole function of this bill is to make tax reasons more important than any other reasons in order to solve a particular problem.

Mr. WARREN. That is your interpretation of it, sir, and I respect it. But that is not my interpretation of it. We can differ. Of course, that is the fun we have in a law school class. We have students who differ with us violently, and we try to get differences. So I have achieved my result today with you. You and I disagree, but I think this is a wonderful thing. I endorse it 100 percent.

Senator BENNETT. It is interesting, the extent to which we are gradually widening or breaking down the theory that cost is cost, and you are only allowed to recover your cost.

That is all.

Senator SMATHERS. Senator Kennedy.

Senator KENNEDY. Thank you very much.

Senator SMATHERS. Our next witness is the former Commissioner of Internal Revenue, Mortimer Caplin.

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STATEMENT OF MORTIMER CAPLIN, CAPLIN & DRYSDALE, WASHINGTON, D.C., FORMER COMMISSIONER OF THE INTERNAL REVENUE SERVICE; ACCOMPANIED BY ROBERT KLAYMAN

Senator SMATHERS. In view of the fact that there is a point at issue, of interest to the Senator from Delaware and others, would you start off with your supplemental statement?

Mr. CAPLIN. I will be very happy to, Mr. Chairman. I do appreciate being back before this committee again, although in a different role. My experiences here have always been very pleasant and the committee has always received my testimony with great understanding and cooperation.

Last night, Senator Kennedy asked me to glance over a part of yesterday's transcript of the hearings before this committee. My attention was particularly drawn to the colloquy between Senator Williams and Treasury officials involving three aspects of the proposed bill.

The first was the provision stating that after the building is fully depreciated the owner can elect to treat it as having been sold to himself at a specified figure. He must recognize capital gain on this assumed resale, and he is not entitled to any further tax credits. However, he is permitted to redepreciate the reduced basis of the building.

Senator SMATHERS. Can I ask you a question on this point? You say however, he is able to redepreciate the building. You added something.

Mr. CAPLIN. The reduced basis of the building. In being permitted to roll this over, you must take into account two factors: one, an allocation to the land, which doesn't give you any depreciation benefits; and secondly, Senator Kennedy's bill requires that the amount that can be redepreciated must be reduced by a certain normal depreciation.

I think that has been a basic misunderstanding throughout all the colloquies on this point.

Senator WILLIAMS. What section of the bill are you referring to?

Mr. CAPLIN. I don't have that in particular.

Senator WILLIAMS. Can the committee staff get him a copy of the bill? I would like you to cite the reference.

Mr. CAPLIN. I believe these provisions are in the amendments that Senator Kennedy offered at the beginning of yesterday's hearing.

Senator WILLIAMS. I would suggest that we keep our testimony to the bill. The bill, itself, does not provide that. Is that true?

Mr. CAPLIN. As originally drafted.

Senator WILLIAMS. So you are talking now about prospective changes after these loopholes were discovered. The point I am making is, I don't question that it is going to be changed, I am sure of that. The bill as it was drafted, and your original statement as it was prepared to deliver to this committee, did not comment on that factor at all, but endorsed this principle, and the rollover.

I appreciate your remarks on the proposed changes, but let's separate your remarks about the prospective changes from what is in the bill.

Mr. CAPLIN. I did assume that Senator Kennedy at the outset of the hearing made an amendment.

Senator KENNEDY. I did.

Senator SMATHERS. To get the record straight, and I think we are straining a little bit, the record will reflect that when the hearing

started Senator Kennedy already had these amendments prepared and said that he wanted the committee to consider them. He felt they were good amendments. He felt that the bill should have been changed before he had completed his testimony, before this matter was even developed in these committee hearings, because he felt there were weaknesses. So we all understand the legislative process.

What we are trying to get at now is: Is the Senator from Delaware correct? Of course, if so, we will amend it. Under the rules of the Senate the Senator can go to the floor and ask permission to amend his bill at any time.

Senator WILLIAMS. He can amend it here.

Senator SMATHERS. He can amend it here. We must consider the bill as amended. He asked that it be amended. Under the amended bill can a man accomplish this windfall, as we will call it for lack of a better term, which has been referred to by the Senator from Delaware.

That is what we are trying to find. There is nobody on this committee, certainly not Senator Kennedy, certainly not the Senator from Delaware, certainly not the Senator from Florida, who wants anybody to have a great loophole through which he can march great wagonloads of money. We are not trying to do that.

We are trying to answer the problems of the slums, intelligently and reasonably.

Mr. CAPLIN. Senator, I have a very brief supplemental statement. If you will permit me to go through that, I will be delighted to answer any questions.

Senator SMATHERS. Go through it and then we will question you.

Mr. CAPLIN. The second provision that came into play is the rollover provision which forgives the capital gains tax at the end of the minimum 7- to 10-year holding period if 100 percent of the proceeds are reinvested in new construction of another poverty housing project.

The third provision is that which granted new investment credits and accelerated depreciation to approved purchasers from the original builder.

The purposes of these three provisions are clear:

The first is aimed at encouraging builders to continue to hold the building, thus retaining stability of management and stability of ownership. To achieve this, an effort is made to maintain a rate of return to the owner which will justify his retention of the project.

Senator KENNEDY. I would hope that you would emphasize that. We keep talking about the fact that this is some sinister scheme in having people continue owning the building. The reason for these provisions is to try to give some stability in the ghetto and have some incentive for the individual owner to keep ownership of the building and not to give it away or get rid of it.

Mr. CAPLIN. Senator, I have reviewed the various provisions as a package and tried to isolate the underlying goals that are inherent in the legislation.

I think the package as a whole is aimed at providing certain rates of return which will attract capital; to induce investors to retain the building, not to go out and sell after they have gotten an advantage; and, thirdly, to set up a machinery which will encourage the tenants themselves ultimately to purchase the project.

Senator KENNEDY. We have talked about the figures so much I think we have missed the point of what the objection sought is.

Mr. CAPLIN. We are watching the trees too closely.

Senator KENNEDY. That is why I was delighted you made the point.

Mr. CAPLIN. On the second point or rollover provision the bill seeks to induce the original builder to reinvest the proceeds of sale of the initial building in new construction of low-income housing.

The third, providing new investment credits and accelerated depreciation for approved purchasers, attempts to maintain a reasonable resale value for the project so that the original builder will not be locked in. This is accomplished by providing adequate rate of return on investment by new purchasers.

The objective of all three of these provisions seem to be desirable. Any questions relate to the sufficiency or insufficiency of the particular incentives.

In the colloquy referred to above, a number of misunderstandings seemed to arise. For one thing, account was not taken of the various amendments which Senator Kennedy noted at the outset of these hearings. To help clarify this record, it might be helpful if I commented briefly on the two examples used.

The first example dealt with the rules permitting the original builder to regard the building as "resold" to himself after the building has been fully depreciated.

The dollar figures used in this example did not reflect certain important factors, each of which reduces the tax benefits to the builder.

First, depreciation was computed on the basis of the total investment in the project. No allocation of purchase price was made to the land. This had the effect of overstating the amount of depreciation, not only during the original period of ownership but during each successive turnover period.

Senator WILLIAMS. Mr. Caplin, to keep the record straight, the assumption that we were dealing with in the hypothetical case was that the $1 million investment was over and beyond the price of the land involved.

We recognized that you cannot depreciate land. But the $1 million figure in the hypothetical case was on the assumution that the $1 million figure did not include any land at all.

Mr. CAPLIN. I didn't have that understanding. I appreciate your comment.

Senator WILLIAMS. That is in the record.

Mr. CAPLIN. The land cost would be far from insignificant.

Senator WILLIAMS. There is no question about that. But the land cost is not a depreciable factor. It was recognized. Therefore, it was removed from the colloquy which we had on these cases.

Mr. CAPLIN. I am glad to hear that.

The example also assumed a turnover and redepreciation every 7 years. Actually, while the first turnover is permitted after 7 years, each of the remaining four turnovers, and there can be only four more, are allowed under the bill after the expiration of 10 years.

Senator WILLIAMS. If I might interject there, it is not clear just what was meant. The bill did provide 10 years. That was the assumption that we started with. The 7-year factor came in as a result of Senator Ken-

nedy's testimony. If he intended just one 7-year term, it would still leave the principle the same. But if he meant to revert to the bill and just change it one time, you would be correct, then it would be 10 years the second time.

Mr. CAPLIN. It saves an extra turnover by using 10 instead of 7.

Senator WILLIAMS. But the principle is still there.

Mr. CAPLIN. Third, the dollar benefits to the owner were not reduced by the capital gains tax which would be payable on each turnover. Every time the owner elects to use this provision, he has to pay a capital gains tax. This might run $40,000, $50,000, or $60,000 on each turnover.

Fourth, in computing the tax benefits from depreciation under the bill on each turnover, the example used a dollar amount based on all of the depreciation arising from the property. No adjustment was made for normal depreciation which would be allowable in all events regardless of the adoption of the bill.

Fifth, on each turnover transaction, the example assumed that the basis for depreciation remained constant. In fact, the bill requires that the basis be continuously reduced by straight line depreciation adjustments. So each time there is a turnover there is a smaller basis. The owner doesn't get full depreciation. Rather, he must eliminate 10 years depreciation in determining the new basis for depreciation.

Senator WILLIAMS. At that point, would you cite that reference in the bill?

Mr. CAPLIN. This is one of the amendments that Senator Kennedy announced at the beginning of the hearings.

Senator WILLIAMS. This is one of the amendments introduced in the Congressional Record yesterday after our discussion here in the Senate.

Senator KENNEDY. Senator, I brought it up in my testimony during the course of the morning, when you were not present.

Senator WILLIAMS. I was present when you testified.

Senator KENNEDY. I brought it up in that period of time and said I was offering the amendments, because I said people had been studying the bills since they were printed and they had made various recommendations, some of which I was accepting.

Senator WILLIAMS. But you haven't submitted them yet. I will ask that they also be printed and made a part of this record.

(S. 2100, amended, to reflect changes suggested by Senator Robert F. Kennedy, appears at p. 421.)

Senator KENNEDY. That is fine. But you should not take into consideration some of the amendments and then refuse to recognize some of the others.

Mr. CAPLIN. Senator, I have one more page of testimony and then I will be happy to come back.

When all of the foregoing adjustments are taken into account in example 1, the tax benefits are reduced substantially.

The second example dealt with the reinvestment or rollover provisions, and the rules permitting new investment credits and accelerated depreciation for approved purchasers from the original builder.

Concern was indicated over a situation of two brothers exchanging properties with each other.

Senator SMATHERS. Just a second, Mr. Commissioner.

I am very anxious that the Senator from Delaware hear this.

Why don't you start at the top of page 5, the second example?

Mr. CAPLIN. The second example dealt with the reinvestment or roll-over provisions and the rules permitting new investment credits and accelerated depreciation for approved purchasers from the original builder.

I believe concern was indicated over two brothers exchanging properties with each other and trading, so to speak, on the available tax benefits.

As Senator Kennedy has previously indicated, the rollover rules are intended to apply only to new construction. Hence, a capital gains tax would be imposed on an exchange of property previously used.

Senator WILLIAMS. Could I interrupt there? I don't question as to what the intent was. You came down here to testify on the bill.

What does the bill provide? That is what we started with. Does the bill provide for that? Or is that something that may be taken care of in an amendment?

Mr. CAPLIN. This is part of the amendment that Senator Kennedy came in with in the morning.

Senator WILLIAMS. I want it to be understood that I recognize in drafting a bill you can make an error, and you will want to change it. But the point I am trying to make or establish is that I questioned the Under Secretary of the Treasury as to how the bill would be applied as it was introduced. There seems to be developing a considerable confusion that perhaps we were all wet and didn't know what we were talking about because they intended something else.

I don't question the intent, not for a moment. But the point I am making is that the bill, as it was introduced, as you originally planned to testify in your original statement, which was prepared for delivery to this committee, not your supplemental statement, so supported that bill.

The bill, as it was originally introduced, did provide the benefits as were outlined in the colloquy yesterday, with the exception that there is a question about the capital gains provision on the rollover provision. Treasury said they could rule either way, but they were sure the intent was there.

Mr. CAPLIN. Senator, again, from my experience with this great committee, I know that these discussions are only in the best of faith to get constructive legislation, and I think it is healthy that we consider these matters and try to resolve them. I think the important thing is to get to the basic principles.

Senator WILLIAMS. That is right.

Mr. CAPLIN. I have a few more sentences I would like to cover because then I touch on that fundamental issue.

In other words, it is possible that the bill doesn't go far enough in dealing with related parties, but this can certainly be adjusted easily by the committee.

What is important now—and I think this is the crux of the matter—are the basic concepts embodied in the bill. They are creative and have the vitality of fresh, imaginative thinking. If the committee decides to move in this new direction, the various incentives in the bill can be modified or shaped to achieve its specific goals.

Once the policy decision is made by the committee, any technical problems which might arise can easily be solved with the aid of the able staffs of this committee as well as the Treasury Department.

I think we would all agree on the capability of these two groups.

Senator SMATHERS. I wonder if at this point we might have a resolution of this problem by stating in general terms something like this—and I hope it will be satisfactory to the Senator from Delaware—that the Senator from Delaware was not incorrect in his interpretation of the illustration which he wanted to use as the bill was originally drafted.

However, at the time that Senator Kennedy made his presentation—and he was the first witness yesterday—there was a recognition that there may have been an overgenerous statement of what could be done in the legislation and he and his staff corrected that even before the hearings actually got underway.

But at that point, Senator Williams was not acquainted with those amendments. So, as is usually the case, there is some adjustment on both sides.

Senator Kennedy has stated—and certainly Senator Williams would agree with him—that nobody connected with this is trying to create a loophole through which you can drive great big trucks.

What we are trying to do is meet the ghetto problem. There has never been a bill introduced before this committee—I have been on this committee for 16 years—that didn't have to be amended substantially.

Senator Williams pointed out an area which he felt should be tightened up. I am certain the committee would agree with him.

As a matter of fact, the author of the bill recognized it at about the same time Senator Williams did, and thereby offered amendments.

Could we at this point say that from this point on the committee will have to work its will, and Senator Williams was generally correct and Senator Kennedy recognized it.

Let's go on and say it is already amended because the author of a bill has the right under the rules to amend it. Let's at this point say that prior to the hearing Senator Williams was correct, substantially correct. When we got started, however, the bill was changed.

At this point, what the Commissioner is saying and what Senator Kennedy is saying is correct.

Would that be satisfactory, John?

Senator WILLIAMS. I am not going to quarrel with this. The record is clear. I don't question the intent of the sponsors of this legislation and I never have. S. 2100 was the bill upon which we were going to hold hearings. That is the bill that we were analyzing and upon which we were seeking testimony.

Senator Kennedy, when he made his statement, did make some changes in his bill. One of the changes, one of the specific changes, was he reduced the holding period from 10 to 7 years, which made it more liberal.

The second major change was changing it from 22-percent tax credit to 30 percent, to make it more liberal. Those were the ones that had emphasis placed upon them.

Later, the Secretary of the Treasury, the Under Secretary, Mr. Barr, was testifying, and we pointed out the actual mechanics of how it would

operate. We were told it was not intended that it operate that way. In fact, during the colloquy, we were first told that it did not operate that way.

But finally the Treasury Department insisted that it did. It was accepted as a fact that it did. The amendments were offered, and the amendments will be considered. But let's get the sequence correct.

It is immaterial here, but I am not going to leave in this record that I was doing a lot of shadow boxing here on some loophole that had already been recognized and corrected because that is not the case.

Senator SMATHERS. On that particular point, John——

Senator WILLIAMS. It may have been in his mind; I don't question that. Maybe he intended to do it by amendments.

Senator SMATHERS. The amendments were prepared and introduced as I understand it, but Senator Williams had no way of knowing it; let's put it that way. He was proceeding on what he knew to be part of the record at that point.

However, Senator Kennedy had previously had the amendments printed. He was doing the proper thing in having them introduced in the Senate. But there was a gap.

I think that we could go on and talk about the principal virtues of the bill and leave this here: Senator Williams is right in his interpretation and Senator Kennedy is right in his interpretation——

Mr. CAPLAN. Might I suggest that this communication process is very difficult in the tax field. There are so many elements involved.

I know from my own experience in the Revenue Service we came forward with new proposals right before hearings. After further study, we often announced new changes. This is not meant as any gamesmanship. It is just the natural process of a very difficult job which ultimately you gentlemen will have to face.

Senator WILLIAMS. That is correct, and I recognize that. But the record shows we started with testimony here around 10 o'clock. Senator Kennedy was the first witness. The amendments were not introduced until sometime in the afternoon. I don't question for a moment that he had those amendments in his pocket.

Senator KENNEDY. Senator, I cannot believe that you are going to prolong this any further. I mentioned it when I testified, and we brought the amendments in. In any case——

Senator WILLIAMS. Where is it in your testimony that you said you were going to correct this particular provision and eliminate it, other than that you were going to take the 22 percent, extend it to 30 percent, and cut the 10-year period down to 7 years? Where in your testimony did you say you were going to eliminate this?

Senator KENNEDY. Let me say it is in the testimony. In any case, if we are going to talk about the bill as you suggested, we should be talking about the bill that is now before us. We are now at a point where I think we are in agreement about the problems of communication.

Can we now go on and talk about the bill? Would not that be helpful?

Senator WILLIAMS. I think it would be helpful.

Senator KENNEDY. We can find out whether Commissioner Caplin approves of the bill.

Senator SMATHERS. John, if you find any other loopholes in it, bring them out.

Senator KENNEDY. I hope you tell me.

Senator SMATHERS. In the legislative process, we have changed many bills on your recommendation and others' recommendations.

Senator WILLIAMS. We can't make suggestions until we get the amendments. They will be before us this morning if introduced yesterday afternoon.

Senator SMATHERS. I am sure you will offer amendments to this bill, as I am sure I will, and there has never been anything written so perfectly that has been presented to this committee since I have been here.

Mr. CAPLIN. I will be glad to address myself to the broader aspects which I think are important.

Senator SMATHERS. I want Senator Williams to be satisfied that we are not trying to say he was off on a wild goose chase. At that point, he had found an area which needed to be closed. That has already been closed.

Senator WILLIAMS. I know I am not on a wild goose chase because I shot the goose yesterday morning.

Mr. CAPLIN. Senator, you have made a major contribution over the years in seeing that our tax laws are vigorously enforced and that we don't have leakage. I know you will continue this and I think it is a very important contribution.

Senator WILLIAMS. I will conclude this very shortly, because it is immaterial to the question before us. I am just trying to get the record straight. That is exactly the way it happened.

Senator KENNEDY. Could I say, Senator, the amendment was submitted to the clerk at the time of my testimony and I gather probably printed up.

Senator WILLIAMS. But you didn't mention it in your testimony.

Senator KENNEDY. Yes, I did.

Senator WILLIAMS. Perhaps I missed it. I would like to refer to it. Where is it in your testimony? I think it would be very important. That would clear it up very quickly.

Senator SMATHERS. I think it is clear. I think everybody has made a contribution, John. Let's go on with the purposes of the bill.

Senator WILLIAMS. I am going to proceed. I understand this, I think, perhaps too well.

You will agree, Mr. Caplin, the bill as originally introduced did provide these windfalls as they were outlined in the colloquy, with this exception: that the capital gains provision on the rollover—it could be interpreted that the capital gains could be applicable.

I am told by Treasury that they would need clarification to make that clear. But nevertheless, proceeding on that premise, other than that——

Mr. CAPLIN. Senator, I would hesitate characterizing it as a windfall. I think any tax benefit in the law can be argued to be a windfall.

Senator WILLIAMS. I am speaking of mechanics, of the mathematics.

Mr. CAPLIN. It was intended to provide a favorable rate of return. Essentially, if these builders of low-rent housing would make, without tax benefits, a 3-percent rate of return, they would just not invest private dollars in the slum areas.

So the package was "priced," if you will, to provide the incentives which would bring the 3 percent up to 12 percent, as I understand it.

If 12 percent is right—and making this type of determination comes up with almost every type of special tax provision that the committee considers—then I think you can devise a package which will reach that result. If 12 percent is too low or too high, in your judgment, the package can be modified.

Senator WILLIAMS. I just wanted to get the mechanics of the bill clear, on this new provision on the rollover, because the rollover is still in the plan. The first rollover is at 7 years, and after that it will be 10 years, each 10 years thereafter. The normal life of one of these apartment buildings would be 35 years, wouldn't it, to be conservative?

Mr. CAPLIN. Yes.

Senator WILLIAMS. What would be the normal depreciation?

Mr. CAPLIN. I think heavy construction of this sort might even have a life of 50 years. I believe the underlying assumption in the bill is 50 years.

Senator WILLIAMS. Let's call it 40 years for mathematical purposes. Even under this proposal, the revised proposal now, an individual—even under the revised proposal—as I understand it, would put in a $1 million investment, and we will assume it is his money for the sake of an argument, and this individual is in the 70-percent bracket. Whether he files it as a separate corporate entity or not, he gets the benefit of it.

We will proceed on that premise.

Under this revised proposal as it is now before us, he would get $300,000 tax credit, would he not?

Mr. CAPLIN. Yes, sir.

Senator WILLIAMS. He could depreciate the full $1 million in 7 years; is that correct?

Mr. CAPLIN. Yes, sir.

Senator WILLIAMS. And that is worth $700,000 tax benefit to an individual who is comfortably in the 70-percent bracket; is it not?

Mr. CAPLIN. Yes.

Senator WILLIAMS. That would mean that under this revised proposal, at the end of 7 years he would have recovered in tax benefits $1 million on a building that cost $1 million; is that not correct? We disregarded the land in this. We are speaking of the building. Is that correct?

Mr. CAPLIN. Yes; that is correct; but, of course, if he made this investment without the bill he would have normal depreciation anyway.

Senator WILLIAMS. I realize that. I am speaking of the mechanics of the bill. He would have $1 million recovered.

Now, he could set up on his books at $700,000 for depreciation purposes in the second 7-year period?

Mr. CAPLIN. In the second period, which is 10 years, he must deduct what would be normal straight line depreciation if he did not have any benefits under this bill.

Senator WILLIAMS. Under what section of the bill does he have to deduct that? That is under one of the amendments; is it not?

Mr. CAPLIN. Yes.

Senator WILLIAMS. That is under the amendment?

Mr. CAPLIN. Yes; that he must deduct that from the depreciable basis.

Senator WILLIAMS. Under the bill he did not have to deduct that?

Mr. CAPLIN. That is right.

Senator WILLIAMS. This is one of these later amendments.

What would be the figure that he would have to deduct for depreciation? The bill proposes this would be termed as a sale to himself, as though it were a sale, and he would pay capital gains. Proceeding on the premise that this is treated as a sale to yourself, and treated on capital gains, how would you set it up on the books?

Mr. CAPLIN. You would set it up on the books at some figure less than the original $1 million.

Senator WILLIAMS. For a hypothetical case, figure it out at $600,000, although it may be entirely out of the way. Let's use it for a moment.

Would he get a capital loss from his original $1 million investment or would he pay the capital gains on the full $600,000?

Mr. CAPLIN. That is right. He reports capital gains under a special method in the bill.

Senator WILLIAMS. That is on the premise that he had a zero cost on that building.

Mr. CAPLIN. That is right.

Senator WILLIAMS. But using that as a figure, I expect $500,000 would be closer to the correct figure than $600,000, that $500,000 would be worth a tax benefit of $350,000 at least for the next 10 years; would it not?

Mr. CAPLIN. Yes. In other words, the remaining basis on your assumed figures would be deductible in the 70-percent bracket.

Senator WILLIAMS. This building, we will say, is 47 years, the life of it, and he would roll that over four times, would he not?

Mr. CAPLIN. Except that each time that base figure gets reduced further and further. You had it at $500,000 on your assumption and it will come down to something less on the second rollover because you have to take 10 more years' depreciation. It keeps on getting reduced.

Senator WILLIAMS. But his capital gains likewise is lower.

Mr. CAPLIN. He still is paying capital gains tax every time he rolls it over.

Senator WILLIAMS. But he would only pay the capital gains on the reduced basis.

Mr. CAPLIN. On the reduced amount; that is right. It reduces down to zero, but he keeps on paying capital gains tax, and getting less depreciation.

Senator WILLIAMS. But it boils down to the fact that, in effect, you are depreciating the same property without ever changing ownership four to five times; is that not correct?

Mr. CAPLIN. It does have the effect of getting more than your original investment in the property as a tax deduction which, of course, is inherent in the investment credit as it exists today.

Senator WILLIAMS. But you only get it once there.

Mr. CAPLIN. You get your investment credit and then your depreciation.

Senator WILLIAMS. But in this instance, you would get the four to five rollovers. In other words, you could depreciate the same prop-

erty over and over, four or five times, during this time. I think we are agreed on that.

Mr. CAPLIN. We are agreed on the principle.

Senator WILLIAMS. Even this modified version will still do it.

As the former Commissioner of Internal Revenue, do you know of any instance where this has ever been done prior to this; that is, where we would allow the same owner of a building to raise his base without a sale, without any expenditures, for depreciation purposes in order to give him more depreciation? Maybe it is good law, but is this a precedent?

Mr. CAPLIN. Well, of course, today there is extremely liberal depreciation in the real estate field. Some people call it a major tax haven that we still have in the code, because of the liberal depreciation the owner has on normal commercial investment.

After buildings have been heavily depreciated, the law, subject to certain adjustments made recently, permits the sale of those buildings at capital gains rates and then permits a new investor to go through the entire pattern once again, and then again and again, with no four-time limitation, but maybe going on for 10 and 15 times.

You merely have to change the identity a little bit, and sometimes the relationship between the original owner and the later purchasers is often intertwined.

So we do have this principle and it has been used. Of course, there has been no congressional reaction other than the modest recapture clauses which now apply.

Senator WILLIAMS. I agree that this is an area where they have an extremely liberal depreciation benefit. But my question is that this goes beyond them and makes them more liberal than the existing liberal law. Is that not true?

Mr. CAPLIN. Yes. The question, of course, is How much of a price is the fisc willing to pay to get housing in urban poverty areas?

Senator WILLIAMS. I am not debating the merits or demerits of it. I am speaking of the principle. But this does do that.

Mr. CAPLIN. Yes. I think Dean Warren made reference to natural resources where you have allowances over and above investment.

Senator WILLIAMS. I never could get your enthusiastic support when you were in to help change that depletion allowance, and I can't get too much support from your successors. But I agree with you as two who are not connected with the Treasury Department that that, too, is a tax haven.

Mr. CAPLIN. Commissioners merely administer the law, Senator. They don't make law. They must follow the statute as Congress enacts it.

Senator WILLIAMS. And as interpreted by the Treasury Department.

Mr. CAPLIN. Subject to interpretation; yes, sir.

Senator WILLIAMS. Therefore, without arguing the issue, we all had a perfect right to accept the interpretation of the Treasury Department, as being authoritative, yesterday.

Mr. CAPLIN. Of course, they have their bounds and limitations. The joint committee certainly keeps an eye on the activities of the Treasury.

Senator SMATHERS. Mr. Commissioner, it has been a fact, has it not, that up to this point private business has not been willing to go into the ghetto areas and build houses for the poor?

Mr. CAPLIN. This is the major problem facing the Nation.

Senator SMATHERS. Is the reason that they have not done this because there apparently has not been sufficient financial incentive for them to do it?

Mr. CAPLIN. That is right, sir. I might add that I happened to be appointed by the Federal court in New York as trustee in the reorganization of Webb & Knapp, the famous Zeckendorf enterprise. Efforts were made in the early stages of Webb & Knapp to get them interested in construction in ghetto areas. Webb & Knapp is in dire financial condition today, but at one time was one of the great real estate ventures of the Nation. While they did move into some of the poverty areas, they were not able to take a major role.

Senator SMATHERS. Because there is not sufficient profitability.

Mr. CAPLIN. No profitability. Business must function for profit.

Senator SMATHERS. After the bill is amended, and assuming everything Senator Williams has said, do you think there will be enough incentive to private business to go into the slum areas and build houses? That is the purpose of the bill.

Is it your judgment, now that you have had your business experience, that this will be sufficient to attract businessmen? If it isn't, we may have to make it more generous.

Mr. CAPLIN. This is a judgment factor, Senator. I think the expressions of the people who are sophisticated in this industry are paramount. I will say, as a practicing attorney, that in talking to real estate clients and talking to businessmen, they find this one of the most imaginative, creative pieces of legislation that they have encountered in this area, and they feel that there is room in which they could make a profit and make a contribution.

I think that would be the ideal, to use the resources of our free enterprise system.

Senator WILLIAMS. I will not delay this any further. I think you have described it. The man who created S. 2100 and this idea had a great imagination.

Mr. CAPLIN. And a constructive one, sir.

Senator WILLIAMS. I will ask one more question.

You have examined the amendments. Do they correct, and in what manner, the fact of the interchange of ownership, where you build a building, as pointed out yesterday in the same hypothetical situation, and I build a building, and at the end of the 7 years I buy your building and you buy my building?

The Treasury Department said that under the measure as introduced, we could each collect the $300,000 tax credit, we could each depreciate the new purchase. In this instance you would revert to your $1 million cost factor. You could depreciate your full $1 million the second time around, which meant during the next 10 years we would get $1 million in tax credit.

A provision of the bill provides that if it is reinvested in a similar property, it would be tax exempt. Therefore, there would be no capital gains, although I understand it is going to be amended to provide that it must be reinvested in newly constructed property. But the bill did not so provide.

You will admit that this tax credit, will you not, was available under the original draft and is it corrected under the revised draft? That is the point I am asking.

Mr. CAPLIN. As I understood, the original example you were concerned about involved related parties.

Senator WILLIAMS. Either related or nonrelated.

Mr. CAPLIN. For one thing, only an approved purchaser would qualify. The Secretary of HUD would be able to exercise some control in this connection.

Senator WILLIAMS. I understand that.

Mr. CAPLIN. Beyond that, there are constructive ownership rules which cure this problem in part in dealings between related parties. I think these constructive ownership rules might be reexamined and perhaps expanded to take care of the types of cases you are referring to.

On the investment credit, from my preliminary readings of the bill, I believe the investment credit is given again when you have a new, qualified purchaser coming in. This prevents the original owner from being locked in, so that if he does want to get out of the situation he has something to sell which will provide an adequate rate of return to the new purchaser.

Senator WILLIAMS. And if he keeps it the full 7- or 10-year period, whatever is determined, the original investor can keep his tax credit. There is no recapture.

Mr. CAPLIN. That is right.

Senator WILLIAMS. It is your understanding that the second investor could get another investment credit?

Mr. CAPLIN. That is right, based upon his purchase price.

Senator WILLIAMS. And is it your understanding that he can still get that investment credit under the revised proposal?

Mr. CAPLIN. That is my understanding.

Senator WILLIAMS. That he can still get it?

Mr. CAPLIN. Yes, sir.

Senator WILLIAMS. Then we haven't corrected it at all.

Mr. CAPLIN. I think you might want to reexamine the bill to find out whether or not this credit is sufficient to induce a purchaser to come in and continue to run this building. We certainly wouldn't want the project abandoned.

Senator WILLIAMS. I realize that.

Mr. CAPLIN. It is hard to get an investor to come in on a 3-percent rate of return. The entire pattern is to say to this man, "We will give you a 12-percent rate of return if you will take on the project."

Senator WILLIAMS. You will agree with me that even under the revised version or the original, that you wouldn't want to leave in our tax laws or in this bill the mechanics whereby, by a half dozen changes of this particular property over the life of it, you could collect—well, say we transfer it five times during the life of it, and collect $1½ million in tax credits on a building that only cost $1 million in the first place, and which has been depreciated five times or 10 times. You don't want that, do you?

Mr. CAPLIN. In the first place, the value of the building has gone down because the original owner has held it for 7 or 10 years.

Senator WILLIAMS. And the status of the taxpayer is going down as he underwrites this.

Mr. CAPLIN. The purchaser is putting in fresh dollars. He says, "I am paying you $700,000 instead of $1 million."

Senator WILLIAMS. I am speaking of sale.

Mr. CAPLIN. That is right, on sales. The outside man is paying $700,000 to buy the building because it is 10 years old. Maybe he will pay less than that.

Senator WILLIAMS. Maybe he will pay $1 million.

Mr. CAPLIN. Conceivably. But with this sort of rental, it is doubtful.

Senator WILLIAMS. I realize that, but hypothetically he could pay $1 million.

Senator SMATHERS. Under present law you can depreciate a building and then sell it to another individual, who might be your brother, and he gets depreciation anyway. Under the present law we have the same thing.

The only difference is that we are trying to make it more attractive to build housing for slum areas. The only way we know how to do it is to increase the benefits to those who would buy it, keep it up and operate it. It is just a matter of degree.

Senator WILLIAMS. It is a matter of degree, but that is quite a degree. Under existing law when you transfer, you just transfer normal depreciation. If the original owner is using accelerated depreciation, he gets 200 percent on a declining balance, but the new owner and each subsequent owner can only get 150 percent. So he gets less each time. So there is not the advantage under existing law.

Nor does the new owner each time get an investment credit of 30 percent. Maybe that is good.

Mr. CAPLIN. You don't have the locked-in requirement that the owner must hold it for 7 or 10 years. He has complete freedom of action.

Senator WILLIAMS. That is correct. I am glad I asked you the question because I did not realize that the revised version likewise carried over this investment credit each time this property would change hands in subsequent years.

It may be that the sponsors would want to consider a further revision. It would be mathematically possible—and maybe it would not happen. But we write these tax laws on the basis of what could mathematically be possible.

We in Congress have to proceed on the premise that those who are working in this field are going to hire the outstanding tax authorities, such as yourself, to advise them.

I have great respect for your advice.

I am sure that they will be aware of this, of what can happen. Therefore, they will take advantage. So then it is theoretically possible even under the revised proposal, forgetting depreciation for a moment, which you can't forget when you depreciate a building five times, it is theoretically possible on one of these projects, by changing hands at the end of each stated period, that the man could collect 150 to 200 percent of his original investment in just tax credits alone.

That is theoretically possible; is it not?

Mr. CAPLIN. Theoretically. But on the other hand, what would it cost if you had to pay dollar subsidies?

Senator WILLIAMS. We would not get into that. I am speaking of this as it is. This could happen.

Senator SMATHERS. Theoretically the same man?

Mr. CAPLIN. No. This is a new purchaser.

Senator SMATHERS. But he did not say that.

Senator WILLIAMS. It would be a new purchaser.

Mr. CAPLIN. A new, approved purchaser, by HUD.

Senator WILLIAMS. But I would be a builder and you would be a builder, and John Jones would be a builder. We would be buying each other's property. It could be.

Mr. CAPLIN. Senator, I think on that I would have to draw the line because, first, the constructive ownership rules would prevent related parties from getting new credits.

Senator WILLIAMS. In the bill, where do they say it?

Mr. CAPLIN. And it seems to me that if there was any hanky-panky here, the Secretary of HUD would have the obligation, through his staff, processing the entire project, to scrutinize a building that is rolling over like a whirling dervish.

Senator WILLIAMS. I think they would, and I think the Treasury and the committee would act. Nevertheless, as a former Commissioner of Internal Revenue, you will admit that the Commissioner of Internal Revenue administers the law as interpreted by the Treasury Department.

Mr. CAPLIN. Yes, sir.

Senator WILLIAMS. And the Treasury Department has interpreted that under the law as it was drafted, and I am not so sure under this revised proposal as you just described it, they would allow this tax credit. Maybe an amendment will be offered to prevent this, to take care of this and an arms length transaction, but if we don't recognize what could happen, you can rest assured that once we pass this somebody is going to find out whether it would happen or not.

We will not be able to correct the measure, to plug these loopholes, if we close our eyes to them or try to belittle them.

We have to lay them on top of the board.

Senator SMATHERS. Mr. Commissioner, I would like to ask you if you in your judgment, having been a Commissioner, think there is any vast loophole in here? We as a committee would very much welcome and appreciate a proposed amendment offered by you to see that there was no ridiculous loophole.

We don't want to do that which is ridiculous. We don't want to encourage the corrupt. We don't believe, however, that everybody in this business is bad, corrupt or looking for some devious way to make a killing.

If you have some suggestion, we would very much appreciate it.

Senator WILLIAMS. I appreciate the contributions he has made. I am wondering if for the record, so we will know whether he is testifying as an individual or not, if you will give us a list of the real estate people your represent.

Mr. CAPLIN. I am a private attorney, sir. My firm is Caplin & Drysdale in Washington, D.C. I represent no clients in testifying before the committee.

Senator WILLIAMS. You appear as a private citizen?

Mr. CAPLIN. Yes; as a private citizen because of my interest in the laws of our Nation.

Senator WILLIAMS. And as a former revenue Commissioner you are interested in liberalizing the tax laws?

Mr. CAPLIN. I am interested in having a fair and decent law and one that is responsive to the needs of the Nation. I regard the whole question of urban housing and unemployment in depressed areas as really one of the two major problems of the day, second only to Vietnam.

I think the resources of the Nation should be brought together—the best brains, the best thinking—to solve this problem. I think this bill is an extremely important and constructive step in that direction.

Senator SMATHERS. Senator Kennedy?

Senator KENNEDY. Could we have the whole of the Commissioner's statement made a part of the record?

Senator SMATHERS. That will be done.

(Mr. Caplin's prepared statement follows:)

PREPARED STATEMENT OF MORTIMER M. CAPLIN, CAPLIN & DRYSDALE, WASHINGTON, D.C.

It is a privilege to appear before this Committee to testify on S. 2100, a bill designed to encourage private enterprise to build and rehabilitate large numbers of low-cost housing units in urban poverty areas.

As S. 2100 leans heavily on a system of tax incentives to encourage this type of investment, it raises the general question of when and how tax policy should be used to achieve critical national goals. More particularly, we must decide what role our tax policy should play in meeting the urgent demands of our nation's slum problems.

At the outset, I want to express my fundamental view that the use of the tax mechanism to accomplish social and economic objectives should be used sparingly. Our overall effort should be toward the development of a simpler tax system—simpler for our citizens to understand, and simpler for the Internal Revenue Service to administer. Great care should be used before adopting amendments which will complicate the tax form or the tax audit process. We cannot expect the great mass of our taxpayers to understand the intricacies of complex tax laws; nor can we ask the many thousands of Revenue agents to interpret and carry out highly sophisticated social concepts.

Nevertheless, to state that our tax law should never be used for social or economic purposes is to ignore past history and reality. The Internal Revenue Code is replete with instances of nontax objectives being sought through tax incentives. Most recently we have examples in the investment credit and accelerated depreciation, designed to encourage modernization and expansion of our industrial facilities. Again, we have charitable deductions to encourage philanthropy; interest and tax deductions to encourage home ownership; rapid amortization deductions to encourage construction of wartime facilities and grain storage facilities; tax benefits to encourage private retirement programs; and many other special tax rules to encourage everything from research and development, to motivation of inventors and corporate executives, to the development of our farms and natural resources.

The threshold issue before this Committee is whether, in the fall of 1967, it is appropriate to use our tax laws to help solve the urgent housing needs of our cities. Certainly our efforts to date through nontax means have fallen far short of the mark, and we are being pressed daily to seek other solutions. In answering this question, President Kennedy's observation in his 1961 tax message comes to mind: ". . . some departures from (tax) uniformity," he said, "are needed to promote desirable social or economic objectives of overriding importance which can be achieved most effectively through the tax mechanism."

In other words, before using our tax laws to achieve nontax goals, two preconditions should be satisfied:

(1) The objective should be one which is of overriding importance to our society; and

(2) It should be one which can be achieved most effectively through the tax mechanism.

Implicit in this second condition is that tax incentives should be better able to achieve the desired result than alternative governmental programs and that they should be able to accomplish this result without substantially higher costs or waste of resources.

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In applying these standards to S. 2100, a strong and convincing case is made that it is appropriate and advisable to adopt a series of tax incentives to encourage private businesses to construct multi-unit housing facilities in our nation's poverty areas.

Let me describe briefly the three main prongs of this bill:

First, it would provide low rentals to the tenants through the use of long-term low interest mortgages and abatements of city real estate taxes. The long-term low interest mortgages would result in low amortization payments by the builder and the abatement of city taxes would, of course, lower the builder's operating expenses. Both of these benefits would be passed on to the tenants in the form of lower rents. The loss of revenues to the city resulting from the tax abatements would be made up by the federal and state governments.

Second, the bill would raise the investor's yield through a series of tax incentives. Presently investors do not build housing in poverty areas because they cannot realize an after-tax return which is high enough to justify such an investment. Under S. 2100 the rentals from tenants would produce only a 3% cash return to the builder. However, with the various tax benefits, this rate of return would rise to levels in excess of 12%—a rate which is felt to be necessary to intice this investment in slum areas.

Third, the bill would encourage tenant ownership of the project by giving home management corporations an option to purchase the project two years after completion of its construction in accordance with a specified price schedule.

As can be seen, the tax incentive provisions are only one phase of S. 2100. They can be summarized as follows:

(a) A tax credit is given ranging up to 30 percent depending upon the amount of equity invested in the project. The purpose of this graduated schedule is to encourage higher equity investment so that less funds are removed from the low interest mortgage pool and a greater number of housing units can be constructed.

(b) Accelerated depreciation is provided in the form of a reduced scale of useful lives with such reduction also being based on the amount of equity invested by the business.

(c) For purposes of this depreciation, the bill permits demolition costs and site improvements to be added to the depercìable basis of the building constructed rather than being included in the basis of the land. This increases the amount of depreciation deductions which would be available.

(d) The bill would forgive capital gain on a sale where the project is either sold to a home management corporation owned by the tenants or where the proceeds are rolled over into another poverty housing project. Moreover, the capital gain which would otherwise apply would be reduced after a minimum holding period ranging from seven to ten years.

(e) Tax credits and accelerated depreciation are also granted to certified purchasers from the original builder. This device insures that the building will have a reasonable resale value and that the purchasers will also be able to realize an adequate return on their investments.

(f) To encourage the original builder to hold the building if he so desires and thus retain stability of ownership, the bill provides that after the building is fully depreciated, the owner can elect to treat it as having been sold to himself at a specified price. If he makes this election he will recognize capital gain on the resale and then be entitled to redepreciate the building. He will not, however, be entitled to any further tax credits.

(8) The bill contains protective provisions to prevent businesses from taking the tax advantages and then turning the property over quickly. Except in the case of a sale to a home management corporation owned by the tenants, which can be made after two years, the original builder is required to held the project for ten years or return the tax benefits received.

Against this background of the provisions of S. 2100, the propriety of using our tax law to fulfill the end purposes of the bill can be tested.

First, there can be no doubt that the objective sought to be achieved is of "overriding importance". The crisis in our urban poverty areas is second only to the war in Vietnam among the major problems which face our country today. To insure that residents of these areas have an opportunity to become productive members of our society, it is essential to provide them with opportunities for decent housing, sound education, and meaningful jobs. S. 2100 would help fill the housing gap by harnessing the creativity and vitality of our business community. Its companion measure, S. 2088, would encourage industrial develop-

ment in these poverty areas and the employment of local residents through similar incentives to private businesses. In combination, these bills strike at two of the most basic needs of our slums.

Moreover, it is clear that the government programs adopted to date are not sufficient to provide the needed housing and jobs, and that some further action is required if we are to grapple successfully with these problems.

Of the three basic purposes of S. 2100—to lower rentals, to increase the builder's after-tax return, and to encourage tenant ownership—only the second is accomplished by features affecting our tax law; that is, the tax provisions are used solely to increase the yield to the builder to an acceptable level, thereby making it desirable for him to participate in this program.

This brings us face to face with the second standard to be applied in using our tax laws for social or economic purposes: i.e., whether this increase in yield to the builder can be achieved most effectively through tax incentives.

It has been strongly urged that business participation on a broad scale could be achieved only through the tax mechanism—and that the costs of using this approach would be little, if any, greater than using a straight subsidy approach.

For one thing, the tax mechanism seems particularly efficient for this special building program. Generally, one of the disadvantages of using taxes for incentive purposes is that part of the incentive will be provided to taxpayers who would have undertaken the desired action even without it. In the case of the investment credit, for example, businesses obtain the credit for all investment in depreciable machinery and equipment, including that which they would have bought in any event. All businesses purchase some machinery and equipment annually merely to replace worn-out items. Hence, part of the investment credit is dissipated without achieving its goal of stimulating those investments which would otherwise be delayed or not made at all. Under S. 2100, however, little waste of this kind occurs. The fact of the matter is that our private businesses are just not building in poverty areas and any construction that would be undertaken would be primarily attributable to the benefits provided for in the bill. It could not be argued that tax dollars are being siphoned off to aid investment that would have been undertaken in any event.

But even assuming no waste, it might be urged that these tax dollars could be funneled to the investor just as easily in the form of a direct subsidy. I think that this ignores several important factors:

First, businessmen in general have an adverse reaction to a direct subsidy. They chafe at the long delays and red tape that are often involved and they are suspicious of continuing and pervasive government regulation. Establishing the administrative machinery for efficient handling of a subsidy program is no easy matter; consequently, this alternative cannot always be considered as an easy and ready substitute for a tax incentive program.

Second, in the case of real estate investment in particular, businessmen are accustomed to examining the cash flow and tax benefits before deciding whether to make the investment. This is the way the real estate investment market presently operates. The provisions contained in S. 2100 build on the adapt to current patterns of business behavior, and do not require the reorientation in thinking that a subsidy program would entail.

It is for similar reasons that the investment credit was made a part of our tax structure. The very standards we have discussed today were clearly taken into account in determining whether the incentive provided by the investment credit should be made a part of our tax code. The conclusion was reached that the tax mechanism was the most effective way of achieving the desired results—that is, modernization and expansion of our industrial facilities. In that case the administration itself reached the conclusion that a tax credit would be most effective because it would require less regulation and conform more to established business practices and patterns of thought.

It is the easy way out to object to all tax incentives merely because a wide variety has been suggested in the past. A stance of blanket disapproval is not justified; rather, the responsible course would be to examine each proposal carefully and rigorously to see if it meets the standards we have considered today. In my opinion the approach of S. 2100 does meet these standards and should be given careful and thoughtful consideration by this Committee.

Mr. CAPLIN. I have given a lot of thought to the question of the use of tax policy to carry out these social and economic goals. I think this

particular project meets the standards which President Kennedy referred to in his 1961 tax message.

Senator KENNEDY. You think, therefore, that use of the tax system makes some sense, in view of the crisis that exists in our country at the moment?

Mr. CAPLIN. We have used our tax law many times—and I have listed examples in my statement—to accomplish social and economic goals. Very few of these goals have measured up to the high standards of this particular project, in terms of national need.

Senator KENNEDY. We have had a good deal of talk about the cost, Mr. Commissioner. I know you have made some studies concerning the bill. I know also that your partner in your law firm, who used to be in the Treasury Department, has also worked hard on a cost analysis of this bill, and the cost in relationship to providing low-income housing under 221(d)(3) and under the rent supplement programs.

Would you identify yourself?

Mr. KLAYMAN. My name is Robert Klayman and I am a partner of Caplin in the law firm of Caplin & Drysdale.

Senator SMATHERS. Were you formerly connected with the Government?

Mr. KLAYMAN. From 1960 to 1964, I was with the Treasury Department, in the Office of Tax Legislative Counsel.

Senator KENNEDY. Mr. Klayman, have you made a study of the cost of this legislation to the Treasury Department of the U.S. Government, and also the cost of this bill in comparison with the cost of lowering rentals under the rent supplements and 221(d)(3) programs?

Mr. KLAYMAN. Yes; I have participated in in such a study.

Senator KENNEDY. Can you tell us in the last analysis what program is more costly?

Mr. KLAYMAN. The analysis that I have made, together with other people, indicates that to achieve the same rental levels, the 221(d)(3) program would be more expensive than this program. The 221(d)(3) below market interest program as it presently exists does not achieve the same low rental levels.

To reduce the rental levels under present law would require the use of part of the rent supplement program.

The cost of those rent supplements would make 221(d)(3) more expensive than the provisions of S. 2100, including the tax benefits.

Senator KENNEDY. So when we add up the tax credits that we have discussed—even up to the 30 percent—if we add to that the depreciation deductions, and the interest rate subsidy involved in providing 2 percent mortgages, if we add those three provisions together which are the major features of the 2100——

Mr. KLAYMAN. Plus the provision that provides for city tax abatements.

Senator KENNEDY. If we add together those four features, the primary features of this bill, they produce less revenue cost to the Government than 221(d)(3) or the rent supplement programs?

Mr. KLAYMAN. That is right. It is less expensive than the interest subsidy involved in 221(d)(3) plus the rent supplement that would be necessary to bring the rentals down to the same level.

Senator KENNEDY. Is it not a fact that it is considerably less costly than the programs that presently exist?

Mr. KLAYMAN. It seems to run considerably less.

Senator KENNEDY. I think it is important since we are talking about these high figures, Mr. Chairman, that the committee have our extensive memorandum which goes into these in great detail before it.

Senator SMATHERS. Would you like to make it a part of the record? (See p. 119.)

Senator KENNEDY. Yes, I am not certain if it went into the record yesterday but I think it would be helpful for the committee to have access to it. It is a long memorandum because it takes various cases and compares them. I think it is quite clear that this program, despite the figures we are talking about, not only brings the private enterprise system into the ghetto, and achieves stability of ownership through tax incentives but gives low rents, and costs less to the Government.

That is why I am so surprised that it should be opposed by the Government.

Senator SMATHERS. Gentlemen, thank you very much.

Our next witness will be Mr. William Naumann, chairman, Legislative Committee, the Associated General Contractors of America.

STATEMENT OF WILLIAM E. NAUMANN, CHAIRMAN, LEGISLATIVE COMMITTEE, THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

Mr. NAUMAN. Mr. Chairman and members of the committee, I am delighted to be here and I thank you very much for your consideration of the change in schedule because I had to come from Arizona this morning and I have to be back there late this evening.

My statement deals with the general merits of the bill and, in addition, with some of the practical aspects of items that might be considered as this legislation moves forward, as it would apply to what conceivably could and will happen if the program goes forward as regards cost.

Since I believe there has been so much discussion as regards cost, these particular remarks might be very appropriate.

I would like to proceed now with my statement.

Senator SMATHERS. Go right ahead, sir.

Mr. NAUMANN. Mr. Chairman and members of the committee, my name is William E. Naumann. I am chairman of the Legislative Committee of the Associated General Contractors of America, a trade association of over 8,200 of the Nation's leading general contractors who perform the greater part of all highway, heavy engineering, and building construction done in the United States each year.

I also serve the AGC as a member of its Executive and Labor Committees and as chairman of its heavy construction and utilities contractors division.

We appreciate the opportunity to comment on S. 2100. May I say at the outset that my remarks here will be of a general nature and will not attempt to pass on all the specific details and technicalities contained in this bill.

Our membership is made up of the Nation's leading general contractors, who are normally engaged in what is termed as contract construction; that is, we perform work for public and private owners for a specific price under terms and conditions set forth in a contract.

Public construction is awarded to the lowest qualified bidder after public advertisement for bidders. Thus while the public housing contemplated under S. 2100 would not normally fall in the general category of contract construction, there is a growing interest among our members in this type of business venture.

In fact, a number of members have had considerable experience in large urban renewal projects and a great many more will be interested if this work can be made attractive from a business standpoint.

S. 2100 appears to meet the housing and urban needs of lower income families in a businesslike manner. This is done through suitable tax credits and accelerated depreciation.

We note that the bill provides inducements for business organizations to pool their talents and resources to tackle the job of rebuilding our cities.

Any construction program of this magnitude contemplates building in the most efficient manner. It means we must develop new methods, new techniques of engineering, design, and construction if this housing is to be built economically, efficiently, and well.

As Members of the Senate, you can help in this regard. Today our industry is burdened by archaic working rules and union practices that fight progress and result in increased costs to the public. We're making some headway in some areas in getting rid of featherbedding and other nonproductive labor restrictions. But the progress has been slow and often discouraging.

The industry recently received a serious setback when the U.S. Supreme Court in a landmark case gave its approval of the worst kind of restrictive practice—the prohibition of the use of prefabricated material. I have reference to the *Philadelphia Door* case, where the U.S. Supreme Court ruled that the Carpenter's Union could lawfully strike an employer-contractor because he used precut doors (3,600 of them) in violation of a local Carpenter's Union working rule intended to "preserve their work."

This happened to be a housing project in Philadelphia. I would like to read part of the majority opinion of the Court which tells us our relief is not with the Court but with Congress:

> The Woodwork Manufacturers Association and amici who support its position advance several reasons, grounded in economic and technological factors, why "will not handle" clauses should be invalid in all circumstances.
>
> Those arguments are addressed to the wrong branch of government. It may be that the time has come for re-evaluation of the basic content of collective bargaining as contemplated by the federal legislation.
>
> But that is for Congress. Congress has demonstrated its capacity to adjust the Nation's labor legislation to what, in its legislative judgment, constitutes the statutory pattern appropriate to the developing state of labor relations in the country.
>
> Major revisions of the basic statute were enacted in 1947 and 1959. To be sure then Congress might be of opinion that greater stress should be put on . . . eliminating more and more economic weapons from the . . . (Union's) grasp . . . but Congress' policy has not yet moved to this point.
>
> *Insurance Agents International v. Labor Board*, 361 U.S. 477, 500.

This is from the majority opinion. Let me now quote from the words of four members of the Nation's highest judicial body, the Supreme Court of the United States, in their dissenting opinion:

> The union's boycott of the prefitted Mohawk doors clearly falls within the express terms of the federal labor law, which makes such conduct unlawful when

an object thereof is forcing or requiring any person to cease using . . . the products of any other . . . manufacturer . . . And the collective bargaining provision that authorizes such a boycott likewise stands condemned by the law's prohibition of any agreement whereby an employer agrees to cease or refrain from handling . . . any of the products of any other employer . . .

The Court undertakes a protracted review of legislative and decisional history in an effort to show that the clear words of the statue should be disregarded in these cases. But the fact is that the relevant history fully confirms that Congress meant what it said, and I therefore dissent . . .

The dissenters concluded:

An employer's decision as to the products he wishes to buy present entirely different issues. That decision has traditionally been regarded as one within management's discretion, and Fibreboard does not indicate that it is a mandatory subject of collective bargaining, much less a permissible basis for a product boycott made illegal by federal labor law.

The relevant legislative history confirms and reinforces the plain meaning of the statute and establishes that the Union's product boycott in this case and agreement authorizing it were both unfair labor practices. In deciding to the contrary, here the Court has substituted its own notions of sound labor policy for the word of Congress. There may be social and economic arguments for changing the law of product boycotts established in 8, but those changes are not for this court to make.

I respectfully dissent.

This, gentlemen, is the No. 1 problem of our country today, production and distribution of the necessities of life and making them available to lower income people. I earnestly request that you address yourself to this matter and correct—by legislation—what the Supreme Court has done by decision.

If you do this, the genius of industry and science will provide the answers in the form of low-income housing within a price obtainable by every American.

That concludes my statement. With your permission, Mr. Chairman, I would like to make these further remarks with regard to the merits of Senate bill 2100. It is the opinion of this construction industry that we will be called upon to do the actual job that this bill provides the mechanics for doing.

I foresee a combination of forces of the investor and the contractor as such. I believe, and this industry believes, that the approach in providing incentives for action and investment in ordinary low-risk areas is an excellent one and is the American way.

I believe that regardless of the considerable discussion that has been had about the cost to Government, that this manner will produce the objective of providing the low-cost urban housing at a cheaper price than would be able to have been achieved under any other method of direct subsidies in this sort of an approach.

I believe further, and this industry believes, that regardless of the cost that we have the problem and that with the combined efforts of private enterprise and the abilities of the strength of the Federal Government to provide the incentive, that this job can be done.

In conclusion, I would urge that in the final consideration of this legislation, in connection with the problems of cost, that this committee give some favorable consideration to a similar provision as was contained in the demonstration cities act under section 1010.

I will read from the act. It states:

Research and studies conducted under this section shall be designed to test and demonstrate the applicability to housing construction, rehabilitation and mainte-

nance, and urban development activities of advances in technology relating to, one, design concepts; two, construction and rehabilitation methods; three, manufacturing processes; four, materials and products, and five, building components.

So the ingenuity of our vast industrial empire and the abilities of the construction industry can be without restriction devoted to this task of the production of urban housing at the lowest possible cost.

I thank you very much.

Senator SMATHERS. Thank you very much. That is an excellent statement. The committee will stand in recess until 2 o'clock.

Mr. NAUMANN. Mr. Chairman, I made a mistake in forgetting to ask permission to file a supplemental statement.

Senator KENNEDY. Could that include what you think the effect would be of this legislation in providing more jobs? Do you think if this legislation were enacted there would be more jobs?

Senator SMATHERS. Include another supplement stating whether or not you think there will be more jobs as a result of this legislation.

Mr. NAUMANN. Yes, sir.

Senator SMATHERS. Thank you.

Mr. NAUMANN. Thank you, Mr. Chairman.

(The document referred to follows:)

SUPPLEMENTAL STATEMENT OF WILLIAM E. NAUMANN

First, let us state that we of the Associated General Contractors of America are very much concerned about the employment of those persons residing in urban poverty areas, in general, and about their possible employment in the construction industry specifically.

Today there is serious unemployment among unskilled workers particularly those from minority groups.

It is paradoxical that this situation exists at a time when many general contractors throughout the nation are experiencing manpower shortages. A survey now being conducted among our 133 chapters indicates that at this time the contractor members of our Association conservatively need somewhere between 20,000 and 30,000 men in the basic trades alone—bricklayers, carpenters, cement masons, ironworkers, and operating engineers. This Association is also aware of a report soon to be released by the Department of Labor, which indicates that between now and 1975 the contract construction industry will need approximately 1 million new workers (wage and salary workers only).

The Association is concerned over this, and other manpower problems confronting the construction industry prompted the AGC to sponsor a two-day manpower conference in order to develop more effective manpower programs for our industry. There were many suggestions put forth for attracting minority groups into the industry; however, under today's apprenticeship standards, rigidly adhered to by organised labor, and faithfully fostered by the Department of Labor, most unemployed urban poverty areas dwellers would be disqualified for entrance into apprenticeship programs. They lack a high school diploma, cannot pass the qualifying examination or aptitude test, or cannot pass a job interview. We are told of a Negro apprentice applicant in Iowa who was disqualified, even though he received the highest score in his group on the written examination, because he only weighed 138 pounds. The question is often asked how many present-day journeymen would qualify for entrance into the construction industry's apprenticeship programs under *today's* standards.

We strongly believe that the Urban Housing Development Act of 1967 (S. 2100) and its companion bill, the Urban Employment Opportunities Development Act of 1967 (S. 2088) will greatly improve the living and employment conditions in our much neglected urban poverty areas, and simultaneously help to improve the manpower situation in the construction industry. It will create jobs in a construction program and will help those who need help the most. We believe that appropriate goverrmental action could very well induce a significant breakthrough in the employment policies of the trade unions resulting in the "opening up" of many job opportunities in a vital industry for many

people, who through no fault of their own, presently find themselves performing no productive function whatsoever.

In conclusion, S. 2100 will create job opportunities for all classes of Americans, but we must make sure that money is not wasted by the blind adherence to restrict labor practices and policies which prevent the use of modern methods and prefabrication.

Senator SMATHERS. We will stand in recess until 2 o'clock.

AFTERNOON SESSION

Senator SMATHERS. The committee will come to order.

Our first witness this afternoon is the distinguished former U.S. Secretary of the Navy, Dan Kimball.

Senator KENNEDY. I think the committee is very fortunate in having Mr. Kimball's testimony. I think that around the country Mr. Kimball has probably done more with his efforts than anyone else to try to bring employment and new jobs to people living in the ghetto.

He is not just testifying from a theoretical point of view. He will not be talking just as a bleeding heart, but as a man who has actually done something; he is a man who has a feeling for the problem, and who has also developed a program that has had some meaning for a lot of people and made a difference to a great number of people.

I think they are very grateful to him. I also want to express my appreciation.

Senator SMATHERS. With that sendoff, Mr. Kimball, please proceed.

STATEMENT OF DAN A. KIMBALL, AEROJET-GENERAL CORP., EXECUTIVE COMMITTEE CHAIRMAN AND FORMER SECRETARY OF THE NAVY

Mr. KIMBALL. Mr. Chairman, I appreciate the opportunity to appear before your committee on the subjects of "Investment in Housing in Urban Poverty Areas" and "Industrial Investment in Urban Poverty Areas."

I agree with your approach to these needs, for unless some incentives can be provided to encourage private enterprise to invest or reinvest in urban poverty areas of our Nation, then we may expect a continuation of riots by those people who will be without jobs and living in substandard homes.

Tax incentives would be a desirable means of attracting new business investment in poverty areas. To be most effective, however, investment incentives should offer some degree of tangible benefit to the businessman who invests in poverty areas regardless of whether his initial period of operation is profitable.

Tax incentives alone may be attractive to a large organization. But for the small businessman, a tax incentive may not be enough. If he operates at a loss the first year or two, a tax incentive will not provide the type of financial relief he needs. A guaranteed return on investment for the small businessman may be an incentive worth considering.

I may say unless you make some profit the tax incentive doesn't do you much good.

There also should be some provision or incentive for training workers for jobs in poverty areas. The supply of labor is readily available,

but even basic skills are not. Many of these people have never held a steady job, so they don't know about timecards or the normal routines associated with the operafion of a plant. They must learn about these things at the same time they are learning how to do a productive job and earn pay for it. Training of this type is expensive for a businessman who locates a firm in a poverty area.

An additional incentive for the businessman could be a form of low-cost insurance protection against loss or property destruction in poverty areas should trouble occur.

I would like to mention here that when we at Aerojet-General Corp. formed the Watts Manufacturing Co. in the Watts area of Los Angeles, no such incentives were considered. This was a year ago.

We organized the company as a normal profitmaking enterprise, using Watts labor and management. We have invested more than $1 million in Watts Manufacturing, and we expect to make money on our investment.

I might say we have promised the people who work there that they will also make a profit.

This Watts plant put us right in the midst of an urban poverty district, so now we are operating plants in urban as well as rural labor surplus areas.

Two years ago, we invested $3 million to organize a manufacturing plant at Batesville, Ark., where there was a serious labor surplus. We trained the people native to the region to do ordnance work. They do fine, and the cooperation with city and State agencies has been excellent. Today we employ some 600 people there.

So successful has been this plant in rural Arkansas that we have established another plant at Camden, Ark., where we employ another 400 people.

In addition to employing local residents at these plants, we have been successful in obtaining people with skills from cities such as Detroit and Cleveland to work in them. So we are reducing the concentration of factory workers in the big industrial centers by bringing them back to rural America to work at their skills. Twenty percent of the management and technical people at the plant are those who left Arkansas and who have returned to Batesville.

Our rural plants are doing well, and we expect the Watts operation to succeed as planned.

In nearly all urban poverty areas of the Nation, substandard housing and the lack of jobs are the two greatest problems. In Watts, it is a little different. Housing is not as much of a problem as in New York or Detroit, as mass transportation. There isn't any mass transit system. People in Watts can't get out of the area to find a job.

In addition, few companies in the surrounding area of Watts would hire them anyway. Many of the people we have employed have police records, some have felony convictions, and few have any previous work history. Certainly they had no skills. We had to train those we hired. So we, in fact, took jobs to Watts, and our people are doing a good job. Some of our employees there are working for the first time in 5 years.

Mr. Chairman, I do not want to imply that all has been easy for us with Watts Manufacturing, but we are far enough along with this

company to know that the concept of operating a manufacturing plant in a poverty area will work. We know the labor supply is there. There were nearly 5,000 applicants for the 425 jobs at Watts Manufacturing. There are another 25,000 people in Watts who could be so employed.

I am disappointed that other industry has been reluctant to locate plants or branches in Watts. We have, however, received many inquiries from other companies regarding our experience with the Watts plant. Some of these companies have sent representatives great distances to obtain first-hand information. But it is obvious that they are hesitant about locating in Watts at his time.

If incentives were made available, they may well do so. If the incentives could be applied during the first years of operation when risks are greatest, they would be far more attractive to business and industry.

We established our Watts plant when Vice President Humphrey a year ago called upon the aerospace industry to assist in providing jobs in poverty areas. Mr. Humphrey has been unrelenting in his efforts to encourage business and industry to open plants in these areas. The incentives you propose, Mr. Chairman, will do much in this regard.

Thank you, Mr. Chairman. A more complete report on the brief history of Watts Manufacturing has been filed with the committee.

(The document referred to follows:)

WATTS MANUFACTURING COMPANY

The Watts Manufacturing Company, a wholly-owned subsidiary of Aerojet-General Corporation, was organized a year ago. It has been in actual production for approximately eight months.

Current backlog is more than $4 million. The work includes light manufacturing—canvas tents, woodwork and metal working. Tents are manufactured for the Defense Supply Agency for 5,000 of field hospital size. Ammunition crates are produced in the woodwork section for the Aerojet plant and a competitor as well. Metal work now centers on components for a 6.25-mile-long conveyor belt system for the Oakland, Calif., Post Office.

The Watts Manufatcuring Company has a total capital investment of $1.8 million, all from Aerojet-General.

The company occupies nine buildings on a three-acre tract in the Watts area of Los Angeles.

The labor force at Watts Manufacturing, 438 employees, is almost entirely from the Watts area. Most of the work force had no real previous work experience.

I. LOCATION IN WATTS

Aerojet decided to open a plant in Watts to employ its residents rather than take Watts residents to its existing plants for several reasons. Among them was lack of public transportation. Also considered was the problem of seniority if they joined the labor ranks at existing plants. These unskilled Watts residents would be the first to be terminated in any work force reduction at plants where employees have seniority. The fact that Watts Manufacturing is an independent operation allows it to establish its own seniority rosters, affording workers greater security.

In addition, a plant in Watts for residents of Watts provides a condition where employees can feel at social and psychological ease.

An on-going plant with informal if not formal dress, speech, and other conduct requirements is one in which many of the hard core residents now reach by the Watts Manufacturing Company could not long last. It is obvious to a visitor of the plant that its workers feel very much at home there. Whatever strains the Watts employees may be able to bear after a successful work experience there, it is clear that the Company now represents a proper setting for their entry or return to productive work. The significance of the atmosphere at Watts is under-

scored by the statistic that one of every three male employees has been convicted of a felony. Such men would find hard going were they set into an existing, middle class factory setting. At Watts, they appear to be doing quite well.

To be sure, a discrete, identifiable operation such as the Watts plant opens its parent company to charges of exploitation far more serious than the Company would face were it merely to take on extra numbers of Negro employees. In part to cope with that problem, the Watts Manufacturing Company has as its president a local businessman selected by Aerojet after an elaborate screening procedure among many applicants for the position. Both the President, James Woods, and the General Manager and Secretary, his son, Leon Woods, have roots within the Watts community as deep as is possible for men making as much money as they do. In the case of Leon Woods, the Company has an extremely bright and capable young man with a college background in accounting and business administration. Although the Woods have been more dependent on Aerojet than are the managers of operations of similar size and scale, both have been vested with real authority and have clearly done their share in carving for the Company a legitimate status within the Watts community.

II. THE COMPANY'S BUSINESS

Critical to the Company in terms of the men it seeks to employ is the fact that all contracts it takes on must be ones which can be performed by high-repetitive, low-facility techniques. Among other reasons, the Company feels that morale problems dictate that its workers become genuinely productive at as early a stage of their employment as is possible. Because many of the men taken on have failed at most of the socially approved efforts they have undertaken, the Company is convinced of the need for the rapid bolstering of confidence that early mastering of work assignments can produce.

An additional requirement for jobs undertaken by the Watts Manufacturing Company is that they entail sufficient physical strength to generate a fairly high male-female ratio. Assertions of the Moynihan Study are living facts in the Watts area, and the Company feels that it must have a fairly high proportion of male employees in order to insure its acceptability and stability in the Watts community. Presently, some 65 percent of the work force is male.

Another aspect of the Company's policy is its conservatism in the expansion of its operations. The Company feels that few risks are worth the effect of periodic layoffs to a work staff in psychological as well as economic need of *steady* work. The Company was burned once, in early April, when it was forced to lay off 50 men because of its premature adoption of a night shift. It is determined to avoid a repetition of that incident if at all possible.

The present lack of competent managerial personnel constitutes another brake on Company growth. It will take a while for the Company to develop an adequate supply of workers capable of stepping into first level supervisory jobs, and until such men can both be developed and spared from the production lines, the Company expects to go it slow. The Company now has a few caucasian supervisors and consultants, no more than four or five at any given time, and hopes as rapidly as possible to be able to phase its regular work staff into all management position.

The Watts management is also determined to take on contracts which have the least possible make-work character about them. For that reason, the first job taken on by the Company was a Defense contract and not an "in-house" order which Aerojet could easily have placed with Watts to set the Company going. The Company had to wait a long while after its inception until its first contract, but its management did not succumb to the temptation to call for an Aerojet order. Although the major wood-working contract and the conveyor contract came from Aerojet, these jobs were only taken on after Watts had established its ability to make do with a rough government customer. Significantly, even here the Aerojet contracts were awarded to Watts only as a result of Watts' low competitive bids for the jobs.

When Aerojet does give in-house contracts to Watts, it is also scrupulous about only giving work which Aerojet would have itself subcontracted out. By being terribly careful on this score, Aerojet avoids adverse criticism of Watts by the principal Aerojet unions, which are naturally sensitive to any "farming out" of work—most particularly to low-wage, non-union operations such as Watts. Much of the work which Aerojet has given and will be in a position to give to Watts

would otherwise have gone to non-union, most generally Southern, subcontracting plants.

Though not initially done as a matter of policy choice, the Watts Manufacturing Company has operated largely without the assistance of the various government programs in the poverty and worker training fields. Initially, Watts retained a full-time man for the purpose of looking into government assistance for its training operations. That approach was given up after Watts found government programs unwieldy and government officials unrealistic in their assessment of the type of work which could initially be offered to Watts employees. Watts started itself out and bore its worker training costs almost entirely on its own.

The real "outside" assistance which the Watts Manufacturing Company has obtained has come in the form of time and expertise provided by Aerojet-General personnel. Watts' legal, public relations and contract administration work is done by Aerojet and without inter-company billing charges. Spot assistance from all Aerojet personnel can be fairly readily called upon. Some Aerojet accountants have been added to the Watts' accounting staff. Aerojet engineers have helped design the production equipment in use at the Watts plant. Additionally, by reason of the major insurance contracts it holds, Aerojet has been able to obtain favorable insurance coverage for Watts.

III. PROBLEMS

A. Worker Productivity

More time must pass, particularly in the tent-making division, before the Watts management can know with certainty the Company is entirely competitive. Although worker productivity has increased from the beginning of operations, the increase must continue through the balance of the year before the Company is fully out of the woods. Watts' management is fairly confident that the work staff will continue to improve. Additionally, the rising wage floor created by the minimum wage law provides further *assurance* of success. As previously indicated, Watts' true competition comes from the low wage areas of the rural South. Although its wages are certainly low—varying from $1.50 to $2.20 per hour for its floor operators, with an average wage of $1.66—Watts believes that its Southern competition pays lower wage scales and that the continued rise in the minimum wage will narrow the compeition gap.

In May, the Company lost a competitive bid for 1,000 tents to a competitor who came in with a winning bid of $860.00 as against Watts price of $890.00. The Watts management believes it could have done better had it "sharpened its pencils" a bit more and is also confident that its productivity has improved over the past three months. Nonetheless, it was faced with a competitor able to pay an average wage which Watts believes was $.20 per hour—or $16.00 per unit—less than it must pay. If, along with its high training costs, Watts is continually forced to pay a significant wage differential, its need for increased worker productivity will become all the greater.

B. Union Organization

The Watts Manufacturing Company is presently non-union and has in fact defeated two efforts by local, independent unions to organize its tent-making and metalwork divisions. Left to its own choice, Watts would prefer continued freedom from unions. As indicated, union seniority regulations in large part led Aerojet to form the Company as a separate entity.

The Watts management is not dogmatic about remaining non-union, however, and indeed feels that it is the anti-union sentiments of its workers, who have long been systematically excluded by restrictive union practices, which more than anything would stand in the way of plant unionization. For itself, the Watts management feels that it has now established a pattern of wage scales and work regulations around which any union would have to operate. As also indicated, Aerojet has not disturbed its own unions by scrupulous avoidance of "farming out" any work to the Watts plant. In any event, the non-union character of Watts presents no major problem to Aerojet or to labor. For one, no major unions have made an effort to organize the plant. Beyond that, the Watts management could live with and might even be helped by a sophisticated and sympathetic union.

C. Government Contracts

Under the assumption that its high training costs will always remain, either because worker productivity levels off or—more likely—because its workers will continually leave for better jobs, Watts is faced with some serious problems in

the government contracts market. The Company dilemma is as follows: On the one hand, the "cost" of extensive involvement with government worker training programs is too great in terms of plant efficiency and flexibility. On the other hand, the dollar cost of the extensive worker training programs assumed by the Company may well tend to make bid prices too high for it to be able to get essential government and defense work.

The key tent contract was only made possible by absence of other bidders for the job at a time of urgent government need. Under that circumstance, the Department of Defense was able to invoke Exception 2 of the Armed Services Procurement Act of 1947, the so-called "public exigency" exception, and to let the contract on a negotiated basis. Now that the tent market and all other defense production has opened up considerably, Watts stands in some jeopardy of not being able to obtain additional government work.

A survey of possible modifications in defense purchasing regulations with Albert Lazure, Director of the Office of Small Business and Economic Utilization Policy at the Department of Defense, and Constantine Cinquegranna of the Defense Supply Agency indicates a few areas in which a measure of compensatory help might be worked out. For one, it may be possible to extend the "mobilization base" exception to the Procurement Act to some degree, particularly to firms making materiels which tend not to be in regular production at the onset of national emergencies. Additionally, and of greater promise, is the possibility that the Department of Labor could define distinct ghetto communities within otherwise healthy cities as persistent labor surplus areas, thus qualifying firms within them or immediately nearby for partial set-aside preferences under Defense Manpower Policy Number 4. According to Cinquegranna, the labor surplus set-aside preference ought to serve as the equivalent of the 5–10 per cent training cost differential which Wayne Mullane has guessed might otherwise be needed by Watts-type companies in the event that such companies are established on a widespread basis. Rulings of the Comptroller General indicate that labor surplus set-asides can be utilized to a fairly substantial degree, and with proper direction, a modification by the Department of Labor of its regulations could make a significant difference. What is most promising about such an approach is that the parent companies would need and receive no direct subsidies, something which Aerojet feels would run counter to the very spirit in which the ghetto subsidiaries must be set up. The fact is, according to Aerojet, that with very little government assistance, or perhaps even without it, such companies can be put on a paying basis.

IV. CONCLUSION

Morale at the Watts plant appears high and its efficiency record is good. For example, the Army now only engages in spot inspections of the tents rather than the 100 per cent inspections it originally insisted upon and expected to use a fairly long time. Although the original order of the woodwork division, the principal problem of the Company is in retaining the semi-skilled workers who find it fairly easy to move on to better paying jobs.

The turnover record of the Company is low. Discounting the 50 workers laid off in April and disregarding the semi-skilled workers who have presumably left to go on to better jobs, employee stability is appreciably better than management of Watts had originally expected. The Company has not made a systematic survey of the people who have voluntarily terminated their employments. It may well be that a far higher proportion than the Company would dream of claiming have left to go on to higher paying jobs.

While the return on capital is, of course, appreciably lower than Aerojet-General might otherwise have realized on a $1.3 million investment, the Company expects to do somewhat better than break even this year. Areojet was prepared to take an operating loss for the year.

Senator SMATHERS. Thank you very much, Mr. Secretary. We do appreciate that statement.

I want to echo the sentiments expressed by the distinguished Senator from New York at the outset. I don't know of any individual who has really been more public spirited, not only during the time that he worked here with the administration, but particularly since he has been out in private business, than yourself.

What you have done in Watts is certainly a type of a shrine and should be looked up to by other business leaders. It certainly is appreciated by those of us in Government.

Senator KENNEDY. I have just one or two questions.

Do you think we are going to have continued problems and more troubles and difficulties in the country if we do not make more jobs available to those who live in the ghettos?

Mr. KIMBALL. I don't think there is any question about it. If you don't give those people jobs, they will go out in the street and cause trouble.

Senator KENNEDY. Do you think we are doing enough at a national level at the present time to provide the jobs, the housing, and education?

Mr. KIMBALL. We are not doing it at all.

Senator KENNEDY. Would you agree that in order to have a successful program, we have to involve the private enterprise system actively?

Mr. KIMBALL. You have to have better housing. Watts isn't quite as bad as the rest of them. But the lack of jobs, the lack of getting to jobs, is very real in all of these places. Most of the people you have to employ in those places are people who are unemployable.

We make our application for jobs very simple. We don't ask them if they have had a felony or have been in jail. Most of them have. The reason they have been in jail is because they haven't had a vigorous push. If they haven't something to do, they go out and get in trouble. But they are very good workers.

Senator KENNEDY. Do you think if we pass legislation along the lines now being considered by this committee in the field of housing, and in the field of employment, that it would interest the private sector in getting involved in some of these matters?

Mr. KIMBALL. In the first place, if we don't pass something like this and get something going like this, I think we are failing in our leadership to do the necessary things to give those people opportunity.

Second, I think if you give those incentives—I have talked to, I guess, a hundred business firms and they all have their doubts—if you give them a little help most of them want to go in and will go in. I think if we really push it, such as with these two bills, I think you can make a real change in this in the next year.

We have talked about it during the last 2 years. You have to get some of the complications of Government out of the way.

We had the plant started and running before they gave us a job training program. You can't do business that way. The Secretary of Labor said this week he has that one handled. If we waited for a job training program, we would never get the plant started.

You have to put the work with the skills they can do. You can't put skills for a high-precision machine in there, because they don't know how to do it. But they are learning and they are learning very rapidly.

Senator KENNEDY. Thank you.

Senator SMATHERS. Thank you very much.

At this point in the record I want to introduce the statement of the mayor of Philadelphia, the Honorable James H. J. Tate, who had planned to be here in person to deliver this statment, but due to an unforeseen emergency had to return to Philadelphia. The statement will be made a part of the record at this point.

(The statement referred to follows:)

STATEMENT IN BEHALF OF THE NATIONAL LEAGUE OF CITIES BY JAMES H. J. TATE, MAYOR OF PHILADELPHIA, PENNSYLVANIA, AND PRESIDENT, NATIONAL LEAGUE OF CITIES

Mr. Chairman and members of the Committee, I am James H. J. Tate, Mayor of Philadelphia, and President of the National League of Cities. In both capacities, I am happy to testify before the Senate Finance Committee on Senate Bill 2100, the Urban Housing Development Act of 1967, sponsored by Senator Kennedy and others, including Senator Smathers of this Committee.

Two weeks have now passed since Labor Day. For some reason which is mysterious to me and the other mayors of America whose job it is to deal with the problems of our cities on a day-to-day basis three hundred and sixty five days a year, a great many Americans, including members of the press, seem to regard Labor Day as a critical turning point in the life of our cities.

The nation's attention, which was riveted on our cities during the summer months of violence and destruction, seems to turn idly to other matters after Labor Day has passed.

But, gentlemen, unless we turn our attention to the solution of summer's problems during the long cold winter months, each succeeding summer will grow progressively worse, as it has grown worse each summer over the past years.

Although the events of this summer thrust themselves with dramatic suddenness on the nation's consciousness, if the nation had been listening when the mayors of America testified before the Committees of congress, when they presented their problems to the executive agencies of the Federal government, when they pleaded for assistance from the governors and state legislatures, they would not have been surprised by the swiftness of summer's violence.

Neither the Executive Branch nor the Congress has yet become fully aware of the needs of urban America or the priority that they require. Without a much greater sense of national urgency, the urban crisis can only get worse. Unless the troubled cities of America can count on the same support from the President and Congress that other more traditional programs receive, we will not solve the problems of the cities.

While such responsible observers of urban affairs as the Urban Coalition, the AFL–CIO, the A. Philip Randolph Institute, and several members of Congress have proposed new programs which would assign from $6 million to $20 billion a year to meet urban needs, the President's recommendations call for only a fraction of these sums. As distressing as this is, it is even more distressing that Congress has debated all summer over spending just a portion of the Preident's minimal requests for urban programs.

The Urban Coalition brought together nearly 1200 leaders from local government, business, labor, civil rights, and religious groups on August 24 to document their concern for urban needs following a long summer of unrest. After expressing this concern to Congressional leaders Coalition spokesmen were unable to report any significant Congressional recognition of the scale of the need or the urgency for getting on with this vital job.

In speaking for over 14,000 mayors and other responsible leaders of American cities—people who deal with these problems on a day-to-day basis—I can only say that if we do not begin now to deal with the basic problems creating unrest and discouragement which vitally affect over 70% of our population; if we do not take steps now to assign substantially greater public and private resources to meet these problems, then we must accept the fact that our troubles have only begun.

It was my privilege to be called by the President to the White House briefing on the announcement of the nation's insurance industry that it will make available $1 billion for development in ghetto areas. This is a significant turn of events but in relationship to the total private sector commitment necessary to assure elimination of substandard urban conditions, it is nominal.

The appeal of S. 2100 and its companion S. 2088, is that they recognize the fact that we must use all of the imagination and initiative of the private sector to provide massive new housing, employment and job training opportunities for the unemployed and the underemployed slum residents.

I want to congratulate this Committee for turning its attention to what is, in my opinion, one of the most crucial factors in the question of how we solve the problems of our cities: How do we attract the vast resources and inventive genius of the American free enterprise system to the urgent task of cutting out

the cancerous growth of slums, whose malignancy threatens the life of every major city in America?

On the basic approach of the legislation before you, which is involving private enterprise in the task of rebuilding our slums by providing adequate economic incentives, the National Municipal Policy adopted in Boston this August by the National League of Cities had this to say:

"A closer link must be established between public and private resources. Urban renewal and urban improvements should attract the investment of private capital. Greater participation of the private sector can be achieved by making rehabilitation and new construction more profitable than retention of deteriorating structures which contribute to an unhealthy environment. Federal, state and local policies which discourage investment of private capital should be modified, and innovative methods should be devised which will lead to the maximum involvement of private enterprise in programs for community development."

The basic thrust of the legislation before you is to create the maximum involvement of private enterprise in programs for community development which our National Municipal Policy calls for.

Moreover, we have a program in Philadelphia, called our Vacant House Rehabilitation Program, which demonstrates that the results which this legislation looks for, can be achieved. Our program is presently supported by a Federal subsidy, but the same results could be achieved without the Federal subsidy if economic incentives were offered private developers to do the job on their own.

The situation we found ourselves faced with in Philadelphia several years ago was that we had some 20,000 properties scattered throughout the city in our poverty areas which literally had been abandoned by private enterprise. They were abandoned, dilapidated and unoccupied. They were horrible eyesores whose very presence caused further deterioration of the neighborhoods in which they were located. They become breeding places for rats, for crime, and were threats to the very safety of the neighborhoods in which they were located. Moreover, the vicious cycle fed on itself. The more houses which became abandoned, the more hopeless it became for private enterprise to operate in these neighborhoods, and the rate of abandonment increased.

My administration proposed to the National Administration that we take these properties and rehabilitate them up to standards of decency and convert them into housing for low income families.

In proposing this to the Federal government I pointed out that it would achieve a great number of worthwhile results. Among these we have noted the following:

1. By rehabilitating these rundown properties we can halt the paralyzing blight which is plunging the slums into further deterioration.

2. Because we are working with vacant structures we do not have to throw people out of their homes in order to create better housing for them. Unlike traditional slum clearance programs, every house we rehabilitate is an instant increase in the total housing supply, without any intervening period of relocation.

3. Through this rehabilitation program we create a new homebuilding industry, achieving economy in operation by building up a volume of units which enables developers to apply mass production methods.

4. Finally, we create decent low income housing of a type preferred by the potential tenants and the neighborhoods in which it is located, quicker and cheaper than traditional high rise public housing projects.

Because of the experimental nature of the program it took some time for the Federal government to work out all of the provisions of the program, and in the meantime a pilot program has been operating in Philadelphia under which we have created 1,200 of these units.

Early in August the Department of Housing and Urban Development announced a grant of $70 million—the largest grant for public housing ever to be made for the creation over the next three years of 5,000 units of low income housing under this program.

We are now in the first month of this new program. Some 85 houses are under contract with private developers at the present time, and another 200 will be put under contract before the month is out. Three weeks from the time the contracts are let the rehabilitated housing will be ready for use by low income tenants.

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From analyzing last year's experimental program we know the results will be those which I predicted from the new program. Last year the Philadelphia Housing Authority produced 1,000 dwellings in less than one-half the time it has taken to produce 500 units on the most recent elevator construction site. The cost of a three-bedroom unit under this program is $11,700, compared to $20,000 per unit in elevator construction. The rent for a three-bedroom unit is $63.00 per month, including all utilities. Because these units represent a different style of living for public housing, tenant applications have doubled since the program started.

I should like to emphasize that this program relies entirely upon private enterprise in its rehabilitation program. I might also add that it relies on small businessmen, and recruits its labor force almost entirely from the ghetto areas themselves.

The thing that makes this program work is a public subsidy provided by the Housing Assistance Administration to our local housing authority. However, the same results could be achieved if sufficient economic incentives were offered to private capital to close the economic gap now provided by the public subsidy. I believe that is the basic objective of the legislation before you. I think our Philadelphia program demonstrates that housing once abandoned by private enterprise can be brought back into the housing market if private industry is offered sufficient enticement to return to the ghetto.

As Senator Kennedy stated himself in the remarks he made on the Senate floor when he introduced this legislation, the provisions of his bill are intricate and complex. The workability of some of the provisions can only be determined by tax experts. However, I should like to make some direct comments on some of the provisions of the bill.

The bill establishes a new Low-Income Housing Administration within the Department of Housing and Urban Development, because, as Senator Kennedy says, FHA's primary interest is in the construction of single family homes for middle income families, and the methods developed to deal with the suburbs are not well suited to ghetto areas. In fact, FHA's financing policies have on one hand encouraged the flight to the suburbs and on the other hand furthered the deterioration of the ghetto by refusing to finance construction in the poverty areas.

However, I am somewhat skeptical of the idea of adding another administrative unit within the Department of Housing and Urban Development with entirely new staff, without creating serious delays and increased internal competition with other administrative units of the department.

My own suggestion is that this program together with other subsidized below-market interest rate programs, such as 221-D-3, 202, 221-H, and others, be grouped together under the Housing Assistance Administration.

I also must express some concern with the goal of the program—that of providing two and three bedroom units in multi-family buildings at "less than $100 a month."

The bill contemplates per-unit construction costs between $10,000 and $15,000, with rentals ranging from $73 to $90 respectively. Housing experts advise me that if we use 18% of a family's income as the figure which should be allocated to rent payments, an annual income of $4868 would be required for a family paying just $73 per month. And even figuring in a Federal subsidy of as much as 7%, an annual income of $3500 would be required for the $73 a month dwelling unit. At 18%, the income figure increases to $6600 for the $90 a month unit.

Such a program does not really strike at the heart of the low-income housing problem, at least as it is felt in Philadelphia. Our greatest need is for units suitable for large families of low income families often only able to afford rentals of $40 to $70 a month, if they are not to be deprived of other important needs, such as food and clothing.

Finally, with regard to the suggested reduction of local real estate taxes with partial reimbursement by the Federal government; this would be impossible in Pennsylvania, as such tax concessions are barred by our constitution. I suspect the same legal barriers exist in other states.

However, in spite of these relatively minor concerns, I heartily endorse the principle of this legislation.

I should like now to address myself to another aspect of the question of federal tax policies and private investment in housing, since this matter also falls under the jurisdiction of this committee.

The National Municipal Policy of the National League of Cities states the following principle:

"Federal government tax policies provide both incentives and barriers to private investment in urban housing. Barriers must be eliminated, as well as certain policies which discourage improvement of property. Consideration should be given to greater use of tax abatements, tax credits, and accelerated depreciation allowances.

"Owners of rental property may now take accelerated depreciation allowances even though needed repairs are not made and a building's condition violates city housing codes. These depreciation allowances should not be available unless rental property owners possess a certificate stating that the property is in compliance with all city codes."

I am pleased to note that Senator William Proxmire has introduced an amendment to S. 2100 which would accomplish this purpose. I heartily endorse his amendment.

Gentlemen, I have devoted my remarks to S. 2100, which is the principle concern of these hearings. However, I would also like to supply for the record a few remarks concerning S. 2088, the Urban Employment Opportunities Development Act of 1967, because I am completely convinced that unemployment and the lack of adequate housing are the root causes of unrest in the ghetto, resulting in idleness and frustration.

Mr. Chairman, I thank you for extending the opportunity to testify before your distinguished committee.

SUPPLEMENT TO MAYOR JAMES H. J. TATE'S TESTIMONY GIVEN ON SEPTEMBER 15, 1967, BEFORE THE SENATE FINANCE COMMITTEE, CONCERNING S. 2100

I would like to make a few remarks concerning S. 2088, the Urban Employment Opportunities Development Act of 1967, because I am completely convinced that unemployment and the lack of adequate housing are the root causes of unrest in the ghetto, resulting in idleness and frustration.

When Philadelphia was threatened by the outbursts of violence which swept so many other American cities this summer I immediately took emergency action to safeguard of our citizens and our community. These efforts cost our city an additional $5 million for added police protection to avoid the devastating destruction which occurred in Newark, Detroit, Milwaukee, New Haven and other cities.

Immediately upon declaring this police emergency, however, I promptly instituted a Jobmobile Program, which cut through the red tape of a Federal employment program in order to put people in the ghettos to work immediately. But this program offered only a limited, short-range solution to the problem of ghetto unemployment. Long-range solutions must be found.

In November 1966, a special survey of employment and unemployment in North Philadelphia conducted by the Bureau of Labor Statistics revealed an 11% unemployment rate. Along side of this sub-employment: Defined as those who were employed only part time; heads of households with incomes of less than $60.00 a week; and those actively looking for work or unable to get it, amounted to 34%.

I could easily continue with the sorry statistics describing the characteristics of the unemployed. Suffice it to say that the loss of production jobs within manufacturing, most of which required little skill, has in no small way contributed to unemployment conditions which prevail at this time.

In the face of these grim facts, we have not been idle. In the period from July 31, 1958 to July 31, 1967, our Philadelphia Industrial Development Corporation through its special devices has managed to retain as well as create close to 50,000 jobs for the city of Philadelphia. Without a doubt, conditions in Philadelphia would be far more severe had this operation not received the full support of business and local government.

The Urban renewal program of the Redevelopment Authority of the city of Philadelphia in the same period has been directly responsible for the retention of 17,500 jobs.

It is important for me to point out however, that these operations confined themselves strictly to real estate operations, making possible the delivery of undeveloped land, the construction of new buildings, or the rehabilitation and expansion of existing ones.

Through a consortium of major banking institutions in the city known as the Southeastern Pennsylvania Development Corporation, another major gap was closed in the effort to stimulate private enterprise, namely the provision of venture capital for product development, for equipment and for overhead operating expenses.

While the accomplishments of these agencies are indeed impressive, what we are doing is still not enough. The fact remains that in Philadelphia at this very moment an estimated 40,000 unemployed persons, one-half of whom are estimated to be Negroes, are seeking jobs.

All of these programs have one common major shortcoming. This is the time factor, in the sense that a project proposed under any of these agencies might take from one to four years to become operational. In contrast, because it operates through the existing private enterprise system, because it does not require the creation of new governmental departments or agencies, because it requires no great new outflows of government spending and at the same time accepts the basic premise of our free enterprise system, namely operation for profit—it is my conviction that quick and positive response to the incentives provided in Senator Kennedy's bill can be anticipated.

In addition to the attractiveness of the tax incentives provided in this bill, the added provision for specific training tailored to the jobs that will be created has my approval and support.

However, I should like to offer additional concepts for your consideration to to assure the effectiveness of this bill in achieving its goal.

First, I should like to recommend that bank loans made to a business enterprise under the provisions of this bill be covered by insurance from the Small Business Administration.

Second, that the interest on bank loans for such businesses in depressed areas be declared tax free. Exempting such loans could release a substantial flow of investment resources.

Third, we are presently aware that any number of opportunities for the creation of new enterprises exist in Philadelphia as in many other cities. By this I mean we can demonstrate that we have the product, the market, the production facilities and in a number of instances, willing lenders. The one ingredient that is missing is management. Therefore, I strongly recommend an increase in the $20 million allocation for special training that would be directly applied to the training of qualified or promising managerial talent.

Fourth, recognizing a common characteristic of business enterprise to "go slow" in any new venture, I would recommend that the minimum of 50 jobs as a qualification for certification be reduced to 25.

We also recommend that the minimum number of employees which must be drawn from the poverty area be reduced from two-thirds to one-half of total employment in order to extend the impact of the bill to industries which use a relatively high proportion of skilled workers.

Fifth, recognizing the inevitable fears that can arise in the ranks of organized labor presently employed and governed under specific union contracts that new employment in a particular trade or skill would jeopardize their position, I strongly recommend that provisions be made requiring advance negotiations and agreement with unions that are affected which would provide for moratoriums on hiring practices, wage scales, and working conditions for a reasonably long enough time to permit the infact operation to stabilize itself.

In conclusion, to quote Senator Kennedy, "This bill will not solve the problems of poverty. But it will help. It will not educate children—but it will give their fathers jobs, and their families income, and thus help create a family atmosphere in which education can more easily take place. The bill will not cure disease—but it will help provide the incomes to buy better food, and decent living conditions, and to pay for decent medical care. It will not comfort the old, or banish discrimination, or create by itself a sense of community in the city, but it will engage the energies and resources of a nation, as they have not been engaged before, in a new partnership against poverty, a partnership of government and its people, business and labor and the poor themselves."

Mr. Chairman, I thank you for extending me the courtesy of testifying before your distinguished Committee.

Senator SMATHERS. Our next witness is Mr. John C. Williamson, director of governmental relations, National Association of Real Estate Boards.

STATEMENT OF JOHN C. WILLIAMSON, DIRECTOR OF GOVERNMENTAL RELATIONS, NATIONAL ASSOCIATION OF REAL ESTATE BOARDS, ACCOMPANIED BY JACK SEXTON, SPECIAL TAX COUNSEL

Mr. WILLIAMSON. I have with me Mr. Jack Sexton, attorney at law, our special tax counsel.

I have a relatively brief statement I would like to present.

Mr. Chairman and members of the committee, I am pleased to present the views of the National Association of Real Estate Boards on certain aspects of the bill S. 2100.

The legislation provides for certain substantive changes in our housing laws, as well as changes in the Internal Revenue Code designed to encourage private industry to construct and rehabilitate housing in certain administratively defined slum areas.

We are limiting this testimony to the tax incentives proposed in the bill. The provisions relating to more liberal housing insurance, submarket interest rates, and the creation of a new constituent agency to cope with the problem of housing assistance for low-income families are under study by the realtors' Washington committee of our association and are on the agenda for consideration at our forthcoming national convention.

The proposals are very complex and our delay in formulating our policy position is not indicative of the sense of urgency with which we view the tremendous problem of upgrading the housing standards of millions of American families.

We address ourselves to the changes in the Internal Revenue Code set forth in S. 2100. Some are identical to proposals made by our association in conferences with the Treasury Department and in testimony before this committee. Others are so far reaching as to require further study by our tax committee.

On the other hand, we will make some recommendations which have a bearing on the objective sought by S. 2100, although not specifically covered by the bill.

Before going into specific details, I would like to mention our misgivings about limiting any changes in the tax laws to specific geographical areas or to specific real estate projects.

We believe that if a change in our tax laws is warranted it should be of general application. While housing conditions in the metropolitan slum areas have deen dramatized by the events of the past 2 years, let us bear in mind that most of the families of lower middle income—those earning from $4,000 to $6,000 per year—are not in metropolitan communities but in small towns and rural areas where they would be less likely to be reached by measures limited to the big-city core areas.

I understand Senator Kennedy is proposing an amendment that would extent this to rural areas. We were not aware of the amendment when we prepared this statement.

The investment credit: S. 2100 provides for a scale of investment credits for both first holders and subsequent holders of section 1391 property, which is property constructed or rehabilitated in a defined area and certified as eligible for the investment credit by the Secretary of Housing and Development.

The 7-percent investment credit enacted in 1962 was not extended to real estate buildings, although certain properties such as elevators and escalators were added in the 1964 Revenue Act.

The investment credit was designed as an incentive to private industry. It was advocated with enthusiasm by the Treasury Department, which apparently was not as concerned then with changes in the tax laws to achieve nonrevenue objectives as it apparently is now in appraising S. 2100.

The Treasury advocated the investment credit as a permanent part of our tax system. Its nonrevenue objective made it an extraordinary method for encouraging expansion of plant and equipment.

While we are not ready to comment on the specific investment credit recommendations in S. 2100, we do believe there is valid basis for extending the investment credit to residential properties under certain extraordinary conditions.

This contradicts the statement I made earlier that changes in the tax laws should be of general application. I think there should be an exception in the use of the investment credit because the Treasury Department over the years has wanted to extend investment credit to real estate buildings on the condition that the capital gains tax on the sale of real estate be terminated to the extent of the depreciation taken.

In our conferences with Treasury in 1962 and 1963, in order to save the capital gains tax, we said that we didn't want the investment credit. But this is an extraordinary situation and calls for extraordinary methods. I think in this instance the investment credit would be justified in handling this particular crisis.

The Congress is now legislating in an atmosphere of crisis more grave than that which motivated the recommendation to give industry the 7-percent investment credit. We have a number of housing and urban subsidy programs which appear to be nibbling at the edges of the urban crisis. Our association supports several of these programs, but their success is hampered by fiscal considerations.

Certainly at a time when we face a probable $28 billion deficit is not the time to consider the Government expenditure route to cope with the critical problems generated by slum areas. We can think of no more propitious time than now to put the private sector to work through the same device—the investment credit—that launched the plant and equipment boom of the past several years.

We, therefore, endorse in principle the provisions of S. 2100 that would extend the investment credit to construction and rehabilitation of residential properties.

CAPITALIZATION OF DEMOLITION COSTS

The Internal Revenue Service takes the position that where a taxpayer acquires property and demolishes existing improvements in order to construct new improvements, the cost of the demolition is treated as part of the cost of the land. (Treasury regulation, section 1.165–3(a)).

On the other hand, the IRS allows costs of excavating, grading, and removal, as well as costs of clearing land, to be capitalized and depreciated as part of the cost of the new improvements. (Rev. Rul. 65–265,

1965-a CB-52; Algernon Blair, Inc., 29 TC 1205 (1958), Acq. 1958-2 CB-4.)

Since demolition of old improvements represents the first step in construction of new improvements, there is no reason to treat this step differently from later steps, such as clearing, removal, and excavation.

Our association has proposed that the net cost—actual out-of-pocket expenses—of demolition be included in the cost of new improvements. While the primary purpose of this proposal is to correct an illogical inconsistency in the present position of the Internal Revenue Service, the proposal would also have the effect of encouraging the replacement of old improvements with new improvements. This provision is included in S. 2100 and we urge its approval.

AMENDMENTS TO SUBCHAPTER S

Our association has long advocated a change in subchapter S to permit a corporation whose income is largely attributable to rents to elect to be taxed not as a corporation. Under existing law, a corporation is precluded from making the election if more than 20 percent of its income is attributable to rents. We believe this was an arbitrary exclusion which bears little relationship to the purposes of subchapter S.

We support this provision in S. 2100, although we recommend it be extended generally and not be limited to section 1391 projects.

DEDUCTION OF PORTION OF REHABILITATION EXPENDITURES

In order to encourage the rehabilitation of old buildings, our association has proposed that a portion—computed on a sliding scale varying with the age of the building, from 20 percent to a maximum of 50 percent—of the cost of rehabilitating buildings at least 20 years old be allowed as a current income tax deduction.

Under present rules, the entire cost is deductible over the many years of the useful life of the rehabilitated building. By providing a more current tax benefit, taxpayers would be encouraged to improve below-quality buildings.

Appropriate safeguards against abuse are included in our proposal. For example, the deduction does not apply to expenditures which increases the floor area of the property. The recapture provisions of section 1250 would be applied to rehabilitation expenditures so deducted.

This proposal would encourage expenditures which would prevent old structures from becoming slums and would rehabilitate old structures which have become slums. We suggest that the committee consider this proposal in its consideration of tax legislation such as S. 2100.

CONTINUED TREASURY DISCRIMINATION AGAINST REAL ESTATE

In addition to the Treasury's refusal to agree to allow the investment credit for real estate, the Department also discriminated against real estate in its 1962 depreciation guidelines (Revenue procedure 62-21, 1962-2 CB-418) in which the useful lives for property other than real estate were shortened sharply in recognition of the admittedly unrealistically long useful lives than in use by the IRS. However,

arbitrarily, useful lives of real property were not granted equal treatment.

This inequality is particularly unfair because obsolescence is an especially important factor with respect to real property causing the decline of the economic usefulness of a property prior to the end of its physical life.

We, therefore, recommend that the Congress direct the Treasury to revise downward the "useful lives" guidelines for real estate.

Mr. Chairman, we have not discussed in this testimony the changes relating to real estate depreciation which in many respects represent the heart of this bill. The reason is that the subject is under review by not only our tax committee, but our Committee on Real Estate Economics.

We are a large trade association of 86,000 realtors. We have 300 directors and many committees. Sometimes it is a long process to determine policy. However, our convention is meeting this fall in Washington, D.C. and we hope at our convention to make a policy determination on other aspects of this bill.

Senator SMATHERS. As a general rule, your association would prefer the use of free enterprise and private enterprise, rather than a Government approach, in the meeting of any problem?

Mr. WILLIAMSON. Yes, sir.

Senator SMATHERS. And while you are now saying your association has not yet taken a specific view as to the long-range concepts in this particular bill, generally you are for the private enterprise approach.

Mr. WILLIAMSON. That is correct.

Senator SMATHERS. Senator Kennedy.

Senator KENNEDY. Would you agree that our urban problems which erupted so dramatically and unfortunately this past summer are so acute and serious that we need at least this kind of an effort to bring the private sector into the ghetto actively?

Mr. WILLIAMSON. It calls for extraordinary methods. We have been working for many years on the other programs, the rent supplement program, the public housing and section 221(d)(3).

As we said in our testimony, these programs just nibble at the edges. Even a section 221(d)(3) program involves the purchase of a mortgage with Treasury money. It is a public debt transaction. Every year the Budget Bureau has to worry about how much money can be spent.

The rent supplement program, which is a promising program, was almost extinguished this year. It might be revived, but if it is revived, it is revived on a very small scale. The problem needs extraordinary methods.

This is the first bill that we have seen that reflects some imaginative thinking, a new approach, to put the private sector to work on a very, very serious problem.

Senator KENNEDY. If you could, I would like to have some followup material on how you would extend this program into some of the smaller communities and whether you think the legislation that is now in existence, 221(d)(3) and public housing, deals with these communities satisfactorily, and, if not, why not. Perhaps you could at least furnish a memorandum to the chairman and to me.

Mr. WILLIAMSON. Yes. We would like to submit a supplementary statement on this bill.

Senator KENNEDY. That would be very helpful.

(The supplementary statement follows:)

SUPPLEMENTARY STATEMENT OF JOHN C. WILLIAMSON, DIRECTOR OF GOVERNMENTAL RELATIONS, NATIONAL ASSOCIATION OF REAL ESTATE BOARDS

This statement is submitted in compliance with Senator Robert Kennedy's request for suggestions as to how S. 2100 may be extended to smaller communities.

As indicated in our testimony on September 15, we feel that the tax benefits which would be accorded by S. 2100 should not be limited to any specific geographical area. Not only are most families in the $4,000-$6,000 income range not located in metropolitan areas, but a majority of persons living in substandard housing live in non-urban areas.

Therefore, we recommend an amendment to S. 2100 to delete the term "urban" from the phrase "urban poverty area" as used in the bill. Thus section 101 of the bill would authorize the Secretary of Housing and Urban Development to issue certificates of eligibility to applicants desiring to provide housing in "poverty areas." The term would be redefined by deleting from section 3(2), following the comma after the word "area", the phrase "within a standard metropolitan statistical area containing a population of at least two hundred and fifty thousand". This would have the effect of granting incentives to persons who build housing in poverty areas regardless of where they are located.

Also, we urge the deletion of the provision in section 101(a)(5)(A), requiring that 100 units of housing be built by a sponsor in order to qualify for a certificate of eligibility. We feel it is undesirable to place any minimum limitations in the bill as to the number of units a sponsor must build.

As the bill is now written only large, high-income sponsors can take advantage of the incentives it would offer. We feel it would be to the government's advantage to encourage smaller entrepreneurs to enter the program, because the lower the sponsor's tax bracket the less the actual cost to the government. All categories of sponsors should be encouraged.

Senator Kennedy also requested our comment on the success of existing programs in non-urban areas. In this regard we note that urban areas have absorbed about as much public housing as they can. Because public housing units are government-owned they are exempt from local taxation. Therefore, there are very definite limitations on the amount of public housing any community can absorb. Thus in recent years, the bulk of public housing projects have been in nonmetropolitan areas.

The rent supplement program has been almost exclusively a non-metropolitan program, and the reason for this is that high land costs and market interest rate make such projects unfeasible in large cities. Even with the supplement, units cannot be provided at required costs. Thus, some 84 per cent of the rent supplement projects approved by FHA to date have been in cities of less than 200,000 population—and a majority of these have been in cities of less than 100,000.

FHA Section 221(d)(3) projects follow the opposite pattern. With the below-market interest rate, reductions in rent do make feasible projects renting at the upper limits of eligibility in large metropolitan areas. The difference is that Section 221(d)(3) income limitations rise well above those for rent supplements and public housing. FHA attributes the lack of success of Section 221(d)(3) in smaller areas to a general lack of construction financing in non-metropolitan areas.

S. 2100 offers a program which can be of tremendous benefit to both urban and non-urban areas. Because of the high equity investment required and the fact that funds can be borrowed at 2%, costs can be kept within feasibility ranges in large areas. Moreover, the federal contributions to local governments will make it possible for large cities to approve Section 235 projects without the fear of loss of revenue with which the cities must contend in the case of public housing projects. On the other hand, because S. 2100 does not require initial funds to be advanced by private lenders and does not rely on inexperienced non-profit sponsors, it can be utilized by smaller communities as well, if it is amended as we suggest.

Senator SMATHERS. Thank you very much, Mr. Williamson.

Our next witness is Mr. Leon Weiner, president of the National Association of Home Builders.

He is to be accompanied by Dr. Nathaniel H. Rogg, executive vice president; Herbert S. Colton, general counsel; and Leonard Silverstein, tax counsel.

I might say for the record that Mr. Rogg is former chief of the Economics and Statistics Branch of the Housing and Home Finance Agency, the predecessor of HUD. He has also been a visiting professor at Harvard University.

Before occupying his present position, he was the organization's chief economist. He has a degree in economics from the University of Michigan and a law degree from Georgetown University. He is regarded as one of the Nation's outstanding experts in housing.

Mr. Silverstein is the senior partner in the firm of Silverstein & Mullins of this city. He served in the Treasury Department, the General Counsel's office, and as a consultant to the House Ways and Means Committee. He has been a professor of tax law at Georgetown and the senior editor of the Bureau of National Affairs Tax Management Portfolio. He is a graduate of Yale and the Harvard Law School.

For the other two distinguished men who are here as witnesses, I will have to fill in later some of their accomplishments because I have not at this moment been provided them.

Mr. Rogg, you may proceed.

STATEMENT OF NATHANIEL H. ROGG, EXECUTIVE VICE PRESIDENT, NATIONAL ASSOCIATION OF HOME BUILDERS, ACCOMPANIED BY HERBERT S. COLTON, GENERAL COUNSEL; LEONARD SILVERSTEIN, TAX COUNSEL; AND JOSEPH McGRATH, LEGISLATIVE COUNSEL AND STAFF VICE PRESIDENT

Mr. ROGG. Mr. Weiner, whose testimony I will be presenting this afternoon, is unavoidably detained. He cannot be with us.

We are also accompanied by the general counsel of the National Association of Home Builders on my left, Mr. Herbert Colton, and by our legislative counsel and staff vice president, Mr. Joe McGrath.

First, I would like to tell you something about our organization and explain our interest in the legislation under consideration.

We are the trade association, the people who build the Nation's homes. We have 47,000 members in 441 affiliated associations in all 50 States and in Puerto Rico. Our national headquarters is in Washington, D.C., where we have approximately 150 persons engaged in providing services and information to our members. We also maintain a research laboratory in nearby Rockville, Md.

Over the past several years the homebuilding industry has averaged about $20 billion annually in new construction. We estimate that each new home provides at least two full man-years of employment, one on the job and one off. Residential construction thus provides about 3 million jobs a year. Its total economic impact, including the collateral requirements which it generates—such as new schools, community facilities, and services—is estimated at over $70 billion annually. This is second only to the food and food processing industries.

I have attached to this statement, for the record, a more detailed

discussion of the significance of homebuilding as one of the mainstays of the American economy. (Attachment A.)

The homebuilding industry produced about 15 million new homes and apartments in the past 10 years and a total of about 32 million in the past 20 years. We estimate that our members built about 7 out of 10 of those housing units or 70 percent of the total production.

This is indeed a very substantial and commendable achievement. Yet, nevertheless, most of this housing was built for average and above-average income families. It was directed toward the marketplace—to those families with the ability to meet the prices and rents dictated by the economics of construction and mortgage finance.

Little of the total housing production record has met the needs of the mass of low and very moderate income families. It has been in fact almost impossible to meet this market need without some type of Federal, State, or other type of subsidy for those families.

The limited monthly payments which low-income families can afford for new or rehabilitated housing are just not sufficient to offset the high and ever-growing costs of land and land development, the high and increasing wage rates for construction work, and the high and rising local real estate taxes.

A builder simply cannot stay in business and produce this type of housing on such an economic basis.

The answer, some critics say, is simply to increase efficiency in the industry and thus hold down costs. This stems from what is probably one of the most pernicious myths about the homebuilding industry as it produces houses today—that it is a relic of a bygone era in terms of industrial efficiency and cost savings.

The fact is that slowly and undramatically the evolution of the industry has been proceeding. But it has not been the kind of dramatic progress and change which accompanies a breakthrough to outer space.

Therefore, and unfortunately, it has not attracted the attention and interest of those outside of the industry in a fashion sufficient to dispel a general lack of knowledge and serious misunderstanding of what has already been accomplished and what is currently in process in the industry by way of cost-saving techniques of construction and improved industrial efficiency.

I am submitting for your record a table, attached to the end of this statement (attachment B), which shows graphically the increasing efficiency of the industry in the use of labor and materials and of new tools and design systems.

In short, in putting together the structure of housing, we now use substantially less of the total dollars going into the final product than we did 20 years ago—a drop from 74 percent in 1944 to 56 percent today.

Furthermore, we believe the techniques of construction will continue to progress and change for the better at an accelerated pace in the years ahead.

For example, new materials, easier to handle, erect, or put in place and, in many cases more durable, are being created and coming into common daily use at construction sites.

The truth is that the cost of building a house relative to all other consumer prices has risen less rapidly during the 1960's. According to

the Department of Labor, using the 1957–59 base period as the 100 level, the housing cost index for 1966 was 111.1.

On the other hand, the consumer price index as a whole rose to the 113.1 level. Further and even more impressively, as I have already noted, a cost study in 1964 showed that the construction cost of homebuilding had actually declined during the preceding 5 years. This was a special report of our economics department issued September 1, 1964, which I have attached to this statement for the record (attachment C).

These are some of the facts which we think are ignored when criticism is voiced in terms of an asserted lack of industrial efficiency in housing production. Ignored, too, are other inherent impediments to large-scale application of industrial techniques—impediments such as financing, zoning, codes, and the nature of the housing market itself.

There is also another pertinent and pervasive factor to consider: While homebuilding in the aggregate is one of the mainstays of the Nation's economy, the typical homebuilder is a very small businessman. He has very limited capital compared to the substantial dollar amount of the product which he produces and the sizable markets which he meets.

The typical member of our association, for example, builds 17 houses per year. Less than 1 percent of all builders build more than 500 houses per year.

Let me emphasize again, however, it should not be assumed that the organization of the industry into small units is synonymous with inefficiency. The contrary is attested to by the tremendous production job done by the industry in the postwar era.

In fact, it can very well be argued cogently that the organization of the industry into small producing units is necessary in the light of the problems which it faces—that this kind of organization provides greater flexibility, permits adaptation to wide local differences in markets, and enables the industry quickly to expand or contract as necessary to meet changes in economic conditions.

S. 2100 and the Housing Industry

Last month in testimony at hearings on general housing legislation, before the Subcommittee on Housing of the Senate Banking Committee, we expressed our hope that the pending bill S. 2100 would be studied carefully in that subcommittee as well as in your Committee on Finance to which it has been referred for primary consideration.

We noted then our position that:

> S. 2100 may very well prove highly productive as an approach to attracting industry generally to core city areas and we certainly commend this effort.

Later at the NAHB board of directors meeting in Buffalo, N.Y., on August 19, our board officially approved a legislative committee report which among other matters stated that as to S. 2100:

> The industry favors tax incentives for equity investment in slum areas, which is the basic purpose of the bill.

Accordingly, we appear here today in support of the objectives and purpose of S. 2100 and of its general approach in the use of tax incentives to aid in the supply of better housing in urban poverty areas.

At the same time, and quite naturally, we have a number of reservations about the bill and we also have some suggestions for improvement of its provisions.

The thrust of the bill is to encourage high-equity capitalization with a minimum equity of 20 percent and with the benefits of the bill increasing with increased equity percentages.

In so doing, as we understand it, S. 2100 is aimed frankly at large industrial corporations and other large aggregations of capital which can afford to invest for a lengthy period the very large cash sums which would be involved.

To the extent that capital from such sources can thus be attracted the proposal is certainly an experiment which should be tried. Whether or not it would achieve this purpose is, of course, a point on which the opinion of the management of such industrial organizations or capital funds is of much more force than ours.

In the construction industry, however, we think it is important for the committee to understand that few if any homebuilders could afford to tie up the necessary amounts of their own capital in long-term equity investment even in consideration of the tax benefits which the bill would provide. Members of this industry are not long-term investors. They must, and do, turn over their cash as working capital in their businesses.

In a typical project of 100 units (the minimum number permitted under the bill) a minimum 20-percent equity would represent an investment of $200,000 or more in cash. Obviously, it would not take many such investments to eliminate even the largest homebuilder as a productive force and to convert him to a static investor.

We also caution against the tacit assumption of the bill that if its tax benefits attract very large amounts of capital into new housing and rehabilitation projects in urban poverty areas, this will automatically achieve lower housing production costs.

We don't think this is necessarily so, for the provisions of the bill cannot reduce land and land development costs; they do not cut labor costs or eliminate restrictive manpower and labor practices, nor can they correct obsolete and wasteful building codes.

We very much doubt that economies in these areas can be achieved only through capital accumulation, as seems to be assumed by the bill. In fact, there is no evidence that the mere accumulation of large capital amounts will result in more efficiency.

On the basis of limited experience, it could be as well argued that big capital—and a concomitant large organization—is less efficient in the peculiar local nature of the homebuilding industry than an organization of more modest size with limited but sufficient capital.

Therefore, we hope that in further considering the bill, the committee will not limit its application solely to large-scale-investor corporations or only to applicants equipped to undertake the provision of "at least 100 dwelling units of housing."

The bill's provisions both as to its housing amendments and its tax code sections should be drafted flexibly so as to encompass and attract all of the conceivable combinations of large- and small-scale investors, businessmen, and builders.

On the housing provisions under titles I and II of this bill, we understand there may be a further opportunity to present our views if and when this bill is considered in the Banking Committee.

We have no present policy with respect to the proposals for a new section 235 in the National Housing Act, or for a new Low Income Housing Administration in the Department of Housing and Urban Development.

We would like further time to look at these and to run them past our legislative policy committee.

These concepts will be given further attention, we would expect, in the Senate Subcommittee on Housing, together with the bill's proposals for the creation of and assistance to home management corporations, for expansion of relocation assistance, for a new special assistance program in the Federal National Mortgage Association, and for the new eligibility and ocupancy requirements pertinent to the bill's certified projects under the proposed section 1391 properties.

At that time, to the Subcomittee on Housing, we should be able to give a more detailed statement.

As you know, there are a number of extensive housing bills now under consideration in that subcommittee and some of the possible decisions there may affect our thinking with respect to the housing amendment proposals in S. 2100.

In general, however, we strongly favor the concept of property and homeownership toward which the proposed home management corporations are directed.

We also favor Federal action to help relieve the heavy and increasing burden of local real estate taxation, which is the purpose of the grant program under section 106 of the bill.

Throughout the bill, and especially in its housing amendment sections, we hope that the proposals will be drafted and considered so as to give maximum freedom to the entrepreneurial initiative and skills of the homebuilder and real estate developer. There has been no great rush of applicants into the existing high-risk urban renewal and lower income housing programs of FHA.

As we see it, a general and large-scale approach such as proposed by the provisions of S. 2100 taken as a whole needs to be framed in terms designed to appeal to and involve the elements of private enterprise which usually seize the initiative in originating a project and pressing it through to a completed job.

The Tax Code Amendments

We know the committee will hear testimony from Government and other sources as to the cost of the proposed tax incentive uses for housing purposes and that you will weigh carefully the comparison with existing programs of housing assistance in urban poverty areas.

We do not understand that the proposals in S. 2100 are offered as alternatives to existing programs but rather as a supplement and expansion of them.

If S. 2100 is to attract the operating homebuilder, however, or the outside investor, both of which we think are vital to its possibilities of success, we recommend two types of amendments to its provisions under the Internal Revenue Code.

I would like now to have Mr. Silverstein discuss these amendments which we think would be effective and helpful to S. 2100.

Mr. Silverstein. These proposals will take two directions, principally. First, we would suggest that the bill permit a homebuilder to

withdraw from his existing homebuilding operations funds for investment in the so-called section 1391 property without dividend treatment or other tax detriment; and, two, we suggest other amendments to the bill to make their provisions more readily available to those who might join with a homebuilder in providing the equity investment.

As to the inducements to homebuilders to withdraw operating funds from their building enterprises, typically an active homebuilder is required to reinvest after-tax profits from sales of homes in payment of land purchases and other costs incident to new construction.

If his business has been operated for a period of time at a profit, and if funds are available for investment in a section 1391 enterprise, it is necessary that a code device be established whereby such funds can be placed in his hands free of any income or capital gains tax.

For example, if a homebuilder desires to construct a section 1391 property as a proprietorship or with partners, and his own funds for equity investment are "locked in" a homebuilding corporation, it is necessary for such a homebuilder to cause that corporation to declare a dividend or to borrow funds from it for construction of the section 1391 enterprise.

Direct payment of a dividend does not normally present a feasible means of obtaining funds because of the high individual tax rates which would be applicable to the dividend.

While, as an alternative, it is theoretically possible for the homebuilder to "borrow" from his corporation for this purpose, such a transaction raises the threat that, upon Internal Revenue Service audit, the purported loan will be treated as a dividend.

There are many cases, perhaps more than any, under the code today, about loans versus dividends. The suggestion is that inducement into an enterprise of this nature should not carry with it the threat of next year's tax loss.

In light of this, we recommend that a provision be added to S. 2100 which will enable a corporation engaged in homebuilding operations—or any corporation if greater incentive is desired—to distribute funds to be used as equity investment in section 1391 property free of ordinary income or capital gains tax.

Presumably, the person receiving such a distribution for a section 1391 investment would, thereupon, have a zero basis for his investment, so that gain would ultimately be payable on the full amount distributed—to the extent realized—when the stock in the homebuilding corporation is sold.

Many homebuilders, of course, retain fresh memories of the income-tax controversies which arose at the time of the post-World War II section 608 housing arrangements.

We do not think it realistic to expect homebuilders to generate equity capital at the price of a longstanding Federal income-tax controversy. And this will take place unless the safeguards which I have just described are enacted.

As to the inducement to attract outside investors: As occurs with many high-rise construction projects, outside investors contribute money to a partnership for that purpose, receiving cash yield together with tax "benefits" in the form of partnership losses, principally depreciation and interest, principally in the form of depreciation and interest.

We presume that opportunity for construction of section 1391 properties in partnership form is available to the same extent as now is

possible with conventional construction projects, but we believe that the opportunity to utilize the corporate form should be made as attractive as possible.

To some extent, S. 2100 achieves a measure of this objective in that a corporation constructing and operating section 1391 property can qualify for subchapter S treatment even though (unlike any other corporation) substantially all of its income is from rents.

Moreover, S. 2100, would provide that such a corporation can qualify for subchapter S treatment notwithstanding that one or more of its shareholders are corporations.

We do not believe, however, that the liberalization of subchapter S is as complete as it should be. On many occasions, it is necessary that a builder induce more than 10 persons who would desire to contribute funds to a corporation erecting and owning section 1391 property.

This is not possible either under the present law or under the proposed amendments contained in the bill.

We therefore recommend that the provisions of the bill provide that subchapter S be amended to cover a corporation having more than 10 shareholders and more than one class of stock.

If maximum flexibility is desired, we suggest that any corporation constructing and owning the designated section 1391 property be treated as though it were a subchapter S corporation.

We have made a suggestion concerning the depreciation allowance, which appears generally to be covered in your amendment introduced yesterday.

Next is an amendment to provide maximum inducement for equity investments and deduction for amounts so paid.

We appreciate the bill's objective of stimulating equity investments through the device of a graduated percentage credit against tax depending upon the amount of the equity investment. Such credit ranges from 3 to 22 percent of the total cost of the project.

We recommend that an alternative to the above could take the form of a direct deduction for amounts paid as equity investments. In such event, the taxpayer's basis in the property would be reduced by the amount of his investment.

By enabling taxpayers to utilize pretax dollars for equity investment purposes, we believe that a substantial flow of capital can be produced for these purposes.

We recognize fully that such a provision would contradict the provisions of section 263(a) of the code which deny a deduction for amounts paid out for new buildings or for permanent improvements.

On the other hand, the provision of section 263(c), permitting the deduction of intangible drilling and development costs, also can result in a deduction for amounts paid in connection with the acquisition, economically, of an asset.

Mr. ROGG. There are other technical aspects also.

Senator KENNEDY. I think a lot of those suggestions will be helpful and should be studied by us.

Mr. ROGG. We will be more than pleased, Senator, to make our resources available to you and to the committee for any further studies or activity to assist the legislation.

Senator KENNEDY. I am sure the committee staff and my own staff would like to work with you.

(The attachments referred to follow:)

SIGNIFICANCE OF HOME BUILDING IN THE AMERICAN ECONOMY

The impact of new residential construction is a major force in, and spreads throughout, the entire American economic structure. For example, last year's one and one-half million new dwelling units generated in construction activity alone approximately $21 billion. When you add to this the impact of expenditures which are directly related to the construction of new dwellings, such as schools, community facilities, service industries, durable goods expenditures and the like, the total directly related impact of housing expenditures amounts to $35 billion, or approximately $1.00 in every $18.00 of the total amount of Gross National Product activity last year.

Each new home built provides about two man years of employment, half off-site, a little more than half on-site. Last year's housing volume thus provided close to three million jobs. In addition, what the economists call the multiplier effect of such expenditures is also enormous. For example, it has been calculated that the multiplier effect of construction activity as it spreads through the economy in economic terms is about double the direct dollar expenditures. The thousands of products used in new dwellings come from every area of the country and affect virtually every industry. What follows is a short summary of this impact:

Single Family Units

Construction Cost (Structure alone) – One million single family homes represent a total direct construction expenditure of about $16 billion, or approximately $16,000 per house.[1] In terms of labor this means 3,300 man hours of employment per home, or approximately two million man years of employment in the single family housing sector alone.[2]

Site Improvement

In addition to home construction the site improvement costs are estimated to be $2,200 per home, or a contribution of $2.2 billion to the Gross National Product.[3]

Multifamily Units

Construction Cost – The construction cost in 1964 of the multifamily structures alone represents at least an additional $5 billion contribution to the Gross National Product.

The amount spent on site improvements of multifamily units approached $1 billion in 1964.

Community Development

The building of new homes stimulates other types of construction activity. They mean new or bigger schools, more churches, better highways, community facilities, expansion of public utilities, etc. A conservative estimate of these related construction activities would be $3,000 per single family and $1,000 per multifamily units, or an additional $4 billion added to the Gross National Product.[4]

Additional Direct Expenditures

Upon completion of a home and its purchase, an additional $1,000 per unit is generated by the service industries. This would include the commission the builder would pay to the real estate broker, the settlement costs the purchaser would pay the title company, a loan placement fee which would be paid to the local lending institution, fee paid to an appraiser, land surveyor, and real estate transfer taxes paid to both the local and Federal governments.[5]

Durable Goods and Furnishings

A new unit, whether single family or an apartment, necessitates the purchase of new appliances, rugs, drapes and curtains, garden plants and equipment, furniture, and for some, maybe even a new car. New home owners also spend about $200 the first year on improvements. The total expenditure is estimated to be approximately $3,000 per unit, or $3 billion additional goods and services in our economy.[6]

Related Service Expenditures

During the first year the average home owner will spend an additional $2,000:

Real estate taxes on the average new house being built are approximately $400 a year. Interest on an $18,000 mortgage would be an additional $1,020. Insurance for fire, liability, theft, etc., would be between $60.00 and $100.00 a year.[7] Heat and utilities an additional $360, maintenance and repair $150.[8]

The Multiplier Effect

Measuring the direct expenditures resulting from

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the construction of one and one-half million housing units each year, a total demand for goods and services of approximately $35 billion is generated.

The employment of these goods and services and the wages paid generate additional purchasing power with the resultant stimulation of virtually every sector of the economy. Conservative estimates of this "multiplier" factor suggest that these billions spent on new construction itself generates at least an equal amount of other economic activity, thus bringing the total economic impact to $70 billion.

High Level of Home Building Essential to the Economy

New housing construction generates not only demand for on- and off-site construction activity, the services of local banking, insurance and real estate agencies, but the manufacturer has a large stake in the home building market. Each home provides a market for better than 3,000 different items.[9]

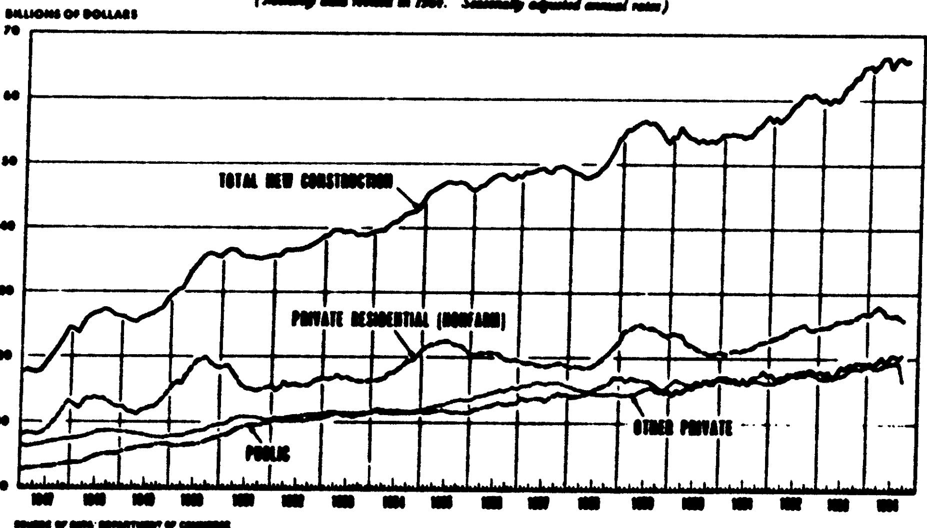
Any change in new construction volume, though it may be slight, would be felt by thousands of factories, national distributors, and their local suppliers. In addition, millions of workers in the industrial community far removed from the construction site would, likewise, be affected.

According to a recent study by the Bureau of Labor Statistics, each $1,000 of single-family home construction price generates a demand for 72 man hours of employment on-site, 35 man hours in transportation, trade and related services, 38 man hours in the manufacturing stage, and 12 man hours off-site construction activity. In addition to these "primary" man hours, they show an additional 47 "secondary" man hours. Translating this into employment statistics we find that for each $1,000 of construction activity, there are 204 man hours of employment generated.[10] A slowdown in construction activity, therefore, would have far-reaching effects on the economy of any community and, in fact, the nation as a whole.

[1] Based on Bureau of the Census C-25 Series, *Sales Housing*, February 1965.
[2] Bureau of Labor Statistics, *Labor and Material Requirements for Private One-Family House Construction*, June 1964.
[3] Housing and Home Finance Agency, *16th Annual Report*, Table III-35, p. 100. Modified to new sales price of new homes as published by the Bureau of the Census, C-25 Series.
[4] M. L. Colean, R. J. Saulnier, *Economic Impact of the Construction of 100,000 Houses*. Chicago: The United States Savings and Loan League.
[5] NAHB Economics Department estimate.
[6] Colean, Saulnier, *op. cit.*, and NAHB Economics Department estimate.
[7] Based on Bureau of the Census, *Sales Housing*, C-25 Series; Housing and Home Finance Agency; American Bankers Association; U. S. Savings and Loan League.
[8] *Survey of Current Business*, and Bureau of the Census, C-25 Series, *Upkeep and Improvements*.
[9] Estimate by NAHB Economics Department, based on Colean and Saulnier, *op. cit.*
[10] Bureau of Labor Statistics, *Labor and Material Requirements for Private One-Family House Construction*, Bulletin No. 1404, June 1964, p. 5.

New Construction, 1947-64

(Monthly data revised in 1964. Seasonally adjusted annual rates)



ATTACHMENT B

COMPARISON OF HOUSING SALE PRICE
1944 -- 1964

	1944	1964
Cost of labor	29%	18%
Materials	45%	38%
Land	13%	25%
Other*	13%	19%

Source: National Housing Agency, Housing Costs (Washington, D.C. Superintendent of Documents, 1944), pp. 24-25.
United States Department of Labor, Bureau of Labor Statistics, Labor and Material Requirements for Private One-Family House Construction Bulletin No. 1404, 1964, pp. 4-7, Chart 2.
National Association of Home Builders, The 1964 NAHB Builder Membership Survey, special tabulation and pp. 22-23.
Note: The 1962 data contained in BLS study was updated by using special survey of NAHB membership conducted in 1964, reflecting changes in techniques and housing characteristics in this period.

* The "other" category in 1944 National Housing Agency Housing Costs study included contractor and subcontractor overhead, and profit. The 1964 data, however, was broader and included sales expenses, equipment expenses, profit, financing costs and services.

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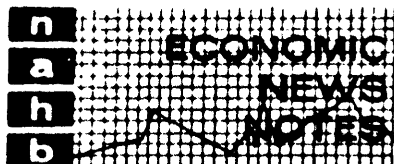

Special Report

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■MICHAEL SUMICHRAST DIRECTOR ■NORMAN FARQUHAR—ASSOCIATE DIRECTOR

SPECIAL REPORT 64-8 September 1, 1964

Rising Land Costs Are Boosting Sale Price of Homes

BY DR. MICHAEL SUMICHRAST

A NEW COSTS STUDY serves to dispel a common belief; it shows that the construction cost of home building has actually declined in the last five years. The drastic increases in land costs, however, have kept upward pressure on the sale price of homes. During this period, while the consumer price index increased 7.1 points, the construction cost of home building in 23 major cities, the study shows, declined 2.2%. It costs 20¢ less per square foot to build the same house than was the case five years ago. Much of this decline is due to greater efficiency of builders. (Previous NAHB research has shown that the increased cost of land, not construction has resulted in higher prices.)

From 1960 to 1964, the consumer price index (1957-59 = 100) increased to 107.8 and the purchasing power of the dollar decreased to 92.9.[1] During the same period, the consumer price index of housing increased to 107.1. The construction cost index, as measured by Engineering News-Record based on 100 in 1913, reached 477 in 1949, 824 in 1960 and 924 in April, 1964. The building cost index showed an increase to 352 in 1949, 559 in 1960, and 607 in April, 1964.[2] (See comparison of construction costs index with building cost index in Chart I.)

The question frequently has been asked. What happened to the construction cost of home building? While it is known that the average price of homes has been increasing,

[1] U. S. Department of Commerce, *Survey of Current Business*.
[2] *Engineering News Record*, June 18, 1964, p. 100.

CHART I

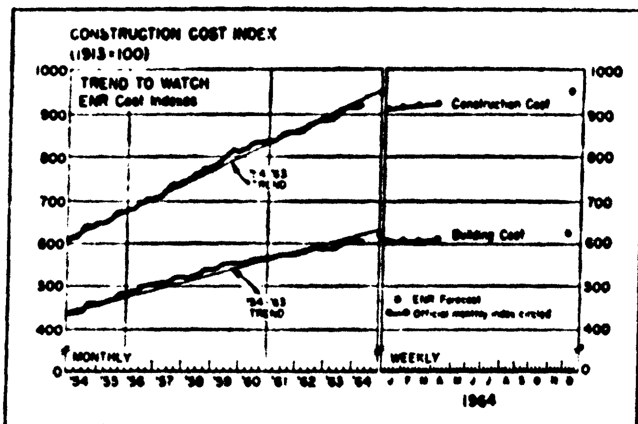

Table 1. CONSTRUCTION COST COMPARISON IN 23 METROPOLITAN AREAS, 1960–1964

City	Cost 1960	Cost 1964	% of Change	Calculated Area in Sq. Ft.	Cost per Sq. Ft. 1964	Type of Construction
Atlanta, Ga.	$ 9,457	$ 9,267	- 2.0	1,229	$ 7.54	Slab, 1-story brick veneer.
Birmingham, Ala.	7,701	7,734	+ 0.4	988	7.86	Slab; 1-story brick veneer.
Boston, Mass.	9,527	9,327	– 2.1	912	10.23	Full basement, 1-story frame, shakes.
Chicago, Ill.	13,789	13,815	+ 0.2	1,196	11.55	Full basement, 1-story, masonry.
Columbus, Ohio	9,911	8,790	– 11.3	1,008	8.72	Full basement; 1-story frame, bevel siding.
Cleveland, Ohio	12,124	11,554	– 4.7	1,064	10.86	Full basement, 1-story frame, wood siding.
Dallas, Texas	8,977	8,690	3.2	1,278	6.80	Slab, 1-story brick veneer.
Denver, Colo.	10,019	9,391	– 6.3	1,073	8.75	Full basement; 1-story frame, wood siding.
Detroit, Mich.	10,650	10,202	– 4.2	1,064	9.59	Full basement, 1-story brick veneer.
Houston, Texas	7,636	7,527	– 1.4	1,012	7.44	Slab; 1-story frame.
Los Angeles, Calif.	8,734	8,265	– 5.4	1,212	6.82	Slab, 1-story frame, stucco.
Milwaukee, Wis.	9,819	9,372	– 4.6	936	10.01	Full basement, 1-story frame, wood siding.
Minneapolis, Minn.	10,111	10,034	– 0.1	1,005	9.98	Full basement; 1-story frame, wood-shakes.
New Orleans, La.	7,330	7,448	+ 1.6	1,014	7.35	Slab; 1-story frame.
New York, N.Y.	11,868	11,467	– 3.1	1,099	10.43	Full basement; split level; frame, asbestos shingles.
Philadelphia, Pa.	7,340	7,344	+ 0.1	1,120	6.56	Full basement, 2-stories masonry, row.
Pittsburgh, Pa.	9,055	8,777	– 3.1	950	9.24	Full basement, 2-stories brick veneer.
Phoenix, Ariz.	7,137	6,994	– 2.0	1,138	6.15	Slab, 1-story masonry.
Providence, R.I.	9,059	9,157	+ 1.1	912	10.04	Full basement, 1-story frame, shingles.
Sacramento, Calif.	10,168	10,418	+ 2.5	1,256	8.29	Slab, 1-story frame, stucco.
San Jose, Calif.	9,873	9,955	+ 0.8	1,224	8.13	Slab, 1-story frame, stucco.
Seattle, Wash.	10,640	10,572	– 0.6	1,141	9.27	Slab; 1-story frame.
Washington, D.C.	10,150	10,180	+ 0.1	1,116	9.12	Full basement; 1-story masonry.
Total	$221,075	$216,280	– 2.2	24,943		
Cost per Sq. Ft.	$ 8.86	$ 8.67				

Note. Cost based on purchasing and production of not a single house, but more houses as usually built in subdivisions. Cost does not include builder's overhead and profit.

Source: Federal Housing Administration and National Association of Home Builders.

reaching $19,100 in March, 1964.[3] it is not accurately known how much of this was due to the average increase in the space provided, different specifications, increase in the price of land, etc. From the construction cost index presented in Chart 1, one would conclude that the cost of home-building construction has been creeping constantly upwards. Previously, because of lack of data, it was impossible to prove that this was not so. But, now for the first time, an NAHB comparison of the construction cost in the last five years is available. The results of this inquiry into what happened to home-building construction cost in 23 major Metropolitan Areas throughout the country in the period studied is enlightening.[4]

The comparison of 1960 and 1964 cost data is adjusted for variations in type and size of house, materials used, and different specifications. Of the 23 cities, 15 registered a decline in cost—as much as 11.3%; while 8 cities showed an increase in cost—as much as 2.5%. The summary of change and the construction cost for each city is presented in Table 1.

The study shows that on the average it cost from $7.35 to $9.27 per square foot to build a frame, one-story, detached house on slab, and from $8.72 to $10.86 to build a frame, one-story, detached, full-basement house. The average cost per square foot for all slab houses studied was $7.79. The average cost for all basement houses (including split-level and 2-stories) was $9.66. Table 2 shows the average cost in all 23 cities.

Table 2. AVERAGE COST PER SQUARE FOOT IN 23 METROPOLITAN AREAS, 1964

Type of House		No. of Cities	Average Cost Per Sq. Ft.
Slab:	Frame	3	$ 8.02
	Brick Veneer	3	7.40
	Stucco	4	8.31
	Masonry	1	6.15
Basement:	Frame	7	9.80
	Masonry	1	11.55
	Brick Veneer	1	9.59
	Split Level	1	10.43
	2-story Brick Veneer	1	9.24
	2-story Masonry Row	1	6.56

Average with slab: $7.79 per square foot.
Average with basement: $9.66 per square foot.

Source: Table 1.

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[3] Bureau of the Census, *Housing Sales*, C-25.

[4] Cost data is based on FHA unpublished *Construction Cost Comparison* for each city, FHA Form 2528. These data, for two time periods, were adjusted to a comparable basis. Each cost item was separately evaluated and priced at April, 1964, cost. The differential for variation in types (such as exterior walls, basement versus slab, or one-story versus two-stories, etc. was reconciled by using FHA cost-data books for each city. Where no comparison was possible, the city was left out of the analysis.
NOTE: Cities cannot be compared to each other. Cost data should be used only in determining a trend in a given city rather than as a yardstick of city-to-city measurement.

During the period studied, some changes occurred in just about every major cost category. This, of course, was to be expected, since the price level of most items fluctuates constantly, depending on the season, demand and supply and a general increase in the price level. Some changes also occurred in specifications. A house is susceptible to a great many changes over a period of time. New materials are constantly introduced and new methods developed. Builders are now cost conscious, constantly looking for improvements in construction techniques. These changes tend to distort the cost comparison analysis. Each segment of construction cost changes, therefore was subjected to a detailed examination of the reasons why it decreased or increased. This detailed analysis revealed a number of interesting items (Table 3). Sixteen selected major construction cost groups were compared in the 23 cities with the results shown in Table 3.

Table 3. MAJOR CHANGES IN THE CONSTRUCTION COST IN 23 METROPOLITAN AREAS, 1960–1964

Items	Cost Declined or No Change	Cost Increased	Not Comparable
1. Windows	20	3	0
2. Interior doors	18	5	0
3. Painting	18	4	1
4. Lumber	17	6	0
5. Carpenters' labor	17	6	0
6. Heating	16	5	2
7. Plumbing	14	7	2
8. Electrical	13	10	0
9. Wall tile	11	5	6
10. Drywall	11	6	6
11. Kitchen cabinets	11	9	3
12. Excavation	10	5	8
13. Concrete	10	9	4
14. Hardwood floor	8	10	5
15. Block and brick	7	10	6
16. Roofing	6	15	2

In eight cases the decrease or no change in the cost of windows occurred because of changes in type of material and type of windows used. In seven out of the eight cases where there was no basic change in the design or type of material used, the unit price declined anyhow.

Only in one case was there a change in the specifications of interior doors and this resulted in an increase rather than a decrease in the unit cost. In 17 cases there was no change in specifications and yet a reduction in cost was shown.

The unit cost for painting was lower in 18 cases, higher in four, w. i one case where no valid comparison could be made. The price of lumber declined or was unchanged in 17 cases. The carpenter labor to erect and finish the house declined, or was unchanged in 17 cases and increased in six cases. For example, in Birmingham, Ala., it took 0.3617 hours to build one square foot of a brick veneer house on slab in 1960 and 0.3257 hours in 1964. In Boston in 1960 it took 0.5482 hours to build one square foot of a one-story full basement house and 0.4952 hours in 1964. In Los Angeles the same figures for a one-story frame-stucco were 0.8869 hours in 1960 and 0.7199 hours in 1964. A city-to-city comparison is impossible, since the carpenter labor cost is not defined the same in every city. Figures available only show what happened to the individual or typical cost of carpenter labor in a given city.

No information is available as to the reasons for changes in cost for the cities studied. But some idea of what happened to cost over the last *ten* years can be derived from a case study included in an unpublished paper, "Probable Economic Impact of an FHA Land Insurance Program."[5] In this case study, prepared by Gene Merryman,[6] an almost identical house built in 1954 and in 1964 was analyzed. The cost of construction was divided into 25 major items and the reasons for changes in cost of each item (where applicable) was broken down to five groups. Table 4 shows what happened to costs and why.

Table 4. INDIVIDUAL COST OF CONSTRUCTION, 1954 AND 1964 AND REASONS FOR CHANGES

Reason for Change	Increase Amount	Increase %	Decrease Amount	Decrease %
1. Increase in specifications	$156	100		
2. Decrease in specifications			$ 503	37.2
3. More efficiency			402	29.7
4. Better buying power			208	15.4
5. More competition			239	17.7
Total	$156	100	$1,352	100

Source: National Association of Home Builders, "Probable Economic Impact of an FHA Land Insurance Program," unpublished, March 1964.

Note that more efficiency alone resulted in a saving of $402. More competition resulted in $239 saving.

The cost of construction is, of course, not the sale price of a house. And even though, in the Table 4 case, substantial savings were achieved (nearly $1,200 or 12.2%) in construction cost, the same house sells for about $200 more in 1964 than in 1954. The main reason is the increase in the price of land. The 1964 BEC Spring Survey[7] documented this increase quite well. In the last five years there was an average yearly increase of 16% in the price of raw usable land. What happened, in the case studied, to all the costs making up the sales price of the house, is illustrated in Table 5.

Table 5. COST CHANGES 1954 AND 1964

Item	Amount	(1954 Base)
1. Construction cost	−$1,200	− 12%
2. Lot	+ 950	+ 40
3. Financing	+ 570	+285
4. Overhead	− 120	− 12
5. Closing costs	+ 75	+100
6. Sales expenses	+ 210	+ 69
7. Profit	− 385	− 34

Source: National Association of Home Builders, "Probable Economic Impact of an FHA Land Insurance Program," unpublished, March 1964.

[5] NAHB, *Probable Economic Impact of an FHA Land Insurance Program*, unpublished, March, 1964.
[6] Gene Merryman, Vice President, Ernest G. Fritsche & Company, Columbus, Ohio.
[7] NAHB Builders Economic Council, *Spring, 1964, Survey.*

Senator KENNEDY. I think you have obviously thought this problem out a good deal and have as much or more knowledge about housing than any other group in the country. After all, what we are interested in doing is making this program most effective. Nobody is wedded to any particular figures or to the exact approach.

But what we are trying to do—according to your testimony—what we are all interested in doing, is developing a program which will give greater incentives to the private sector than exist now to invest in housing in this Nation's poverty areas. Then I think there should be very close working relationships between your group, with its wide experience in the housing filed, and any new companies or corporations that might become interested in the field.

Mr. ROGG. We would like to do that, Senator. If we have learned one thing in these postwar years, it was the experience that given the opportunity and the incentive, the private enterprise system can produce for everybody in this country.

The greatest spurt in housing came with the section 608 program. It has been somewhat much maligned, but it was the one that broke the back of the postwar housing shortage and it did this by making the production of houses for the returning veterans a profitable enterprise.

Senator KENNEDY. Could you not foresee that we could have a close working relationship between the investors and the builders in connection with legislation of this kind?

Mr. ROGG. We do talk to the mortgage bankers and saving bankers but they are obviously not the people to which this bill is principally addressed.

Senator KENNEDY. I mean if this legislation is passed.

Mr. COLTON. I thing the point, Senator, is that homebuilders are entrepreneurs and they are not general contractors. The relationship between the investor and the homebuilder, therefore, should not be one solely of a builder building for some corporation or aggregation of capital which takes the benefits, and where the builder gets only the building fee.

Our people are not of that type. We are the entrepreneurs, the businessmen, who, with some participation in the inducements of the bill—and I think that is what Mr. Silverstein's suggestions are intended to obtain—will bring about the type collaboration that you mention. In fact, they will initiate this relationship.

Senator KENNEDY. Would you agree that we need some kind of program of this kind to really stimulate activity in this area which, as you indicate in your testimony, has been so long ignored?

Mr. ROGG. Through our National Housing Center Council, we have a council of 50 of the largest manufacturers and producers of building materials in the country. They work very closely with us on matters of this kind and some of these companies are even now engaged in trying out some of private enterprise's answers to this problem.

I refer to companies like United States Gypsum, Owens-Corning, U.S. Plywood, and so forth.

Senator KENNEDY. Do you think they will invest in the ghetto in any major way if we do not have these kinds of programs?

Mr. ROGG. I can't see it, Senator.

Senator KENNEDY. Are you going to be able to do much more yourselves if you do not have this kind of a program?

Mr. ROGG. No; not for the group of people to whom this type of program is directed.

Senator KENNEDY. Do the programs that presently exist, 221(d)(3) and public housing, effectively supply, in your judgment, the housing needs of the people?

Mr. ROGG. No, sir.

Senator KENNEDY. They have not?

Mr. ROGG. No, sir.

Senator KENNEDY. If we just have a continuation of those programs—and I am not against those programs or opposed to them—I do not think they will bet the job done that we must be prepared to do.

Mr. ROGG. The job is so immense that I think we ought not think there is a single answer to it. I think we ought to approach it with an open mind, using a whole number of answers to a whole series of problems.

Mr. COLTON. If I may address myself to what the Senator said, his question was do we think investors of that type, the large corporation, would come into this. I think what we are saying is that there must be some interest, such as the interest of the builder, in building these projects to begin with.

Mr. ROGG. I think the Senator's question was whether they would come into it without this kind of a program.

Did I misunderstand you?

Senator KENNEDY. That is correct. And whether we were going to get the job done without this sort of a program.

Mr. COLTON. I would say that even with this, it may well be that not sufficient interest would be generated by companies. You must also bring into it those who have an interest to begin with in tackling this particular field, not coming into it simply from the start and looking at it purely as an investment.

There must be some inducement other than that.

Senator KENNEDY. I would think that by working with your people and utilizing your expertise we can probably refine this legislation and improve it.

Have you studied the figures sufficiently to know whether you think it is enough of an incentive?

Mr. ROGG. No; I haven't. I studied them with considerable interest. I think it would be very useful, Senator, if the committee could address that kind of question by mail or otherwise to some of the larger corporations. You can then find out what their enconomic interest in investing funds in this kind of a deal would be.

That is the only way you are going to find out.

Senator KENNEDY. We have gone to them. We have visited them. These are the figures that we came up with. As I said at the beginning of my testimony, we are not wedded to those figures and we would hope that by testimony and by suggestions and recommendations from others they could be improved. I did not know whether you might have had them.

Mr. ROGG. No; we don't have them.

Senator KENNEDY. Have you anything else you would like to add?

Mr. ROGG. Not at the moment.

Senator KENNEDY. I am sure that if there are other things that come up, you will get in touch with the Committee and supplement your testimony.

I think all of your information is very, very useful. If any kind of a program is going to be effective or successful in this field, it will need your leadership and cooperation.

Mr. Rogg. And we pledge it. Thank you very much, Senator.

Senator Kennedy (presiding). Mr. Bittker.

Do you have a statement?

STATEMENT OF BORIS I. BITTKER, SOUTHMAYD PROFESSOR OF LAW, YALE LAW SCHOOL

Mr. Bittker. Yes, I have, which I would like to submit. If you wish, I will confine my oral remarks to the highlights of the statement itself.

Senator Kennedy. That will be fine.

Mr. Bittker. I am happy to have this opportunity to testify in support of S. 2100, to encourage and assist private investment in low-income and lower middle-income housing in urban poverty areas. It is my understanding tht the extent of the need for such housing, the business and economic effectiveness of the incentives offered by S. 2100, and the comparative merits of S. 2100 and other Federal approaches to the problem will be discussed with you by experts in these issues. Since I claim no expertise on these issues, I will not attempt to duplicate their testimony, but I ought to say at the outset that I approach the tax provisions of the bill, on which I shall offer my comments, with the conviction of an interested citizen that the need for such housing is desperate and that the entry of private investors into the area would provide a much-needed diversity of plans and responses to the need.

Like most academic students of the Federal income tax system, however, I tend to be skeptical of proposals to encourage specific types of investment or other behavior by amending the Internal Revenue Code; and it was in this spirit that I read S. 2100 for the first time.

After studying it with care, however, I have come to the firm conviction that its tax provisions are a reasonable as well as imaginative way of encouraging private business enterprise to invest in this type of housing.

Moreover, the bill contains a variety of restrictions and safeguards that, in my opinion, ought to satisfy even those tax specialists who are much more adamant than I in opposing tax concessions for specific investment or other programs. I should like to return to this point in my general comments at the end of my testimony, after I have described and commented on the tax provisions separately.

The first incentive——

Senator Kennedy. Where are you going to now?

Mr. Bittker. I am on page 2.

Senator Kennedy. I was following down to "separately." Are you going down into "Investment Credit"?

Mr. Bittker. I thought I would say something about each of the points.

Senator Kennedy. Yes, because I think that is important.

Mr. Bittker. Under existing law, buildings and their structural components (except elevators and escalators) do not qualify for the 7-

percent investment credit that was enacted in 1962. S. 2100 grants an investment credit, patterned on the investment credit of existing law, in an amount that varies from 3 to 30 percent of the taxpayer's "qualified expenditures" for section 1391 property if he is the first investor in such property (2 to 23 percent in the case of subsequent investors).

The amount of credit allowed varies from 3 to 30 percent depending on the amount of the taxpayer's equity investment percentage.

Since the credit is only 3 percent for the first holder of the property with an equity percentage of 20 to 25 percent but rises to 30 percent in the case of 100 percent equity investment, the bill provides a significant incentive for taxpayers to risk their own funds either in full or to the extent necessary to obtain private financing rather than to rely on Government guarantees.

There is no exact parallel to this sliding scale of credits in existing law, but the reduction to three-sevenths of the regular credit applicable to public utility property under section 46(c)(3) reflects the view that a credit is less necessary for industries whose business risks are mitigated by an actual or virtual monopoly of the market. S. 2100 build on this principle, but applies it more consistently—so that a taxpayer who depends on a FHA guarantee for more than 80 percent of the cost of the property gets no investment credit, while one who proceeds without any FHA guarantee gets the maximum credit allowable (30 percent).

In comparing the investment credit proposed by S. 2100 with the widely favored investment credit of existing law, it should be noted that the latter makes no effort to distinguish between investment that would have been underaken by the taxpayer in any event and investment that will be undertaken only with an extra "push" in the form of Government aid. (As originally proposed by the Treasury, the 1962 bill endeavored to make such a distinction by linking the amount of the credit to the taxpayer's current depreciation deductions; but this restriction was not incorporated in the bill as enacted.) S. 2100, by contrast, offers the credit to a type of investment that is almost totally unattractive to business under free market conditions, with the result that virtually none of the allowable credit will be "wasted" on projects that would have been constructed in any event.

One of the reasons given by many tax scholars for opposing tax concessions tc otherwise worthy activities is that the concession's incremental effect will be slight or at least debatable if the activities can be expected to occur to a significant extent even without the concession's encouragement. This argument, in my opinion, is not applicable to the investment credit of S. 2100.

The second major tax concession made by S. 2100 is a reduction in the depreciable life of section 1391 buildings. Depending on the taxpayer's equity investment percentage, the building's useful life is reduced to 14 to 40 percent of a 50-year normal life in the case of the first holder of the building, and to 24 to 40 percent of a 50-year normal life for a subsequent holder. (In no case, however, can the normal life in the hands of a subsequent holder be cut to less than 10 years.) A reduction under section 1393 is optional with the taxpayer; that is, he is permitted to use the normally computed useful life if he prefers.

If an election is made, however, the accelerated depreciation methods authorized by section 167(c), double declining balance, sum-of-the-years-digits, and so forth, may not be used.

There is a recapture provision designed to prevent abuse of the section 1393 election, as well as abuse of the investment credit permitted by S. 2100.

A reduction in the useful life of depreciable assets is a familiar method of encouraging investment in such property: examples include the accelerated amortization of wartime and defense facilities during World War II and the Korean war and of atomic facilities under section 168. These provisions, of course, permitted the assets to be written off over a much shorter period than is allowed by S. 2100. This is also true of section 169 (amortization of grain-storage facilities over 60-month period).

Moreover, I think it is recognized that the revised depreciation guidelines issued by the Treasury in 1962 were designed in part to have an incentive effect by giving taxpayers shortened lives over which depreciation on property, machinery, and equipment and so on could be computed.

Still another example of accelerated depreciation is section 179 (additional first-year depreciation allowance for small business); although it does not operate by reducing the useful life of the property, it is a device for providing an incentive to a particular group of taxpayers by speeding up their depreciation allowances.

Thus, in reducing the useful lives for section 1391 buildings in order to encourage investment in this area, S. 2100 does not depart in any significant way from a long-established legislative pattern.

Another aspect of this area is the provision that allows the builder of qualified property to include expenditures for demolition of existing structures and for site improvements in his depreciable basis even though these expenditures would normally be treated as part of the nondepreciable cost of land under existing law.

Here again S. 2100 follows a familiar pattern. The Internal Revenue Code is literally studded with provisions that allow taxpayers to deduct or amortize over a short period of time expenditures that would normally be treated as permanent investments to be held in abeyance and taken into account for tax purposes only when, as, and if sold, abandoned, or otherwise disposed of.

Examples are the treatment of magazine and newspaper circulation expenditures, research and experimental expenditures, expenditures by farmers for soil and water conservation and for clearing and fertilizing land, and trademark and trade name expenditures.

The principal difference, in my view, between these provisions in existing law and the power that S. 2100 would grant to include site demolition expenses as part of the depreciable base is that S. 2100 is more conservative. It requires the writeoff to take place over the useful life of the building, whereas the examples I referred to permit the expenditure to be written off either as incurred or else over a period as short as 5 years.

Turning next to the bill's treatment of sales or dispositions of section 1391 property, an important point to be noted is that home management corporations have the power to purchase the property at a fixed price,

the first builder's investment, less straight line depreciation computed over a 50-year period.

That means that inflation in land values or an increase in the replacement cost of the property will not inure to the benefit of the builder or investor if the home management corporation chooses to exercise its option.

The point it, and this is quite significant to me, that the bill puts a limit on the amount of profit that the builder or investor in property of this kind can realize. As against that background, the limited possibility of profit, one must look at the tax concessions that are given to the builder.

First of all, the bill provides if he sells to a home management corporation after a 2-year holding period, he does not have to recognize a gain on the sale. Now it seems to me that that tax abatement privilege should be viewed as at least in part a way of assisting the home management corporation by encouraging the builder to accept a lower option price at which he will sell to the home management corporation, in exchange in part for not having to recognize the gain on the sale.

This is a privilege inuring to the advantage of the builder, but taken in its full context, it has a very important impact in offering an incentive to the home management corporation; and it ought to be viewed therefore in that light.

Secondly, the bill provides that upon a sale and reinvestment of the proceeds, the gain on the sale need not be recognized. This is similar to a provision of existing law that applies in the case of property taken by condemnation or destroyed by fire, under which the condemnation proceeds or insurance proceeds can be invested in replacement property without recognition of gain.

The bill also contains a provision dealing with the computation of gain on other types of sales after the minimum holding period that is of a rather complicated character. Unless I am asked to specifically go into it, I would rather rest on my statement, where I have dealt with it in some detail and explained why it seems to be an eminently reasonable provision.

Senator KENNEDY. Is it your judgment that anybody under this legislation could make an extraordinary, I do not even know whether I should use this word extraordinary, but an unnecessary windfall that would be to the detriment of the Treasury?

Mr. BITTKER. It seems to me there is a limit on the amount of profit that can be made, resulting from the option of the home management corporation. If the value of the property goes up very substantially, it inures to the advantage of the home management corporation.

Consequently, there is a limit on the total amount of profit in economic terms that can be made. Beyond that, there are obviously important tax incentives in the bill, but it seems to me that taken in context, and I include in the context the limit on the amount of profit and the restriction on rents, they are reasonable.

I would not describe this as opening the door to loopholes. There may be technical details that ought to be tightened up; I have made a couple of suggestions in my statement with respect to specific points. But in broad outline my answer to your question, Senator, is "No." It seems to me there are sufficient safeguards so that in broad outline I have no hesitancy in supporting the bill with enthusiasm.

Something was said this morning about the provision in S. 2100 for restoration of basis. I don't want to go over that area needlessly, but I would like to make two points with respect to it, which I think were not adequately developed this morning. One is that the power to depreciate property over a period of years and get the cost back is not the same as the power to get your cost back the day after you buy the property.

That is to say, depreciation down to zero, as was described this morning, takes place over a period of years. The current value of those future depreciation deductions is not the full amount of the tax that will be saved, but some discounted amount.

Secondly, under existing law, including section 1250, it is possible for property to be sold at the capital gain rate at the end of the period of time, recognizing no ordinary income, and the owner is then free to use these proceeds to invest in other property with a current basis equal to his cost, and to depreciate this newly acquired property.

I do not see any great difference between a builder who sells out, reinvests, and then depreciates a second time and the builder who depreciates the same property the second time if he holds it twice as long. It seems to me as far as the Treasury is concerned the impact is identical.

From a social point of view I can see advantages in the longer holding period, as against the switching around which is permissible under current law—and which incidentally would have been permissible within certain limits even under the Treasury's proposal in 1962, which was somewhat altered when section 1250 was enacted.

In concluding, I should like to return to a comment I made at the beginning of my statement: that I aproached my first reading of S. 2100 with some skepticism about the use of tax incentives to achieve the ends, however desirable, of this proposal. My original skepticism reflects a feeling that tax incentives are often "wasteful," conferring benefits on taxpayers for activities that they would have undertaken to a substantial extent in any event; that their incentive effect, if it turns out to be powerful, may be unpredictably excessive; and that once enacted, they are not likely to be reassessed as economic or social conditions change, but instead tend to live forever.

Some tax commentators argue that these and similar risks create a virtually conclusive presumption against the incentive use of the Federal tax system; for me, they are rather counsels of prudence that require every proposal to be examined with care, but which may be outweighed in any particular case by the merits of the proposal itself.

In my opinion, it is not necessary to choose between these attitudes in reaching a conclusion about S. 2100, because it contains a variety of safeguards—all to rare in such proposals—that meet the objections I have mentioned above.

There is, to begin with, powerful evidence from experience that the kind of investment that would be encouraged by S. 2100 is simply not being undertaken under existing laws, so that the chance of conferring tax benefits on projects that would have been built anyway is minimal.

The benefits are dependent on a certificate of eligibility to be issued by a Government agency with continuing responsibility for overseeing

the programs, which need not issue a certificate for projects that do not require this assistance. Its stewardship of the program, moreover, serves to prevent the level from becoming excessive.

There are a number of further safeguards, in that funds must be appropriated for a variety of purposes under S. 2100 to put it into effect. No other provision of the Internal Revenue Code is accompanied by such an elaborate set of restrictions.

The closest parallel, and it was in fact a great deal less confining, was the requirement of a certificate for the rapid amortization of wartime facilities during World War II and the Korean war.

Because appropriations are required, it seems to me that another objection that is often offered to the use of tax concessions is also met—the argument that tax concessions are not as visible as appropriations and are not subjected to that kind of examination that results from going through the ordinary budgetary and appropriation procedures of the executive departments and of Congress.

This is a bill which has a combination of tax concessions and appropriation requirements and it seems to me, if anything, you have double scrutiny of its enactment and operation.

I might make one more point in response to a quotation in this morning's New York Times relating to testimony yesterday to the effect that the tax law ought not to offer incentives for a narrow and specialized type of investment.

I would not describe this field as "narrow and specialized"; but even if one did, I would like to call attention to the fact that there is pending before the Senate Foreign Relations Committee a series of bilateral tax concessions which offer investment credits for foreign investment to American investors, and they include such distinctions as a credit if one builds a hotel in Israel but not if he builds one in Thailand, a credit for a gas and electric plant in Thailand but not if one is built in Brazil; a credit if a smelting and refining plant is built in Brazil but not if it is built in Israel.

There may be very good reasons for these specialized rules, which vary industry by industry and geographical area by geographical area. I am not criticizing them, because I don't know the background out of which they grow.

It does seem to me very hard to reconcile the Treasury's support of those geographical and industry distinctions with the view that S. 2100 applies incentives in an excessively narrow or specialized area.

Senator SMATHERS. While you are reciting those illustrations, could you give us an illustration as to how frequently we have used the tax code for social objectives?

Mr. BITTKER. I think it is very difficult to disentangle economic from social objectives. It seems to me that many of the provisions that I mentioned are for combined social and economic objectives, including the investment credit, shortened depreciation life, and so on. Many of the distinctions in the investment credit itself, it seems to me, are somewhat of that character.

The investment credit in existing law distinguishes between foreign investment and domestic investment, between building for transients and building residences, public utility activities, and others. So that it does seem to me that we have in existing law a great many distinctions that were designed to encourage specific socioeconomic ends.

Of course in the personal field, Senator, the provisions with respect to old-age retirement, qualified pension plans, medical expenses, charitable deductions, and a number of other, I would say, have social as well as economic objectives.

Senator SMATHERS. Would you not classify the problem of the ghettos, the crime that results there, the lack of housing and what that means—would you not classify these within the broad term of "socio-economic problems"?

Mr. BITTKER. Without any question, I certainly should.

Senator SMATHERS. Has that not actually in many respects been the prime objective of much of our legislation, tax and otherwise?

Mr. BITTKER. Yes, I think that is correct, Senator. I would be hard pressed to say whether one ought to regard this as social legislation or economic legislation. It seems to me it is directed at an economic problem which has had enormous social consequences, which in turn have economic costs.

Senator SMATHERS. We could say, could we not, that if somebody wanted to classify this as strictly a social problem, which I think would be incorrect, nevertheless it cannot be answered except by the use of an economic benefit which is the way this bill is trying to answer the problem. If it is only a social problem, through economic advantages you answer only the social problem.

Mr. BITTKER. I agree with that entirely.

Senator SMATHERS. I want to take a moment to compliment you on your statement. I don't know when I have been privileged to see a more comprehensive and detailed and better prepared statement than this.

Mr. BITTKER. Thank you very much, Senator. I hope I can take your remarks back to my students.

Senator SMATHERS. You certainly can for me. Tell them I think they are very, very fortunate to be in your class.

Mr. BITTKER. Thank you.

(Mr. Bittker's prepared statement follows:)

PREPARED STATEMENT OF BORIS I. BITTKER, SOUTHMAYD PROFESSOR OF LAW, YALE LAW SCHOOL

I am happy to have this opportunity to testify in support of S. 2100, to encourage and assist private investment in low-income and lower-middle income housing in urban poverty areas. It is my understanding that the extent of the need for such housing, the business and economic effectiveness of the incentives offered by S. 2100, and the comparative merits of S. 2100 and other federal approaches to the problem will be discussed with you by experts in these issues. Since I claim no expertise on these issues, I will not attempt to duplicate their testimony, but I ought to say a the outset that I approach the tax provisions of the bill, on which I shall offer my comments, with the conviction of an interested citizen that the need for such housing is desperate and that the entry of private investors into the area would provide a much-needed diversity of plans and responses to the need.

Like most academic students of the federal income tax system, however, I tend to be skeptical of proposals to encourage specific types of investment or other behavior by amending the Internal Revenue Code; and it was in this spirit that I read S. 2100 for the first time. After studying it with care, however, I have come to the firm conviction that its tax provisions are a reasonable as well as imaginative way of encouraging private business enterprise to invest in this type of housing.[1] Moreover, the bill contains a variety of restrictions and safeguards that,

[1] As indicated in my statement, I wish to suggest that some changes of detail be made in specific provisions; and no doubt this Committee's examination of the bill, with the aid of other witnesses, will result in other revisions.

in my opinion, ought to satisfy even those tax specialists who are much more adamant than I in opposing tax concessions for specific investment or other programs. I should like to return to this point in my general comments at the end of my testimony, after I have described and commented on the tax provisions separately.

INVESTMENT CREDIT

Under existing law, buildings and their structural components (except elevators and escalators) do not qualify for the 7% investment credit that was enacted in 1962. S. 2100 grants an investment credit, patterned on the investment credit of existing law, in an amount that varies from 3 to 30 percent of the taxpayer's "qualified expenditures" for section 1391 property if he is the first investor in such property (2 to 23% in the case of subsequent investors). (The term "qualified expenditures" means, in the case of a builder, the adjusted basis of his section 1391 property at the time that construction or substantial rehabilitation of the building is completed; in the case of a purchaser of such property, it means the property's cost, or other basis in the hands of the purchaser at the time of purchase.) As with the investment credit of existing law, the credit cannot exceed the taxpayer's liability for tax for the taxable year, but unused credits can be carried back 3 years and forward 7 years. If the taxpayer disposes of any section 1391 property before the end of its "minimum holding period" (normally 10 years), the credit is subject to recapture, unless the disposition is a non-recognition transaction described in § 1250(d) or a sale to a home management corporation (owned and controlled by the residents of the project) after a 2-year holding period.

The amount of credit allowed for the first investor's qualified expenditures varies from 3 to 30 percent (from 2 to 23% for subsequent investors), depending on the amount of the taxpayer's equity investment percentage. The term "equity investment percentage" means the ratio of (a) the holder's adjusted basis less the amount of any NHA-insured mortgage, to (b) the adjusted basis; thus, the equity investment percentage is 100% if the construction is financed without a NHA-insured mortgage, 25% if 75% of the cost is covered by a NHA-insured mortgage, etc. Since the credit is only 3 percent for a first holder of the property with an equity investment percentage of 20 to 25 percent, but rises to 30 percent in the case of a 100 percent equity investment, the bill provides a significant incentive for taxpayers to risk their own funds (either in full, or to the extent necessary to obtain private financing), rather than rely on government guarantees. There is no exact parallel to this sliding scale of credits in existing law, but the reduction to 3/7ths of the regular credit applicable to public utility property under § 46(c)(3) reflects the view that a credit is less necessary for industries whose business risks are mitigated by an actual or virtual monopoly of the market. S. 2100 builds on this principle, but applies it more consistently—so that a taxpayer who depends on a NHA guarantee for more than 80 percent of the cost of the property gets no investment credit, while one who proceeds without any NHA guarantee gets the maximum credit allowable (30%).

In comparing the investment credit proposed by S. 2100 with the widely-favored investment credit of existing law, it should be noted that the latter makes no effort to distinguish between investment that would have been undertaken by the taxpayer in any event and investment that will be undertaken only with an extra "push" in the form of government aid. (As originally proposed by the Treasury, the 1962 bill endeavored to make such a distinction by linking the amount of the credit to the taxpayer's current depreciation deductions; but this restriction was not incorporated in the bill as enacted.) S. 2100, by contrast, offers the credit to a type of investment that is almost totally unattractive to business under free market conditions, with the result that virtually none of the allowable credit will be "wasted" on projects that would have been constructed in any event.

One of the reasons given by many tax scholars for opposing tax concessions to otherwise worthy activities is that the concession's incremental effect will be slight or at least debatable if the activities can be expected to occur to at significant extent even without the concession's encouragement. This argument, in my opinion, is not applicable to the investment credit of S. 2100.

REDUCED USEFUL LIFE FOR § 1391 BUILDINGS

The second major tax concession made by S. 2100 is a reduction in the depreciable life of § 1391 buildings. Depending on the taxpayer's equity investment percentage, the building's useful life is reduced to 14 to 40 percent of a 50-year

normal life in the case of the first holder of the building, and to 24 to 40 percent of a 50-year normal life for a subsequent holder. (In no case, however, can the normal life in the hands of a subsequent holder be cut to less than 10 years.) A reduction under § 1393 is optional with the taxpayer, i.e., he is permitted to use the normally-computed useful life if he prefers. If an election is made, however, the accelerated depreciation methods authorized by § 167(c) (double declining balance, sum-of-the-years-digits, etc.) may not be used.

To prevent abuse of the § 1393 election, § 1395(a) provides for a recapture of "excess" depreciation if the property is disposed of before the end of its minimum holding period (normally 10 years). The recapture rule makes use of § 1250 of existing law, but requires 100% of the excess depreciation to be "repaid" by the taxpayer (i.e., the percentage does not decline with the length of the holding period, as under existing law).[2] As with S. 2100's recapture of the investment credit for § 1391 property, recapture is not required if the property is sold after a 2-year holding period to a home management corporation.[3]

A reduction in the useful life of depreciable assets is a familiar method of encouraging investment in such property: examples include the accelerated amortization of wartime and defense facilities during World War II and the Korean War and of atomic facilities under § 168. These provisions, of course, permitted the assets to be written off over a much shorter period than is allowed by S. 2100. This is also true of § 169 (amortization of grain-storage facilities over 60-month period). It is reasonably clear, moreover, that the depreciation guide-lines announced by the Treasury in 1962 provided useful lives for depreciable property that were substantially shorter than normal for many industries and taxpayers, and the incentive purpose of these shortened useful lives was widely noted. Another example of accelerated depreciation is § 179 (additional first-year depreciation allowance for small business); although it does not operate by reducing the useful life of the property, it is a device for providing an incentive to a particular group of taxpayers by speeding up their depreciation allowances.[4]

This, in reducing the useful lives for section 1391 buildings in order to encourage investment in this area, S. 2100 does not depart in any significant way from a long-established legislative pattern.

If a taxpayer makes an election under § 1393, he is permitted to include expenditures for the demolition of existing structures and for site improvements in his depreciable basis, even though these expenditures would otherwise be treated as part of the non-depreciable[5] cost of the land. In granting this concession, S. 2100 follows a familiar pattern: the Code is literally studded with provisions permitting taxpayers to deduct or amortize expenditures that would otherwise be treated as permanent investments, to be taken into account only when, as, and if sold, abandoned, or otherwise disposed of. Examples are: § 173 (newspaper and magazine circulation expenditures), § 174 (research and experimental expenditures), §§ 175, 180, and 182 (expenditures by farmers for soil and water conservation and for clearing and fertilizing land), § 177 (trademark and trade name expenditures), § 248 (corporate organizational expenditures),

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[2] This strict rule is applied not merely to excess depreciation resulting from a § 1393 election, but also to the excess resulting from an accelerated depreciation method (i.e., even if the building's useful life is not shortened under § 1393).

[3] The recapture rule is buttressed by § 1395(b), treating part or all of the gain on a sale of the corporation's *stock* as ordinary income, rather than capital gain, if the sale occurs before the end of the minimum period applicable to any § 1391 property owned by the corporation. Gain on the sale of stock to be treated as ordinary income (rather than capital gain) to the extent of its proportionate share of any § 1250 gain that would have been realized if the corporation had sold its § 1391 property (unless already held for its minimum holding period) at, in the case of a first holder, the home management corporation's option price.

Exceptions are provided for sales of stock by minority shareholders, for a corporation whose § 1391 properties have an aggregate net value of less than 10% of its net worth, and for certain dispositions of stock in non-recognition and similar transactions. In my opinion, it would be appropriate to add an exception for sales of stock to a home management corporation, parallel to the exception provided in § 1395(a) for sales of the property itself to such buyers.

[4] In his statement to the Senate Small Business Committee on March 22, 1967, Secretary Fowler pointed out that the combination of the investment credit, the 20% first-year depreciation allowance, and double declining balance depreciation in effect permits the tax-free recovery *in the year of purchase* of ⅔ds of the cost of a $10,000 asset with a useful life of 10 years. To this, one might add that if the asset has a 1962 guide-line life of 10 years, it is not unreasonable to assume that its probable actual business life is substantially longer.

[5] See Treas. Regs. § 1.165–3.

and §§ 263(c), 615, and 616 (expenditures for exploring, drilling, and developing mineral properties).

The principal difference between these provisions of existing law and the treatment that would be accorded by S. 2100 to expenditures for demolition and site improvement is that S. 2100 is more conservative—the expenditures are to be added to the cost of the § 1391 building and depreciated over its useful life, which can never be shorter than 7 years under the § 1393 (14% of 50 years, in the case of a 100% equity investment), and is more likely to be 10–20 years (equity percentage, 50% to 20%). By contrast, the investments I have cited above can be written off immediately as incurred, or over a period as short as 5 years; and in some cases the taxpayer can select the period that will give him the greatest tax advantage.

Section 1393 also provides that a § 1391 building shall be treated as having no salvage value if a § 1393 election is made by the taxpayer. It is my understanding that salvage value is ordinarily quite minimal in the case of a building. In the case of personal property with a useful life of 3 years or more, § 167(f) permits salvage value to be disregarded if it is not more than 10 percent of the property's cost. The provision in § 1393 for disregarding salvage value is probably not very different in its practical consequences, serving mainly to avoid annoying disputes over trivial amounts.

RULES GOVERNING SALE OF DISPOSITION OF § 1391 PROPERTY

S. 2100 contains a number of special rules governing the tax treatment of sales and other dispositions of § 1391 property. Unless these rules apply, the tax treatment of § 1391 property on a sale or other disposition is governed by the regular rules of the Code, the most important of which (assuming a gain on the disposition) are:

1. Gain is recognized in full unless one of the non-recognition rules applies (e.g., exchange of property for like-kind property, reinvestment of proceeds on a sale or condemnation of property, etc.).

2. The depreciation recapture rules of § 1250 apply if the taxpayer elects to use an accelerated depreciation method and the conditions of § 1250 are otherwise applicable.

3. The balance of the gain would be subject to § 1231 (resulting, in most instances, in capital gain), unless the property is held for sale to customers in the ordinary course of the taxpayer's business, in which event the gain would be taxed as ordinary income.

Before turning to S. 2100's exceptions to these rules, I call attention to the fact that any "home management corporation" (an association of residents of the project) established for a § 1391 project is entitled to purchase it (subject to terms prescribed by the Secretary of HUD) at any time after a 2-year holding period at a price equal to the first holder's aggregate qualified expenditures less straight-line depreciation computed on a 50-year life. This option puts a ceiling on the profit that can be realized by builders and investors in § 1391 projects. No outsider is likely to pay more than the option price, in view of the possibility that a home management corporation may exercise its overhanging option against him. If, despite this risk, an outsider is willing to pay more than the option price, it would be advantageous for the residents of the project to organize a home management corporation, acquire the property and either hold it for their own account or reap the potential profit by selling to the third party themselves.

Thus, S. 2100's special rules for computing the tax on gain from the sale or other disposition of a § 1391 project are not "open-ended." The option price imposes a very practical limit on the amount of gain that can qualify for these concessions, to which I now turn:

1. Sale to home management corporation.—If the property is sold or exchanged, after a 2-year holding period to a home management corporation, no gain is recognized. If the option price at which the corporation is entitled to buy the property is *less* than its fair market value, the abatement of the seller's tax on the sale can be appropriately regarded as compensation to him for giving up the "excess" value—compensation that is paid by the government, on behalf of the home management corporations who benefit from the favorable option price. If the option price is *more* than the fair market value of the property, the option will not be exercised (and there will be no tax abatement) unless the owner accepts a lower price in order to induce the home management corporation to

purchase. In their negotiations, moreover, it can be expected that the home management corporation will offer less than competing third party purchasers, since a sale to it will be tax-free to the seller—with the result that at least part of the seller's tax abatement will have to be shared with the home management corporation. Here again, therefore, the tax abatement privilege can be properly regarded as a concession to home management corporations, not merely to builders and owners of § 1391 property.

2. Reinvestment in another § 1391 project.—If the property is sold or exchanged after the minimum holding period, and the proceeds are reinvested promptly (within 1 year after the sale or exchange, or within such extended period as is authorized by the Treasury) in another § 1391 project (or in a similar project, as approved in HUD regulations), gain is not recognized under § 1396(b). This provision is comparable to § 1033 of existing law, permitting a tax-free reinvestment of the proceeds of property lost by fire, condemnation, etc.; and it seems to me to be an appropriate way of encouraging the builder to continue his investment in this type of housing.[6]

3. Ceiling on gain after minimum holding period.—If the property is sold or exchanged after the minimum holding period (which depends on the reduced useful life described above), and one of the special rules above is not applicable, the gain is computed in the normal manner applicable to other property; but the portion thereof to be recognized is limited by a special rule. I can best explain this rule by an example. If a building costing $1,000,000 ($200,000 cash above a NHA-insured mortgage of $800,000) has been depreciated down to $100,000, and is sold for $800,000 ($300,000 in cash and the balance by assumption of the NHA-insured mortgage with a remaining principal balance of $500,000, the gain realized and the amount thereof to be recognized would be computed as follows (in thousands):

1. Amount realized:	
1a. Cash	$300
1b. Mortgage assumed	500
	800
2. Less: adjusted basis	100
3. Gain realized	700
4. Amount realized	800
5. Mortgage	500
6. Excess of 4 over 5	300
7. Gain recognized (lesser of line 3 and line 6)	300

Although the limitation of § 1396(d) may seem anamolous, it is actually of minor importance when placed in proper context. If § 1396(d) did not apply, the taxpayer would be faced with the necessity of reporting $700,000 of gain (line 3) on a transaction producing only $300,000 of cash (line 1a). Since the tax on his gain would be $175,000 (25% of line 3),[7] the transaction would leave him with only $125,000 (cash received of $300,000, less tax of $175,000). Recognizing this fact, a knowledgeable investor would probably not make the sale; but would instead raise such additional cash as he wanted by increasing the debt on the property. With a value of $800,000, the property might sustain an increase in debt (in the form of a refinanced mortgage, or a second mortgage) of $100,000 or even $200,000—without any recognition of gain. Thus, the investor would get his additional cash, report no taxable income, and continue to own an equity in the property. He might continue to hold the property until death, at which time it would acquire a new basis equal to its fair market value; and his heirs could then dispose of it without reporting any taxable gain.

An alternative would be a sale of the property to a charitable institution for it adjusted basis ($100,000), a transaction that would produce no taxable gain[8]

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[6] Although S. 2100 does not explicitly so provide, I assume that a carryover of basis on such a tax-free reinvestment was intended, as under § 1033 of existing law; and I recommend the inclusion of a specific provision to this effect. It would also be appropriate to permit a tax-free exchange of § 1391 properties, as well as a sale-followed-by-reinvestment, as under § 1033.

[7] Assuming he is not a dealer and that § 1250 does not apply (e.g., because the property has been held beyond the period prescribed therein).

[8] Treas. Regs. § 1.1001–1(c), Example (2).

and would entitle him to a charitable contribution deduction of $200,000 (equal to his equity in the property of $300,000 less the $100,000 paid by the charity). Adding together the cash received from the charity ($100,000) and the tax savings resulting from the deduction ($140,000, assuming it is applied against income subject to the 70% rate), his "take-home" from the part-gift-part-sale would be $240,000—almost twice the cash produced by an ordinary sale to a third party.

The special rule of § 1396(d), applied by S. 2100 to the case just described, limits the amount of gain to be recognized to the cash (or other property) received by the taxpayer, above the NHA-insured mortgage, viz., to $300,000.

In reaching this result, § 1396(d) can be regarded as an accommodation to a set of existing rules that are of general application, permitting the owner of § 1391 property to obtain directly the tax advantages that owners of other types of excessively-mortgaged property can achieve only in less expeditious fashion. Even if the general rules were reformed (as recommended unsuccessfully by the Treasury in 1963), § 1391(d) might be reasonably proposed as a tax incentive to encourage § 1391 construction. The issue, in other words, is not whether our tax rules governing property that is mortgaged in excess of its basis correspond to some ideal, but whether this incentive, for this type of construction, is a sensible, effective, and economic way to encourage private enterprise to build urban housing for low and lower middle income groups. In my opinion, the limitation of § 1396(d)—available only if the property is held for at least its minimum holding period, it should be noted—is a reasonable one. It simply means that the builder may take advantage of the accelerated depreciation that is one of S. 2100's major instruments for encouraging this type of construction, without having to repay the deductions at a later time if a sale does not produce enough cash. Put another way, § 1396(d) merely sees to it that one of the bill's principal incentives is not neutralized by the way gain is computed on a sale.[9]

The example I have used to illustrate the purpose and effect of § 1396(d) is a project financed to the extent of 80% by a NHA-insured mortgage. In order to encourage the private financing of projects, § 1396(d) puts all investors on a par by limiting their gain on a sale to the amount of cash they would have received if the project had been financed with an 80% NHA-insured mortgage. Without this parity provision, the ceiling on gain imposed by § 1396(d) would have been totally inapplicable to a taxpayer who relied entirely on non-NHA sources for his financing. Put another way, without the parity-rule, investors would have been encouraged by the investment-credit and shortened-useful-life provisions of S. 2100 to increase their equity investment percentage, and by § 1396(d) to decrease it. The parity-rule serves to keep § 1396(d) consistent with these other provisions of S. 2100.

4. Qualification Under § 1231.—If the property is sold or exchanged after the minimum holding period, § 1396(e) provides that gain or loss on the sale or exchange shall be treated as derived from § 1231(b) property. This provision makes § 1231 applicable (which, in turn, ordinarily means that the gain will be taxed as capital gain) even if the § 1391 property is held for sale to customers in the ordinary course of the taxpayer's business. In many instances, § 1391 property held for as long as its minimum holding period (ordinarily 10 years) will qualify for § 1231 treatment on its merits, independently of § 1396(e), since the rapidity of turnover is an important criterion in determining whether property is held for sale to customers in the ordinary course of business. The use of separate corporations for each § 1391 project is another way of improving the taxpayer's chance of qualifying under § 1231. Thus, § 1396(e) in application may be more important as a way of reducing litigation in disputed cases than in converting ordinary income into capital gains in the case of clear dealers, though it will of course reach some of the latter cases as well.

As an incentive device, it may be compared with an exception provided by § 1248(d)(3) for "less developed country corporations." Under § 1248, part or all of the gain on the sale or exchange of stock in a foreign corporation is taxable, under certain conditions, as ordinary income—but, as a device to encourage investments in less developed countries, § 1248(d)(3) grants a partial or complete exemption for stock of a less developed country corporation, permitting the gain thereon to be reported as capital gain.

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[9] For a similar reason, Congress in 1964 repealed § 48(g), which had required the basis of investment credit property to be reduced by the amount of the credit. In repealing it, Congress said that it "substantially reduces the incentive effect of the credit." S. Rept. No. 830, 88th Cong., 2d sess., reprinted in 1964–1 C.B. at 545.

RESTORATION OF BASIS

As an incentive to the continued holding of § 1391 property beyond its maximum holding period, § 1394(a) provides that the owner may elect at the expiration of this period to be treated as having sold and re-purchased the property at the home management corporation's option price (or, in the case of a subsequent holder, the option price or his aggregate qualified expenditures less straight-line depreciation computed on a 50-year useful life). To qualify for the election, the owner must agree to hold the property subject to § 101 of S. 2100, i.e., as a regulated, limited-rental project.

The effect of the election is to give the owner a restored basis for the property, which can be depreciated by him as though he were a subsequent holder of the property. (A second round of investment credits, however, is not allowed.) The price he must pay for this fresh start is a tax on the hypothetical gain realized on the § 1394 "sale." The amount of the gain will be the excess of the hypothetical sales price over his adjusted basis for the property (subject to the limitation of § 1396(d)); and it will qualify for § 1231 treatment except to the extent that § 1250 applies.

In the absence of this provision for a restored basis, the owner could achieve a similar result by selling the project and investing in another project (avoiding the preservation of basis under the qualified reinvestment provision of § 1396(b) by waiting more than a year to reinvest) or by selling the property to a corporation under common control, or the shareholders could liquidate the corporation and hold the property as partners. There are other, more esoteric ways of achieving a similar result. Thus, § 1394's novelty is its direct provision for a result that can usually be obtained in a roundabout fashion. The entire area of sale-and-repurchase deserves legislative attention, because the existing remedies (§§ 1239, 1245, and 1250) against taxpayer efforts to trade off capital gain against ordinary income deductions are inadequate.

These inadequacies—which result more from accident than conscious planning— are, however, no reason for objecting to § 1394. Unlike these haphazard and "gimmicky" ways of restoring the taxpayer's basis, restoration of basis under § 1394 is proposed for a well-defined legislative purpose—encouraging the continued holding of § 1391 property after its maximum holding period [10]— and it is entitled to be judged in terms of its aims. Viewed in this light, it is in my opinion a reasonable way of achieving its intended purpose.

SUBCHAPTER S AMENDMENTS

S. 2100 amends Subchapter S in several respects, in order to make it feasible to use a Subchapter S corporation to build and hold a § 1391 project. These amendments, of a technical character, are harmonious with the underlying function of Subchapter S, viz., to permit taxpayers to obtain the limited liability and other private law advantages of a corporation while reporting the income and loss of the enterprise on their individual tax returns. Under existing law, however, a corporation owning § 1391 property would ordinarily be unable to make a Subchapter S election because of the "passive investment income" restriction of § 1372(e)(5), under which the election is terminated if more than 20 percent of the corporation's gross receipts consists of "passive investment income," a term that is defined to include rents. S. 2100 would amend the definition of "passive investment income" to exclude rents from § 1391 property.

This change will enable individual investors in § 1391 projects to be taxed on a non-corporate basis, so that the tax losses that are expected in the early years of the project can be utilized on their individual returns. Although they could obtain the same result by operating in partnership or proprietorship form, this would entail some added private law risks for the investors without creating any benefits for the tenants or the government. Thus, the change seems entirely reasonable to me. In fact, it is arguable that the "passive investment income" restriction of § 1372(e)(5) should not be applied to the builder or owner of any active rental project. Such rents are ordinarily excluded from "personal holding company income" by § 543(a)(2) in recognition of their non-passive quality, and a similar broad exclusion from § 1372(e)(5) would be not unreasonable.

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[10] The Treasury's 1963 proposal, which as revised became § 1250, set a 15-year limit on recapture of real property depreciation deductions, permitting capital gain to be reported thereafter regardless of the amount of depreciation deducted in prior years.

Section 1879(a) provides that a NHA-insured loan to a Subchapter S corporation shall be treated as though it had been made to the shareholders of the corporation, followed by a loan of the proceeds by them to the corporation on the same terms; conversely, payments by the corporation are to be treated as made by it to the shareholders, and by them to the lender. The purpose and effect of thus treating the shareholders as conduits between the lender and the Subchapter S corporation is to increase their investment in the corporation in applying the limitation of § 1374(c)(2), under which the shareholder's share of the corporation's net operating loss for any taxable year cannot exceed the adjusted basis of his investment in the corporation. Without this change, Subchapter S would be of little use to an investor in a § 1391 project, because operating losses could be passed through only to the extent of his stock investment (plus any loans he might make to the corporation)—whereas an investor whose § 1391 project is owned by a proprietorship or partnership could deduct net operating losses to the full extent incurred.

Section 1392(c) provides that a Subchapter S corporation's expenditures qualifying for the investment credit of § 1392 are to be apportioned pro rata among its shareholders—thus enabling them to claim their proportionate shares of the § 1392 investment credit that would otherwise be allowed to the corporation. This provision is substantially identical with § 48(e) of existing law, which apportions the § 38 investment credit among the shareholders of a Subchapter S corporation.

Finally, § 1371(a)(2) of existing law, which prevents a corporation from making a Subchapter S election if any of its stock is owned by another corporation or a trust, is amended to permit non-individual shareholders if the electing corporation derives more than 90 percent of its gross receipts from the operation or sale of § 1391 property. The purpose of this amendment is to encourage corporations to participate as investors in a corporation owning a § 1391 project, by permitting a pass-through of the latter corporation's tax losses and investment credits to the investing corporations.[11]

CONCLUSION

In concluding, I should like to return to a comment I made at the beginning of my statement: that I approached my first reading of S. 2100 with some skepticism about the use of tax incentives to achieve the ends, however desirable, of this proposal. My original skepticism reflects a feeling that tax incentives are often "wasteful," conferring benefits on taxpayers for activities that they would have undertaken to a substantial extent in any event; that their incentive effect, if it turns out to be powerful, may be unpredictably excessive; and that once enacted, they are not likely to be reassessed as economic or social conditions change, but instead tend to live forever.

Some tax commentators argue that these and similar risks create a virtually conclusive presumption against the incentive use of the federal tax system; for me, they are rather counsels of prudence that require every proposal to be examined with care, but which may be outweighed in any particular case by the merits of the proposal itself.

In my opinion, it is not necessary to choose between these attitudes in reaching a conclusion about S. 2100, because it contains a variety of safeguards—all too rare in such proposals—that meet the objections I have mentioned above.

There is, to begin with, powerful evidence from experience that the kind of investment that would be encouraged by S. 2100 is simply not being undertaken under existing laws, so that the chance of conferring tax benefits on projects that would have been built anyway, is minimal. The benefits are dependent on a certificate of eligibility to be issued by a government agency with continuing responsibility for overseeing the program, which need not issue a certificate for projects that do not require this assistance. Its stewardship of the program, moreover, serves to prevent the level from becoming excessive, and a similar set of controls on the program's scope is to be found in the restricted sise of the Equity Insurance Fund, the Tax Abatement Fund, and the Home Management Assistance Fund, the amounts appropriated for relocation allowances, and the amounts avail-

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[11] In view of this limited purpose, which is indicated by the catch-title of proposed § 1371(e), I suggest that it be revised to permit shares of an electing corporation to be owned by other corporations, but not by trusts, in view of the "income-splitting" uses to which trust ownership could be put.

able for mortgage insurance and to purchase insured mortgages. No other provision of the Internal Revenue Code is accompanied by such an elaborate set of restrictions; the closest parallel,—and it was in fact far less confining, was the requirement of a certificate for the rapid amortization of wartime facilities during World War II and the Korean War.

There is still another set of restrictions, serving to limit the aggregate economic benefit to the builder or owner of a § 1391 project by restricting his profit—rents are controlled; and the residents have the power, through a home management corporation, to purchase the project at a fixed price, regardless of inflation in land values or building costs. These controls place a ceiling on the aggregate amount that even the most fortunate investor can realize on a § 1391 project. Here again, the tax concessions of S. 2100 are limited in a way that is unusual if not unique among such proposals.

It is often argued that direct subsidies are preferable to tax concessions, because the former must pass through the ordinary budgetary and appropriations procedures of the executive departments and of Congress and thus are more "visible" and open to public criticism than tax provisions. In the case of S. 2100, the program is achieved by a combination of appropriations and tax concessions, permitting double scrutiny; with the result that the advantages seen by some in the subsidy route are in fact attained. Moreover, I find it difficult to visualize a subsidy program that would serve the varied purposes that S. 2100's tax concessions are designed to serve.

A subsidy for the building itself is readily visualized, of course, but how would the subsidy program be elaborated in order to accomplish such additional ends as encouraging sales to home management corporations, encouraging continued holding if such a sale does not occur, encouraging reinvestment of the proceeds if a sale is made to another investor, encouraging subsequent purchasers to rely on private investment rather than NHA-insured mortgages, etc.? A most complex series of bounties would have to be offered (and perhaps revised from time to time) if this diversity of objectives were to be served by a subsidy program, rather than by tax concessions.

It is of course true that the "value" of tax concessions depends on the taxpayer's tax brackets—although this argument can be overstated, since for many investors the rates in question would be primarily the 50% corporate rate on income over $25,000 and the 25% capital gains rate. What is often overlooked, however, is that the "value" of a subsidy also varies with the recipient's tax rate. If the subsidy is taxable, then competing recipients receiving the same subsidy will not necessarily have the same amount left after taxes. And if it is tax-free, this privilege [12] has a different "value" to high-bracket taxpayers than to low-bracket ones.

As I said at the outset, I do not have the expertise necessary to comment on the the business and economic appeal of S. 2100, and hence do not know whether it will succeed in accomplishing its objectives. As an interested citizen, however, I hope it will; and from the professional perspective of a student of the federal tax system, I am happy to recommend favorable action by this Committee.

Senator SMATHERS. Mr. Palmer Baker.

Come up, Mr. Baker, and then we will have Mr. Edward Eichler.

Mr. Baker, we are delighted to have you. We apologize for having delayed you so long.

STATEMENT OF R. PALMER BAKER, JR., NEW YORK, N.Y.

Mr. BAKER. Mr. Chairman, I am privileged to be here. I have enjoyed and learned a great deal during the day. I feel much more informed on this bill now than I did when I arrived at 10 o'clock this morning. I do appreciate the chance to comment briefly on the provisions of S. 2100. Taken with the industrial investment provisions of S. 2088, these seem to me ingeniously designed to draw business and private capital into our Harlem and Bedford-Stuyvesant areas.

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[12] If a subsidy is receivable tax-free, the recipient gets a combination subsidy-and-tax-concession, though those who claim to prefer subsidies to tax concessions often fail to acknowledge this fact.

My interest in these bills comes both from my experience as a practicing tax lawyer in New York City and as a layman in the voluntary New York City welfare field. I have served as chairman of the Advisory Committee on Child and Family Welfare of the Federation of Protestant Welfare Agencies and on the boards of some of its member agencies. After about 17 years of such experience, I am dismayed with others to find the needs of our community no less than they were before, and the alienation of our New York City poor—and hence the larger part of our Negro community—perhaps even greater. Maybe legislation along the lines of S. 2100 and S. 2088 can release these people from their dependence on government and bring them at last into the American system where they belong.

Investment tax credits excite corporate treasurers and financial vice presidents and private investors in the top brackets like the tax shelter of fast depreciation. S. 2100 holds out these inducements in a technically intriguing way, so effectively described by Professor Bittker before me. Their benefits would be increased as the rate of equity investment is increased. This is contrary to what I believe to be the financing pattern of the homebuilding industry and, I realize, deliberately so. I do not know of any more promising way of bringing capital and business energy from outside the industry into corporate partnership with it.

In regard to industrial or commercial investment in underdeveloped poverty areas, the effectiveness of income tax incentives has certainly been well demonstrated both here and abroad. At one time I had thought that the complete exemption device—for a limited period—of the Puerto Rican Industrial Incentive Acts was worth trying in our own cities. Administratively, however, the combination of investment and wage allowances proposed in S. 2088 is easier to deal with and in my opinion is preferable. This bill also seems to me ingeniously drawn to achieve its purpose.

Richard Revere in the New Yorker magazine has some interesting things to say in support of these proposals, including the statement that they "do not draw on any passion for justice or good works but, instead, rest on the solid foundations of American avarice and lust for profit." I do not think this is quite true and probably the credit and depreciation rates should be higher, and I think your amendments, yesterday, Senator, were in the right direction in that respect. But I do think that legislation along these lines would make it possible for responsible leaders of American business at least to try their hand. That hand, it may be suggested, ought not be unduly restricted by certification requirements, particularly those which call for Federal and local agreement. If the tax incentives for business entry into a poverty area can be furnished with reasonable safeguards against abuse, then business and the private investor should be free as possible of any Federal inhibitions to determine whether to enter the area and how to operate there. Certainly these bills contain effective protective devices.

I think all of us who heard Secretary Kimball's statement earlier this afternoon were moved by it and I think that these bills, if enacted, may make it possible for others to testify later along the same lines.

Senator SMATHERS. Thank you very much, Mr. Baker. That is an excellent statement. Again we appreciate your coming down here and your patience in waiting to be heard. This makes a real contribution.

Senator KENNEDY. May I ask one question.

Do you think the present programs that are in operation by the Federal Government are sufficient to deal with the problem?

Mr. BAKER. They surely are not.

Senator KENNEDY. Do you think what is presently anticipated so far as the future is sufficient to deal with the problem?

Mr. BAKER. It seems to me it is more of the same.

Senator KENNEDY. From your experience in these areas, do you think we are progressing or retrogressing?

Mr. BAKER. I think we are doing well if we are holding our own, Senator.

Senator KENNEDY. In your judgment are we holding our own?

Mr. BAKER. I think so far as physical rehabilitation is concerned we may barely be holding our own. This is particularly true in New York City where the situation may be better than somewhere else. Insofar as the general condition and state of mind of the people who live in these areas are concerned, we are retrogressing.

Senator KENNEDY. What do you think is going to happen if we do not pass legislation of this kind?

Mr. BAKER. I think eventually one can only expect what is a revolutionary spirit on the part of a very few to become prevalent.

Senator SMATHERS. Thank you again.

Senator KENNEDY. Thank you very much. You have been very helpful.

Senator SMATHERS. Our last witness for the day is Mr. Edward Eichler, vice president of Reston, Inc., Reston, Va.

STATEMENT OF EDWARD P. EICHLER, VICE PRESIDENT, RESTON, INC., RESTON, VA.

Mr. EICHLER. Mr. Chairman, members of the committee, my name is Edward P. Eichler. For 9 months I have been vice president of Reston, Va., Inc. Prior to this I directed a study of new towns at the Housing Commission, served on an advisory committee to HUD on standards for the model cities program, and taught urban economics at the Universities of Stanford and California. But perhaps the experience most relevant to the matter before your committee, Senate bill 2100, was my service with a family owned, residential construction company, Eichler Homes.

During the 1950's Eichler Homes achieved national and international acclaim as a builder of detached, suburban homes of excellent design, and pioneered in its policy of selling on an open occupancy basis. In 1959, it became the first homebuilder to offer stock for sale to the public. In the early 1960's, we decided to enter the field of downtown urban renewal apartment construction in San Francisco. The company, especially my father, wanted to bring its skill and resources to bear on our city's housing problem. In the succeeding 5 years, Eichler Homes built over 1,000 apartments in San Francisco, 575 units of which were in a 221(d)(3) project. Although there were other con-

tributing factors such as tight money and a dramatic downturn in the California market, this decision to enter the field of central city housing crippled the company. Last year, after the family had relinquished control in an attempt to strengthen the financial base of the company, Eichler Homes was forced into a chapter 11 proceeding.

Senator SMATHERS. Chapter 11 bankruptcy?

Mr. EICHLER. That is right. The experience was chastening. But I shall confine myself to those lessons learned, which are relevant to the bill you are considering.

The first factor is demand. Land acquired through condemnation and the use of market interest rate loans, insured by FHA, did not really permit us to tap the latent demand. We were forced to charge rents which only higher-income families could pay and for which demand was extremely limited. Even with the below-market interest rate under 221(d)(3), our rents for a 2-bedroom unit could not be cut below $130 per month. The weight of construction costs in the central city, of high and rising property taxes, and of operating expenses, was simply too great. As in most American cities, San Francisco has a significant share of its population living in overcrowded and substandard housing. But even the combination of will and Federal aid were insufficient to serve this market.

The bill before this committee addresses itself to this problem. It contains the kinds of aids which might really make this demand effective. Through a lower interest rate, 2 percent, a longer loan, 50 years, and payment of a meaningful share of local property tax abatement, it provides means not merely for the promise but for the achievement of lower rents.

I might add that I understand there has been some prior testimony that a limited dividend 221(d)(3) project is likely to be a profitable venture to an entrepreneur. I would say that not only our experience but that of most of the builders I know in the country goes against this thesis.

Senator KENNEDY. Could I ask a question there?

Mr. EICHLER. Yes.

Senator KENNEDY. There have been newspaper reports in the last day or so about the billion dollars to be made available by the insurance companies which is going to be utilized in the ghettos in connection with housing particularly. That, according to the testimony, is going to have to come under the market rate program, 221(d)(3). Is it going to be possible for that money to be available to construct housing which will be usable by residents of the ghetto.

Mr. EICHLER. Senator, I think that it might just barely be possible that the aid provided in this bill will accomplish that. I don't doubt the sincerity of the insurance companies in their statement. But if they are going to use 221(d)(3), meaning funds from the Treasury, and make only construction loans, this is a rather minor part of the whole business. If they mean market interest rate, permanent loans, they will be way off on the ability to help these people. I don't question their interest in the problem, but they can't very well borrow money at 4 or 5 percent and lend it at 2 percent. There may be some marginal benefits in marginal areas in that program, but in the major cities, in the cities where the costs are high and the ability to pay low, I don't see what they can do.

Senator KENNEDY. Unless we have legislation of this kind passed by Congress, that billion dollars is not really going to be very effective or very useful.

Mr. EICHLER. I think probably it will not find its way into use.

Senator SMATHERS. On that point is it not a fact that today most of the type of housing needed in the ghetto is actually not being built in the ghettos but in lower cost areas, in outlying areas, more toward the suburbs? In other words, as you pointed out a moment ago what made your company go broke was the cost of the land, the rehabilitation, everything else that was so expensive because of the midtown location that you could not come out on it and you could not charge less than $130 a month.

Mr. EICHLER. That is correct.

Senator SMATHERS. It looks to me as if it does not make any difference where you borrow the money. As you say, that is not the problem. The problem is how can you borrow the money and build houses for rents at less than $130?

Mr. EICHLER. That is right. I think much confusion has occurred around this. Are we going to use loans or grants, rent supplements, or low interest rates? There may be very valid reasons to debate these questions. But the central issue is that one way or another we are going to have to commit aid to reduce those rents particularly because in several cities in the United States, the costs are so much higher in the city for doing business.

Senator SMATHERS. And it is going to require government aid in some form. It is your judgment that this type of tax credit, tax incentive, is a better method of aid than just straight appropriations?

Mr. EICHLER. The bill contains really both. I think both are required.

Senator KENNEDY. You mean the tax abatement.

Mr. EICHLER. It contains a grant of tax abatement, loan and tax abatement.

Senator KENNEDY. But the idea of getting the private sector involved is through the use of tax incentives.

Mr. EICHLER. That is right. That is a very important provision.

Senator SMATHERS. Even under the bill, am I correct that the Government does not give that money directly to the private builder, to the private company, it just makes it available to make up the difference? The corporation loans the money. So, we have the difference betweeen some builder going to the Federal Government and saying, "Look, I have built 25 apartments, they all look alike, I don't care much about them, I have made my money, give me my money and let it go at that," on the one hand, or on the other hand, the tax incentive such that the hand of the Government is not directly involved. The investors can take whatever losses they have here and apply those losses against some other operation they have four counties away, but their name is on the building and they want to take pride in it, just as you people wanted to have the pride of having done a good job in building those apartments. There is that difference.

Mr. EICHLER. That is right. This really is the second part of my testimony which has to do with the question of staying power. The difficulty with these kinds of projects, with the best intentions and skill, is that they are fraught with uncertainties. Whatever the administra-

tion of the program it is going to be difficult, time is going to be consumed The normal developer and builder is unlikely to be able to stand any major delays or uncertainties which come on. I think this is a great reason for the requirement in this bill of giving a tax incentive and at the same time requiring fairly high equities, which means that what would otherwise be very severe problems in the first 2 or 3 years of the program can be offset by the later benefits through the tax program.

As a matter of principle I am not normally in favor of using the tax laws for social purposes although I understand they have been used frequently for complicated purposes, but I think it is just an inevitable requirement in this situation.

Senator SMATHERS. All right, sir.

Mr. EICHLER. That will lead us to the third problem which is management. Whatever your idealogy it must be admitted that public ownership hasn't worked. In the main the submarket interest rate programs have been based on a fiction: the existence of competent, nonprofit, sponsors and owners. The spirit may have been willing but the flesh has been incapable. S. 2100 proposes incentives, mainly through tax benefits, to original sponsors to retain ownership. Perhaps this will induce management capability, which is sorely needed. Again I confess a conflict between my usual opposition to subsidy through the tax system and the particular problem at hand. I think the proposal is worth a try.

The fourth problem is administration. The Federal Housing Administration has played an important and laudable role in making the long-term, amortized loan respectable and in providing a mortgage instrument which can cross State lines. At the proper behest of Congress, it has done this job while behaving as a prudent insurance company. Its officials are justly proud of their record of minimal losses and a gigantic surplus in the fund. Such an institution should neither be asked nor be expected to administer a program the basic purpose of which is social—not economic.

FHA officials are supposed to minimize risk. They are judged and judge themselves by their ability to do business and avoid trouble. This is not a criticism but a statement of fact. When we built the 221(d)(3) project in San Francisco, we experienced many difficulties which were caused or exacerbated by FHA. Local officers, quite correctly, stated that their primary concern was the safety of their insurance, no matter what their personal feelings. I am a supporter of FHA as an important contributor to a more fluid mortgage structure, but programs like 221(d)(3) and rent supplements, which are by nature risky and innovative should be administered elsewhere. S. 2100 properly provides that the Secretary of HUD set up a separate group within the Department to administer these new aids. In addition, it provides for an insurance fund, which should encourage the administrators and developers to take the inevitable risks. I cannot emphasize too strongly the need for this provision.

My comments so far have been related to the task of promoting new construction or rehabilitation, which will really provide housing for the poor. In addition, I would like to comment on two provisions of the bill which have social implications after a project is in being.

The first is ownership. Hopefully governmental programs will help the poor gain a stake in an orderly society. It is possible that the

tenants of a project, created under this legislation, will want to buy and manage the building or buildings. S. 2100 provides for grants to assist such groups in acquiring the necessary skills, for financing of the required equity, and tax inducements to the original owner to make such a sale. There are risks in this proposal, but I think the risks are worth taking.

Second is the matter of tenure. To my knowledge all subsidy and low interest rate programs have required the tenant to move when his income rises about a certain figure. S. 2100 allows such a tenant to remain if he pays a proportionate share of his higher income. This principle was suggested in the California housing report in 1963 and has been adopted in several European countries. Eviction because of economic improvement encourages prevarication and discourages the development of local leadership. I urge the adoption of this provision not only in this but all subsidized programs.

(Whereupon, at 4 p.m., the committee recessed, to reconvene at 10 a.m., Saturday, September 16, 1967.)

TAX INCENTIVES TO ENCOURAGE HOUSING IN URBAN POVERTY AREAS

SATURDAY, SEPTEMBER 16, 1967

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 2221, New Senate Office Building, Senator George A. Smathers presiding.

Present: Senator Smathers.

Also present: Senator Robert F. Kennedy of New York.

Senator SMATHERS. The committee will be in order.

We regret the necessity of having to call a meeting of this nature this early, and on a Saturday morning, but the urgency of the problem is such that we do want to conclude the hearings and see if we can't bring about some solution.

Our first witness this morning is Mr. Curtis Berger, a professor of real estate law at Columbia University.

Mr. Berger, I would like to ask you this question: Of course, you are familiar with the bill which is under consideration, but have you made a special study of the cost of S. 2100, if enacted, in relation to the cost of the present programs?

STATEMENT OF CURTIS BERGER, PROFESSOR OF LAW, COLUMBIA UNIVERSITY

Mr. BERGER. Yes; I have, Senator Smathers. Later in my statement I would like to make some reference to that.

Senator SMATHERS. In that case, you go ahead and make your statement as you planned. I just wanted to identify that part of the subject which you are giving special attention to.

Mr. BERGER. In addition to my statement, which I would like to read, I have prepared several charts to illustrate some of my conclusions about cost, and to improve the esthetics of this hearing, I have asked Miss Miller, from Senator Kennedy's office, to act as chart holder.

Senator SMATHERS. That is the biggest favor you have done for us.

Mr. BERGER. I hope my wife is not watching on television.

(Chart 1 follows:)

CHART 1

RENT SUPPLEMENT PROGRAM

Shelter cost—$12,500 unit—221(d)(3)—Market rate

900 percent mortgage—6.5 percent—40 years
10 percent equity—6.0 percent—Return

Debt service	$800
Real estate taxes	375
Maintenance	480
Owner's return	75
Annual shelter cost	[1] 1,730
Rent to occupant ($3,700 annual income)	[2] 930
Rent supplement	800

[1] $144 a month.
[2] $77 a month.

Mr. BERGER. Congress has been concerned—and actively—for more than a generation about the physical decline of our Nation's cities. Their difficulties are, of course, human as well as physical, but the most visible sign of urban distress is the block upon block of housing decay that erodes the central city, as well as the lives of persons who must call this housing "home."

Notwithstanding an endless cascade of program innovations, the wearying task of reducing the slums continues. So, too, does the search for novel, yet untried, approaches. Having watched S. 2100 pass through its embryo stages, I am here to support the bill as a sound and constructive new look in housing legislation.

The program that is to produce housing in the city slums must contemplate three realities. The first reality is the arithmetic of shelter costs which, like the multiplication tables, is grim and inexorable. The $4,000-a-year family cannot afford to live in the $12,000 unit. Yet in many of our cities, even renovated housing cannot be built for less and new housing costs substantially more.

I would like to demonstrate that the $12,000 unit is out of reach of the family whose income is $4,000 a year.

For my model, I have used a slightly more expensive unit, one costing $12,500. I have made these assumptions about the model:

First, that it receives no subsidy; that it pays its full shelter cost; that it is financed under the section 221(d)(3) market rate program, which is the rent supplement program; that the mortgage is a 90-percent mortgage, all due in 40 years, with an interest rate, including FHA insurance premium, of 6.5 percent, and that the investor has a 10-percent equity on which he earns a 6-percent return.

Whether we are talking about housing in the midst of Harlem or a luxury apartment on New York's upper East Side, or housing in Omaha, Nebr., the shelter cost of that housing can be broken down into four components. They are:

First, the debt service, the principal and interest payments on the mortgage.

Second, the real estate taxes paid to the local municipality.

Third, the aggregate of what I call maintenance expenses. These include utilities, insurance, management, repairs.

And finally, the owner's return on his investment.

If we work out the arithmetic of this $12,500 unit whose shelter cost is unsubsidized, we have a debt service of $800 a year, real estate taxes of $375 a year, maintenance of $480 a year, and an owner's return of $75 a year, or a total annual shelter cost of $1,730, which works out to $144 a month.

If the occupant has a $3,700 annual income, just under the $4,000 figure spoken of in my statement, and is asked to pay 25 percent of his annual income for shelter, which is the formula of rent supplement, all that he can afford to pay is $930, or $77 a month.

In order for him to afford to live in that $12,500 unit, he must receive an annual rent supplement of $800. This is essentially the way that the rent supplement program works.

Senator SMATHERS. Let me ask you this: In actuality, is it working just that way? I am unfamiliar with how it is really working.

Does the occupant of that hypothetical building ask the Government to pay him $800, or, if it is working, does the Government pay to the owner of the building $800? What are the mechanics at that point?

Mr. BERGER. The developer enters into a contract with HUD prior to undertaking the project. It is a contract for 40 years in which the Government agrees to pay the developer the difference between the market rental of his apartment, which would be $1,730 a year, and 25 percent of the occupant's annual income.

Senator SMATHERS. Is this program actually in effect in New York now? I recall we passed the bill and it is law, but are they doing it?

Mr. BERGER. I read in the paper some months ago that the first contracts had been signed. I don't know what the present status of the program is. My impression is that there are not a great number of rent supplement units actually in operation.

Senator SMATHERS. I am advised by a member of the staff that there are none in existence. As far as you know, there are none in existence?

Mr. BERGER. That is right.

Senator SMATHERS. All right.

Mr. BERGER. I have tried to demonstrate by this chart that the family whose income is just under $4,000 a year cannot afford a $12,500 unit, and equally the family whose income is $6,000 a year cannot afford this $12,500 unit, even if we ask it to pay 25 percent of its income for shelter cost. Its ability would be limited to $1,500 and the difference between $1,500 and $1,730 would be the required supplement.

The second reality which any new program for slum housing must confront is the absence of responsible private investment in slum housing.

If I may digress just a moment from my prepared remarks, I would like to comment on the administration's announcement 2 days ago that the life insurance companies have agreed to make available to slum housing $1 billion.

There is a perversity in the administration's comment on that agreement compared with its reaction to S. 2100. In speaking of the life insurance companies' proposal, the administration said that the companies were making an historic contribution to the problems of slum housing.

Yet in speaking of S. 2100, 2 days ago, the Secretary of HUD said that this bill represents a significant step backward.

Let's compare what private enterprise is being asked to do under the two plans.

The life insurance companies have agreed to loan $1 billion. They will get for their investment a 6-percent return fully guaranteed by the FHA. There is absolutely no risk at all to that investment.

The only duties that the life insurance companies will have as mortgagees are the making of the initial decision as to what projects to invest in, and the sending out of monthly notices to the mortgagor that his next installment is due.

By contrast, the sponsors who are asked to invest under the provisions of S. 2100——

Senator SMATHERS. Before you proceed, let me ask you a question, in all fairness, so that we are very clear.

The announcement was made, and I must state that it was uniquely timed. The announcement that was made with respect to the $1 billion being made available by the insurance companies contemplated, did it not, that builders will go and borrow this money and that private builders will actually be responsible for the building of the so-called housing in the slum areas, and that they, the builders, will somehow retain possession and operation and to that extent will have some pride in and operate the housing?

Mr. BERGER. There is no question at all about that, Senator. But the risk being taken——

Senator SMATHERS. There is no risk, I agree.

Mr. BERGER (continuing). Is the builder's and not the mortgagee's.

Senator SMATHERS. Let me ask you this further question: Actually, isn't that very much true today, that the insurance companies heretofore would always lend money on property which they thought was good property if it happened to be in suburbia, and isn't the only new feature that the FHA is guaranteeing it?

So the insurance companies are not doing any more than they have done in the past except that they have a guarantee for the money which they lend. That is the only different feature in that particular proposal; is that not correct?

Mr. BERGER. That is so.

Senator SMATHERS. It really doesn't offer one single advantage to the private enterprise getting into this field that wasn't already there except that the insurance companies will lend money and be guaranteed for it. But it doesn't put private enterprise, in fact, into this area.

Mr. BERGER. It doesn't put one new producer into these homes.

Given the unusual perils of a slum area investment, racial unrest, vandalism, canceled insurance, the infection of surrounding blight, we cannot ask the prudent private investor to risk his capital unless we offer him an explicit, generous profit incentive.

Public and charitable agencies have been the major suppliers to date of new slum area housing. They have done much, but they cannot do the job alone. We must appeal also to responsible free enterprise. But if we cannot convince them that it is both profitable and respectable to invest in the slums, the appeal will go unheeded.

The third reality is the high rate of tenancy among the urban poor, with all the sorry byproducts of that statistic. We must clear the path

of homeownership for the urban family trapped or wishing to remain in the city so that it may have some recourse from the dreary, unsatisfying prospect of a lifetime of tenancy.

In short, the need for subsidy and profit incentive, and the potential of homeownership for the occupants, should be the cornerstones of a wise housing program.

What I like about S. 2100 is that each of these cornerstones has been carefully carved and placed, and in the next few minutes, as I review the provisions of the bill, I will indicate why.

In a certified project, a two-bedroom apartment costing $12,500 to renovate will rent for about $80 a month, within reach of the $4,000 a year family.

Now I would like to turn to chart 2.

(Chart 2 follows:)

CHART 2

SHELTER COST

CERTIFIED PROJECT

80 percent mortgage, 2 percent, 50 years
20 percent equity, 3 percent return

Debt service	$380
Real estate taxes	45
Maintenance	480
Owner's return	75
Annual shelter cost	[1] 980

[1] $77 a month.

Mr. BERGER. I have made these assumptions about the certified project: That the producer will make a 20-percent equity investment on which he will realize a 3-percent cash return; that the balance of the financing will be 2 percent repayable over 50 years.

Once again we have the four components of shelter cost. The maintenance of a certified project is the same as the maintenance of a rent supplement project, $480 a year, and the owner's return, despite the fact that the return on equity is only 3 percent compared with the 6-percent return in a rent supplement project, is also $75.

That they work out the same, results from the fact that the investor in the certified project has twice as much equity as the investor in a rent supplement project.

The two components of shelter cost that the certified project significantly reduces are: First, the debt service, reduced from $800 to $380 a year; second, the real estate taxes, reduced from $375 a year for the rent supplement project to $45 a year for the certified project. These reductions lower the annual shelter cost of a certified project to $930 a year which, incidentally, is one-fourth of a family income of $3,700 a year.

There has been a good deal of discussion and testimony as to the comparative cost of rent supplement and the certified project program. I would like now to refer to chart 3 to indicate what those comparative costs are.

(Chart 3 follows:)

CHART 3

RENT SUPPLEMENT

Comparative treasury expense of reducing shelter cost

Rent supplement	$800
Certified project:	
Real estate taxes	250
Debt service	150
	400

Mr. BERGER. Here we are speaking about the comparative cost of bringing down the shelter cost so that a family whose income is under $4,000 a year can afford to live there. We noted that the cost of the rent supplement program was $800 per unit per year. The comparative cost of the certified project program is $400 per unit per year, and that cost has two components—real estate taxes, taking the form of a Federal grant to the local municipality which may be as much as 75 percent of the normal real estate taxes on that project, and the debt service component.

The debt service component is based on the fact that in order to provide 2-percent mortgages the Federal Government has to borrow at 4½ percent and then it loans money out at 2 percent. So the debt service component is the cost of 2½ percent per year on the unpaid principal balance of the mortgage that finances the construction of this unit.

Senator SMATHERS. Let me ask you a question there. The interest rates go much higher. You can't borrow this money at 4 percent. It will be at 6 percent. This is also reflected, is it not, as an additional cost in the rent supplement program?

Mr. BERGER. Yes.

Senator SMATHERS. So they work together.

Mr. BERGER. That is right. The cost to the Federal Government for its money would go up as the cost generally of the mortgage money.

Senator KENNEDY. In the rest of your statement will you touch on the other advantages of this program over the rent supplement?

Mr. BERGER. I would like to make some comment on the comparative advantages.

Senator KENNEDY. I do not want to interrupt the continuity of your testimony.

Mr. BERGER. Let me do so now, Senator, since you have asked me.

I think there are other advantages of the certified project program over the rent supplement program, apart from the reduced cost of the certified project program.

In the first place—and I will touch on this later in my statement—the certified project program has built into it procedures for transition from tenancy to ownership of the occupants living in the project. The possibility of conversion from tenancy to ownership is also present incidentally as a feature of the rent supplement program.

But in a certified project the producer has a definite incentive to pave the way from tenancy to ownership, and as early as 2 years after the project is completed.

Moreover, once the conversion takes place, the new owner in a certified project will be paying mortgage interest at the rate of 2 percent a year, whereas the new owner in a rent supplement project will be

forced to pay interest on his debt at the rate of 6½ percent a year, so the cost after conversion from tenancy to ownership of market rate interest under the rent supplement program is a cost that the occupant-owner himself would have to bear.

In addition, the rent supplement program operates somewhat as a dole. "Dole" is a loaded word, but I will use it here for emphasis.

The market rental of a rent supplement unit, as we have worked out the arithmetic before, is $1,730 a year. The occupant is only able to pay $930 a year. In effect, what the Government is saying to him through the rent supplement program is, "This is a unit that is too expensive for you to afford, but we will make up the difference between what you are able to pay and what this unit costs by making an annual payment to your landlord."

Under the certified project program, the cost of the shelter is brought down so that it is within reach of the occupant. The tradition in this country is not to price an item, a commodity, out of reach of the consumer and then make a payment to him periodically so that he can afford the commodity. Rather, the tradition in this country is to try to bring down the cost of the unit so that the consumer is paying his own way, or at least psychologically feels that he is paying his own way.

Senator SMATHERS. What you are saying, as I understand it, is that there is much more incentive under S. 2100 for an occupant to purchase and become the owner of his house than there is under the rent supplement program, even though the rent supplement program does have a provision providing for the occupant finally to become the owner. The principal reason which you cite, and I guess there are others, is that when the occupant becomes owner of a certified house under S. 2100, he has a long-term mortgage on which he has to pay only 2 percent interest, whereas if he is under the rent supplement program he has to pay what amounts to the going interest rate, presumably 6½ percent. Is that right?

Mr. BERGER. Yes.

Senator SMATHERS. Are there any other reasons why this would be better? That is a good reason, but I wondered if there were others.

Senator KENNEDY. I gather also from your figures, and I don't know whether you actually stated it, that it is also much less expensive to the Government.

Mr. BERGER. Yes. Once the conversion takes place——

Senator KENNEDY. I gather then that S. 2100, as far as providing low rentals, is much less expensive to the Government.

Mr. BERGER. Yes. I gave that as the original difference between the two programs.

Senator SMATHERS. You may proceed, Mr. Berger.

Mr. BERGER. If it passes S. 2100, Congress will have said to the private investor, "The opportunity is yours, openly, legally, and without shaving corners, to produce and operate slum area housing, and to earn a return commensurate with the difficulties such activity is likely to endure."

This bill recognizes that if rents are to remain low, the investor's return cannot be added to shelter cost, but must take the indirect form of income tax incentive.

That advantage is the mixture of tax credit and rapid depreciation which results in a tax loss and which affords the producer having

outside sources of income the equivalent of a cash return through tax reduction, sufficiently large, I believe, to invite a serious look at the potential in slum area housing.

Tables already before you indicate on a 20 percent intial equity investment a range of return from over 12 to over 19 percent a year with the range moving upward as the cash equity increases.

I might also say that in his testimony yesterday afternoon, Professor Bittker, in a beautifully analyzed exposition of S. 2100, reasoned that this bill is not a windfall to the producer, that the safeguards necessary to prevent the producer from abusing the tax incentives have been incorporated into the bill.

Senator SMATHERS. Would you go through that again please?

Mr. BERGER. In his testimony yesterday afternoon, which you commended, Professor Bittker made the case that S. 2100 is not a windfall, and that the precautions necessary to prevent this tax incentive from becoming a windfall have been incorporated into the legislation.

Senator SMATHERS. And do you agree with his conclusions?

Mr. BERGER. Insofar as I have any competence to do so I would agree with his conclusions. I learned taxation at the feet of Professor Bittker, so I must defer to my mentor for the validity of the conclusions.

Senator SMATHERS. You passed the course and you are out. So, independently, can you say from your own observation and study of the bill whether you believe there is any windfall?

Mr. BERGER. I do not believe there is any windfall.

It has also been argued that the 221(d)(3) below-market interest rate will provide a comparable return to the limited-dividend sponsor during the first years of his investment. But do not be misled, and certainly few potential investors will be misled, by the deceptiveness of that return.

Like the wisp of smoke, it will eventually disappear as the mechanics of tax accounting convert a paper loss into a paper profit, and the property owner is taxable on more income than he actually receives.

I will not labor you with either the theory or computation which explains this. There is already in the record a very elaborate exposition.

What it comes to is that the investor in a BMIR 221(d)(3) project really cannot hope for much better than an 8 percent return under the best of circumstances.

I do not believe that this is a sufficient return to be inviting to the private investor.

Senator SMATHERS. Is it not a fact that that is not high enough to make them invest their time and money in areas where they are liable to be subjected sometimes to difficult tenants, riots, and violence, and a lot of other disadvantages which they would not incur if they spent their time and money out in suburbia?

What you are saying is that there is not enough incentive; is that not correct?

Mr. BERGER. Exactly. An 8-percent return is insufficient incentive. Let me give you an analogy. Six or 7 years ago, in the late 1950's and early 1960's, real estate syndication became a prevalent form of investment in New York City and some other larger cities throughout the country.

When syndication began, the investment return to the syndicators ranged from 12 to 15 percent. That was sufficiently high to attract private investors.

By 1962 the rate of return on syndicate investments had been driven down to below 10 percent and when the return got down to 8 or 9 percent the flow of private money into the syndicates simply dried up.

S. 2100 does not neglect the aspirations for homeownership which seem as indigenous to the poor as to everyone else. Yet S. 2100 is not a reckless tender of the responsibilities of ownership. It provides, through the management corporation device, and custodial powers of HUD, some assurance that project occupants will be ready for their greater obligations if they wish to assume them.

Still through an imaginative use of the tax incentive, the bill induces the project sponsor to pave the way for an early transfer of ownership to the occupants and, if need be, to provide some of the management training that will facilitate the transfer.

This is really the dual incentive toward homeownership that the certified project provides. On the one hand, the subsidized rent, as you pointed out, Senator Smathers, provides the incentive to the occupant to ready himself for homeownership, and on the other hand the arithmetic of the tax incentives is such that the producer will try to convert his project to homeownership as quickly as he can.

As I have indicated already, S. 2100 opens up homeownership to families at a considerably lower income capacity than is possible under the rent supplement program.

Briefly I have tried to summarize the features of S. 2100 that seem responsive to the three realities of a low-income housing program: The reduction of shelter costs, the creation of profit incentive, the transition to homeownership. No once can predict whether free enterprise will accept the challenge that S. 2100 holds out, but the needs are too great, our cities are too inflamed, and the consequences of failure are too great for Congress not to lay it on the line to responsible private industry in a way it has never done before.

Thank you.

Senator SMATHERS. Senator Kennedy, have you any questions?

Senator KENNEDY. What are the rates of return under S. 2100?

Mr. BERGER. The rate of return will vary with the producer's investment decisions: the length of time he holds the project, whether he sells the project to a home management corporation, or to another private developer or operator, and if he sells privately, whether he reinvests the proceeds in a new certified project.

The rate of return will also depend on the size of the producer's initial equity. Twenty percent initial equity, as I understand the depreciation schedule now, permits a range of return from 12 to 19 percent.

Senator KENNEDY. In view of your description of the bill and some of the problems of the rent supplement programs, why do you think we have not moved in the direction that has been suggested by this bill rather than in the direction of rent supplements?

Mr. BERGER. I think we are improving our housing programs in stages. The rent supplement program as it was enacted by Congress was really an alternative to conventional public housing. It was the first serious effort to invite private enterprise to supplement the traditional role of the local public agencies.

I think we have begun to realize that the traditional methods of producing housing in slum areas and the traditional incentives that we have provided are simply insufficient. The public agencies and the charitable agencies cannot do the job themselves.

We are just beginning to recognize the need to enlist the resources of private enterprise.

Senator KENNEDY. Do you think that the tax cost of producing the yields that you have discussed are higher than the cost involved in the rent supplement program?

Mr. BERGER. The subsidy that S. 2100 provides must be divided into two components. First, the subsidy that makes possible the reduction of shelter cost from $150 a month to under $80 a month.

As I have indicated, that subsidy is less than the equivalent subsidy under rent supplement.

The second component of subsidy is what is needed to give the producer a return sufficiently large to enable him to produce and operate slum housing.

As to that subsidy the cost of the certified project program exceeds that of rent supplement. However, the increased cost of providing a decent return to a producer is more than offset by the decreased cost of reducing the rent to a level that the occupant can afford to pay.

Senator KENNEDY. What we really have in this program is a mechanism for bringing the private enterprise system into this rebuilding effort in a major way. It will allow them to invest on housing in the ghettos in a way they have never done before. It provides for rents that are feasible for people with low incomes, and the overall cost is really less than the cost of any of the programs that are presently in existence, which are unfortunately not very effective.

Mr. BERGER. There is a memorandum in the record to that effect.

Senator KENNEDY. Thank you.

Senator SMATHERS. Thank you very much, Mr. Berger, for your testimony.

Mr. BERGER. There are two charts I did not go through.

Senator SMATHERS. We will make them a part of the record.

Mr. BERGER. The fourth and fifth charts make a similar comparison between the 221(d)(3) BMRI program and the certified program. They also show a lower cost of reducing the rent under the certified project program.

(Charts 4 and 5 follow:)

CHART 4

SHELTER COST—$12,500 UNIT

90 percent mortgage, 3 percent, 40 years
10 percent equity, 6 percent, return

Debt service	$480
Real estate taxes	375
Maintenance	480
Owner's return	75
Annual shelter cost	[1] 1,410
Rent supplement	480
Rent to occupant ($3,700 annual income)	[2] 930

[1] $120 a month.
[2] $77 a month.

CHART 5

BMIR

Comparative Treasury expense of reducing shelter cost

Rent supplement	$480
Debt service	77
	557
Certified project:	
Real estate taxes	250
Debt service	150
	400

Senator KENNEDY. Is it going to be possible—as Secretary Weaver suggested—to use the $1 billion that will be made available by the insurance companies to construct housing in the ghettos without rent supplements?

Mr. BERGER. Absolutely not. It seems to me this is a critical comment to make. The 6½-percent return which the mortgages will get produces the shelter cost set forth in chart No. 1. The only existing program we have to bring down that shelter cost to the family with a $4,000 a year income, so they can afford to live there, is through rent supplement. We would need rent supplement to use the billion dollars.

Senator KENNEDY. Mr. Chairman, you will remember that Secretary Weaver said they would use rent supplements for only a small part of that program.

If you do not use rent supplements and you have the $1 billion available, you will not be able to construct housing for people in the ghettos. Moreover, when you use the rent supplements, it is the most expensive way of producing low-income housing.

Mr. BERGER. Yes.

Senator SMATHERS. Thank you very much.

Our next witness will be Whitney Young, the executive director, National Urban League, from New York.

STATEMENT OF WHITNEY M. YOUNG, JR., EXECUTIVE DIRECTOR, NATIONAL URBAN LEAGUE, NEW YORK

Senator SMATHERS. We are delighted to have you with us as a witness this morning. You may proceed in any way you wish.

Mr. YOUNG. Thank you, Mr. Chairman.

Mr. Chairman, members of the committee, my name is Whitney M. Young, Jr. I am the executive director of the National Urban League.

Mr. Chairman, I would like to express the appreciation of the National Urban League for the invitation to appear before this committee to testify on S. 2100.

The National Urban League is a nonprofit, charitable, and educational organization founded in 1910 to secure equal opportunities for Negro citizens. It is nonpartisan and interracial in its leadership and staff.

The National Urban League has affiliates in 83 cities, in 33 States and the District of Columbia. It maintains national headquarters in New York City, regional offices in Akron, Atlanta, Los Angeles, New York, and St. Louis, and a Washington bureau.

A professional staff of 800, trained in the techniques and disciplines of social work, conducts the day-to-day activities of the National Urban League throughout the country aided by more than 8,000 volunteers who bring expert knowledge and experience to racial matters.

The National Urban League is deeply grateful for the committee's invitation to appear today and it is with pleasure that I take the opportunity to testify on the Urban Housing Development Act, S. 2100, dealing with housing in urban poverty areas.

As we are all aware, we meet now in the shadow of a summer of conflict and crisis. It can be news to no one that our Nation's crisis is a dual one—a crisis both urban and racial.

It must be clearly understood that the two problems, the "crisis of the cities," and the racial crisis are inseparable. Neither can be resolved while the other remains unresolved.

It is an understatement to speak simply of the urgency of the situation. The situation is urgent almost beyond our powers to grasp it. Nor has it ever been so clear that interracial solutions and the goals of integration and dispersal, are at the core of any reasoned and reasonable solution to the urban and racial problems besetting us.

The convulsions of our cities represent a far more dangerous threat to the stability of our national life than any other problem before us—foreign or domestic.

The first priority of a republic in torment, and a people in anguish, must be the curing of its own, and their ills—poverty, discrimination, ignorance, and a blighted environment. We can no longer afford to practice racial brinkmanship. The future of a society that would call itself civilized is at stake.

Among the most critical of the problems to which we must address ourselves is that of housing, the subject before us today. We have an estimated 7 million substandard housing units in the slums and ghettoes of the Nation's cities which require rehabilitation and replacement, and in addition, we are faced with an enormous need for new low- and middle-income housing.

There can be no solution to the problems of the ghettoes without massive rebuilding, rebuilding on a scale far in excess of anything in our experience to date.

Whatever specific approaches are adopted, the first imperative is that we devise programs appropriately scaled to the scope and urgency of the housing problem we face, and the second is that we develop a whole battery of techniques, competitive if necessary, to get the job done.

There are now a multitude of housing proposals before the Congress I do not choose to get involved in the precise details of specific bills or in an assessment of the precise mechanics of any bill.

I will leave to men of good will in the Congress the final determination of what the precise mechanics and details should be. But, I am prepared to state, as I have stated in the past, what I think the basic issues and necessities are.

Whilie our recent history has clearly demonstrated a national tendency to look to the Federal Government for the solution of major social problems, it is now clear that the job is too big for Government alone.

Success will require the fullest possible commitment of both the public and private sectors and must enlist the fullest cooperation of all

institutions within the entire society. I think the recent action of the insurance companies of contributing $1 billion, and the action of the National Council of Churches yesterday, in which it agreed to set aside some of its capital for rebuilding in the ghettoes, is a step in this direction.

I would point out, Senator Smathers, that I think another advantage of the $1 billion from the insurance industry is that they agreed to do this in what are admittedly high-risk areas at the same rate of interest as they do in low-risk areas.

To me, for that body it is almost revolutionary.

Senator SMATHERS. I agree, and I don't want to debate with you about it. But we must remember that they get a 100-percent guarantee from the Government. So their risks are minimized considerably. But we still want to commend them, for as you suggest this is at least movement in the right direction with respect to committing their funds.

Thank you.

Mr. YOUNG. In devising a basic framework for acion to obtain the fullest participation of the private sector and to establish the most effective role for the Federal Government, the National Urban League is firmly committed to the belief that the appropriate framework will consist of the fullest possible use of the tax, credit, and subsidy powers of the Federal Government on a massive and coordinated basis in a fashion designed to involve the initiative and incentives of competitive free enterprise.

I would further state that the debate which rages over whether to rebuild the ghetto or disperse it is a debate without substance. To say that to rebuild the ghetto is merely to "glid" it and thereby institutionalize it, is to overlook the steps which must necessarily precede dispersal.

What are now ghetto areas must be rebuilt and rebuilt without delay, no matter who lives there now or 10 years from now. The ghettoes of our cities are not at present fit for human habitation by anyone, and we can no longer condemn any segment of the population to continued living in circumstances that make a mockery of human life.

In addition, dispersal is a two-way street. Not only do Negroes have to have both the opportunity and the incentive to move out of the ghetto, if dispersal is to be accomplished, but white people must have good reason for moving into what are now ghetto areas and there will be no such "good reason" until the ghettos are rebuilt.

Our immediate objective must be to create an open society and to insure that all its citizens have freedom of choice within it. There are many Negroes who, for many years, may continue to feel more comfortable in a familiar ethnic neighborhood.

There are many to whom the "unknown" in unfamiliar neighborhoods and in the suburbs will act as a powerful deterrent to dispersal. What we must guarantee is the availability of options, a meaningful freedom of choice.

A range of options, be it in questions of housing, education, training or jobs, is as important to the ghetto resident as it is to those at middle and upper income levels. One of the greatest tragedies of the ghetto today is the lack of individual options.

As Senator Kennedy said in introducing S. 2100, "in the long run, it is only by a rebuilding process of which physical reconstruction is

an integral part, that we can achieve the comparability of housing which is an indispensable requirement of full integration."

While, as I have said, I will leave it to the technicians within the Congress to determine the final mechanics and precise formulas of this or any other housing bill, I find much in S. 2100 to recommend it.

I believe that it is responsive to, and embodies many of the essential principles I have outlined. It recognizes that fundamentally the job of rebuilding the ghettos must be accomplished by private enterprise.

It creates a framework within which the tax credit and subsidy powers of the Federal Government would be mobilized to involve the initiative and incentives of competitive free enterprise.

It is a program which would concentrate its full authority on recognized ghetto areas as identified by the Bureau of the Census for the Office of Economic Opportunity.

It is committed to a recognition that "the immediate need is for decent and dignified conditions where people live now." It is scaled for the rebuilding, not of single dwellings alone, but of entire blocks and entire neighborhoods.

It is impossible to be certain how any one proposal will work until it is tried. But, one of the most interesting innovations in the Kennedy bill, in addition to its system of tax incentives and dynamic mortgage arrangements, are those provisions designed to help stabilize the construction industry itself, a necessity if we as a nation are to build at the rate required of us.

As I testified in December before the Senate Subcommittee on Executive Reorganization, one big reason for our present failure in the housing field is the state of the housing industry itself.

The housing industry is not, in fact, an industry at all—in the sense that we think of the steel industry or the automotive industry. It is, instead, a miscellaneous collection of small entrepreneurs, in no way equipped, as such, to meet our national housing needs.

One of the first items on the Federal agenda must be a careful consideration of steps to be taken in order to create a housing industry worthy of the name and capable of meeting our housing needs at a realistic and desirable level.

To date, the governmental role has been one of propping up this faltering collection of small-scale operations, rather than exploring the fundamental questions relating to the scale and efficiency of operation necessary for us to reach a satisfactory level of production.

The Kennedy proposal, by inducing a greater equity investment on the part of the builder, would create a situation in opposition to that which pertains today in which the construction industry is financed almost entirely through borrowings, and therefore stops and starts as the interest rate goes up and down by fractions of a point.

I also testified at length in December in relation to homeownership as a viable option for low-income people, an option which, through the pride of ownership constitutes the surest way to create a stake in the community for individual families and contributes most to the health and stability of the community over the long haul.

While homeownership is not at the core of the Kennedy proposal, the Kennedy proposal allows for homeownership and, I think it does so through an organic mechanism, that of the home management cor-

poration in combination with incentives to the builder to sell to the home management corporation, thus providing tenants with apartments on a cooperative or condominium basis.

The home management corporation would also be used, within the Kennedy formula, as the vehicle for undertaking educational, cultural, employment and health programs, which seems to me to be an approach worthy of trying.

The provisions which would require that management remain stable for a minimum of 10 years, except where sale of the building to the home management corporation is negotiated, strike me as strong and important provisions. And, the provisions whereby tenants would make a larger contribution in rentals upon an increase in income, rather than being forced to move, which practice robs the community of its successes and natural leaders, is an essential ingredient for strengthening community life in urban poverty areas.

In short, through its system of tax incentives, mortgage arrangements and by establishing a competitive rate of return, the Kennedy proposal is designed to attract sophisticated money into the rebuilding of the Nation's ghettos.

I am prepared to say that there will be no real breakthrough in the solution of our urban and racial problems until the private sector recognizes the full extent of its stake in our current social crisis and until money from major sources is attracted into the ghetto in large amounts to do the massive job that only massive, privately generated moneys can do.

The provisions whereby individuals and corporations would be permitted to pool their resources and allowed to pass rental income and tax losses through to their shareholders are important for a number of reasons.

If it is true that the American economy works because everyone owns a share of it, then it is fair to assume that the broader the American investment in the ghetto the greater the sensitization of the American people to what goes on in the ghetto, a development which, while indirect in terms of the formulation of this bill, can only be good.

I see no conflict between a program instituted along the lines proposed by Senator Kennedy and the administration's Turnkey and Turnkey II approach.

I testified at length in December about the strength of the Turnkey approach in creating public housing, citing then its advantages in cost, timesaving, and flexibility in design, construction techniques, and the type of developers in comparison with traditional Government construction.

I am no less persuaded of the virtues and strengths of the Turnkey approach today and I applaud Secretary Weaver's decision last month to include private management contracts within the Turnkey formula, as recommended by the President's Committee on Urban Housing, on which I have the honor of serving.

The President's Committee also recommended that the Turnkey formula institute a component to encourage the selloff of public housing projects to cooperatives and to private families as a means to materially improving conditions in many public housing projects, and I hope that the Department of Housing and Urban Development will respond favorably to that recommendation, too.

The main problem at this date, however, is that we need to build some 500,000 public housing units a year and we are now building only about 31,000. It would seem clear that if we are going to generate building activity commensurate with our needs we need a still broader battery of techniques in order to tap the full potential of the private sector's participation.

We need to develop everything that can be developed within the Turnkey formula, but it is essential that we move out of the pilot project phase, and move out of it fast. What is needed are massive appropriations in support of the Turnkey formula and, in addition, the development of any and all additional techniques which can usefully broaden the spectrum of our housing approaches.

To repeat, I do not see the Kennedy proposal as competitive with the Turnkey approach, but simply as a means to broadening the Federal battery of techniques in solving the housing crisis.

I should also like to take a moment to comment on former Senator Paul Douglas' suggestion that the 48,000-odd single-family houses, largely in the suburbs, on which mortgages are foreclosed each year by the FHA, be used for public housing clients.

Inadvertently, or not—and I think it was more advertent than inadvertent—the Federal Government through both the FHA and the old Public Housing Authority bears a heavy responsibility for present patterns of housing discrimination, both North and South.

Early legislation governing FHA mortgages required homogeneous neighborhoods and from 1935 to 1950 public housing law required only that public housing be equitably distributed among the races. Both of these stipulations served to intensify housing segregation in the South and the FHA's insistence upon homogeneous neighborhoods, actually created widespread segregation in housing in the North in areas where it had never existed before.

In light of the Federal Government's historical responsibility in the creation of segregated housing patterns, it would seem only fitting now that it should take the step suggested by Mr. Douglas in an effort, no matter how belated, to reduce segregated housing patterns.

In summary, the housing tools we already have available must be massively utilized, and, in addition, new tools must be added to the Federal arsenal.

I am in favor of all creatively conceived bills which will broaden our battery of useful techniques and which are directed toward real solution, and I congratulate their authors as I congratulate Senator Kennedy for the creative content of S. 2100.

The time has passed for halfway measures, token gestures, and small-scale efforts, no matter how well meant or well designed. The crisis of our cities defies any such simple solution. The expanding ghettos are not only thoroughly destructive to the people who live in them, but they threaten the welfare of every major city with strangulation and dry rot. They are sapping the fiscal strength of the cities and threatening to rend the very fabric of American society.

The simple fact is that we need to utilize all available and conceivable devices, and we need to do so massively. We need rebuilding, rehabilitation, and new construction. We need rent supplements and below market interest rates. We need provisions for homeownership and provisions for self-help and sweat equity.

We need powerful tax incentives and mortgage arrangements designed to galvanize the private sector into massive action. We need Turnkey housing, but we need it massively. We need immediate broad-scale implementation of the model cities program. In short, we need the broadest possible range of alternative approaches. This is a time for action, not contemplative research.

Clearly, it is up to the Congress to determine what the nature of our solutions will be, and yet, despite the indisputable urgency of the situation, despite the compelling need for solutions to our dual crisis, urban and racial, the mood of the Congress today apparently is regressive.

The more the urgency of the problem becomes apparent, the more the record is misread. The more the real record of the way people live in this country's urban ghettos becomes known and understood, the more deeply American society seems to founder in a miasma of social confusion and tragedy.

It must now be clear to one and all that nothing less than massive effort can produce results. As Roger Wilkins, Director of the Community Relations Section of the Justice Department, said in the wake of the Newark riots, "Unless we can change the lives of people, it is all band-aids and lollipops."

In short, we must marshal all our available resources, public and private, for the job at hand and proceed on a scale commensurate with the challenge. We are in terrible danger, and our cities in desperate peril, if any among us permit ourselves the luxury of "thinking small."

Senator Smathers, I would like to add one statement. Since this testimony was prepared, I have had the opportunity to visit Vietnam. While there, I had a chance to talk to many of the young men who are making great sacrifices there, many of whom lived in the kind of neighborhoods I am describing, and whose families continue to live in them.

While they are doing very little complaining about the sacrifices they are making, they are terribly upset when they read of what is happening in this field, the cutting out of rent supplements, the cutting back on the model cities appropriation, the defeat of the rat control bill, and what they describe as an almost brutal callousness and indifference. It is very difficult.

I do recall the words of former President Kennedy when he said in his Alliance for Progress speech, that if peaceful resolution is impossible, then violent revolution is inevitable.

I want to make my concern a matter of record. I don't presume to lecture to the august body of this country, the Congress, nor the administration, but I must confess my concern and my distress at what appears to be too much debate around personalities and partisan politics, and too little discussion of the substantive matters that we are talking about in this bill.

In the last 2 days, newspapers have covered the conflicts surrounding this bill, but they have not dealt with the very important positive, substantive things in this bill. In effect, it looks like we are fiddling while Rome burns.

One out of six Negro families live in substandard housing as compared to one out of 32 for white citizens. We can't make slum housing

a political football: If we do, I can tell you now what the score is going to be. It is going to be nothing to nothing. Nobody is going to win this one, if we make it a political football.

I would urge that whatever reasons people may have for taking issue with this bill and that bill, that we somehow get together on the important problem. That is housing. Take the good out of every bill, drop the bad and let's move on with a housing bill.

Senator SMATHERS. Thank you very much, Mr. Young, particularly for that last very moving and graphic statement about the needs. Of course, that is the reason why the bill S. 2100 was introduced and the reason we are here today.

Your statement is a very useful and helpful contribution to the solution of this problem. I particularly liked your sentence on page 7, which I think so well describes what is the intent and purpose of this particular bill, in which you say:

> I am prepared to say that there will be no—

and you have "No" underlined—

> real breakthrough in the solution of our urban and racial problems until the private sector recognizes the full extent of its stake in our current social crisis and until money from major sources is attracted into the ghetto in large amounts to do the massive job that only massive, privately generated monies can do.

I think that very well summarizes what we are trying to do with S. 2100. We recognize, as you do, the great contribution which they can make and which they should make in this field. S. 2100 seeks to get them involved heavily and massively in meeting this particular problem.

Senator Kennedy, have you any questions?

Senator KENNEDY. I think Mr. Young has put it very well, Mr. Chairman, and I think his statement is very moving and very important in our consideration of this bill.

I just have a couple of questions. On page 9 you say that the main problem is that we need to build some 500,000 public housing units a year and we are now building only about 31,000.

I understand from Secretary Weaver's testimony the other day that only a small percentage of those 31,000 units which are going for the poor, and are obviously most worth while, are going into the ghetto areas where the need is so tragically apparent.

Mr. YOUNG. We have been encouraging that there be some dispersal of public housing. We do not feel it is helpful to the ghetto community to put housing in there that simply tends to reinforce segregation.

Senator KENNEDY. But just the small amount of units which have been built—31,000 a year—that is not even a reasonable percentage of what is needed in the ghetto, let alone around the rest of the country.

Mr. YOUNG. Even with the new policy decisions, there is so little money appropriated that it will hardly scratch the surface.

Senator KENNEDY. Secretary Weaver stated that four-fifths of the public housing program serves communities of less than 25,000 and better than half of those communities have populations of less than 5,000.

My point is that housing is needed in these small communities as it is needed in the ghetto. But we are not scratching the surface at all

when we talk about 31,000 units, with only a small percentage of them going into our urban slums where the need is so apparent.

Mr. YOUNG. And particularly when you consider the mobility of this particular population, that they have moved in such large numbers to the city. We aren't beginning to meet that need at all.

Senator Smathers, I believe you took issue with a previous witness who said that this was sort of a specialized and unique kind of population and problem.

I believe that was the language. That rebuilding the ghetto was a narrow and specialized purpose, that slum rehabilitation was a narrow and specialized purpose, and that it affected such a small group of people.

That was a shocking statement to me; and I am very glad that you took issue with it.

Senator SMATHERS. Thank you.

Senator KENNEDY. The housing need is so desperate in this country. As the chairman has said and as I have said, we think that the figures we come up with are the best possible figures for depreciation and tax credits, but if somebody else has some alternative suggestions, certainly they would be considered. But the need is so desperate and this is such an inexpensive way of bringing about housing and bringing private enterprise into the whole effort that we must deal with it honestly.

It seems to me, as you say, it should be embraced, refined and improved, and perhaps more emphasis placed on certain points than we have done.

But this is the approach we should take, it seems to me, when the need is so desperate. The fact is that the programs that are presently in operation and have been in operation, are just not adequate or satisfactory in dealing with the housing problem.

The problem is going to continue to get worse. Our population is going to become more desperate. We are just not dealing satisfactorily at a legislative level or at the executive level with the problem. It seems to me that we are going to face a terrible situation in this country unless there is a change in attitude.

Mr. YOUNG. I concur in that.

Senator SMATHERS. Thank you very much, Mr. Young, You have made a fine contribution.

Mr. YOUNG. Thank you.

Senator SMATHERS. Our next witness is Elmer Winter, the president of Manpower, Inc., from Milwaukee.

STATEMENT OF ELMER WINTER, PRESIDENT, MANPOWER, INC., MILWAUKEE, WIS.

Senator SMATHERS. You may proceed as you like, Mr. Winter.

Mr. WINTER. Thank you.

My name is Elmer Winter. I am president of Manpower, Inc. Our company is in the temporary help service field. We have over 500 offices throughout the United States and in a number of foreign countries.

We employ, during the course of the year, over 300,000 people, who work on temporary jobs for Manpower, Inc. Our international headquarters office is located in Milwaukee, Wis.

As you know, Milwaukee has had a serious racial conflict, which is still taking place. The main thrust of the current racial strife appears to be to gain an open housing ordinance in Milwaukee.

In addition, there is a continuing and forceful move on the part of the Negro community for the general improvement of living conditions in our central city.

We have some 85,000 to 90,000 Negroes living in Milwaukee—this is slightly under 10 percent of our population. There are only 600 Negro families living outside of the central city area, which houses over 85,000 to 90,000 Negroes.

The homes in the inner-core area have deteriorated rapidly. I submit that there is a great need for our community to provide thousands of new living units for Negroes and for a relatively small number of Puerto Ricans who live in Milwaukee.

Our community is seriously concerned about our central city housing problems. Recently a biracial group, called We Milwaukeeans, organized a development corporation known as the Housing Development Foundation for Greater Milwaukee, Inc., to build on a nonprofit basis, 150 homes in our central city.

I have the privilege of serving as chairman of this development corporation. We have designed what I think is an important concept for urban living; namely, we are attempting to bring suburbia into our central city.

The 150 homes that will be built will be individual, ranch-style homes on 60-foot lots and will sell on a co-op basis for approximately $13,000—land and building included. The co-op owner will pay $110 to $120 per month and will acquire ownership at the end of 40 years.

While I believe that the building of these 150 homes will help us some in solving our housing problems, it is really a drop in the bucket when one looks at the total number of inadequate houses that exist in our community.

The only way that we can remove the blight and obsolescence that exists in the housing in our community is by a massive attack on this problem.

I do not believe that Government alone can provide the full answers in this regard. I believe that private industry must be brought into this program. I believe industry has the expertise, the concern and the desire to rebuild our central cities so that all of our citizense may have an opportunity to live in decent homes. I believe that in order to attract businessmen to build homes in the central city tax incentives must be provided.

Many corporate leaders have expressed, in clear and precise terms, that they believe that we on the business side have a responsibility to improve the housing and social conditions that exist in our communities.

However, the economics of the situation have to be taken into consideration. Investments in building of homes in the central city today do not offer an attractive return.

On the other hand, it is my belief, if incentives as provided in S. 2100 were made available to industry, the rebuilding of the central cities would move forward at a rapid pace.

During these past 3 years, I have served as the chairman of an organization known as the Milwaukee Voluntary Equal Employment

Opportunity Council. This council has over 200 members. Our membership is made up of the leading business firms in Milwaukee.

It is our responsibility, as a council, to open wider the employment doors of industry to all persons regardless of race, color, religion, or creed. It is also our responsibility to improve the training facilities for minorities so that they can climb the corporate ladder.

We have seen a number of our employers, who were located in our central city, move out and open plants in the suburbs. I doubt very much that it will be possible to attract companies today to build plants in our inner-core area without again providing some type of incentive.

I believe that we could make a serious dent in our unemployment among minorities if there were jobs available to them in the areas adjacent to where they live. Unfortunately, as a result of companies moving to the subrubs, it becomes more difficult for minorities to get out to the jobs.

How can we make it attractive for industry to build its plants in the central city and, thereby, offer jobs to minorities? I say that tax incentives have to be given to companies that are willing to build their plants in the central city. The incentives provided in S. 2100 should make it attractive for companies to build plants in the central city.

I suggest that this problem must be approached from two sides—the building of new housing by industry through proper tax incentives and the building of new plants, again through proper tax incentives. Unless both forces are at work, the total job cannot be done.

While 221(d)(3) Housing has its place in the rebuilding of our communities, the sponsorship is limited to nonprofit groups and to limited dividend corporations.

There does not appear to be a real opportunity for private enterprise and, as a result, less housing will be built than is needed, unless incentives are provided.

-It would appear to me that we need to offer private business the necessary incentives so that it can throw its full weight behind programs to provide better housing for the citizens of this country.

If industry is given the incentive, as provided in S. 2100, I would be reasonably certain that you would see springing up, throughout this land, new and imaginative programs to tear down our slums and provide new and desirable housing for our citizens.

We would also find industry, using appropriate incentives, building new plants and creating new productive facilities which could be staffed by those who live in our central cities.

For these reasons, I support S. 2100 and urge the passage of this important legislation.

Senator SMATHERS. Thank you very much, Mr. Winter. We appreciate that statement. It is a good statement, and certainly it evidences that you have captured the flavor, intent and purpose of this bill which is just, as you say, to get private enterprise into this field.

Mr. WINTER. I have a release which appeared in the Milwaukee Journal in July which describes the program that we have developed to build integrated housing in the central part of our city, the 150 homes that I referred to.

I would, with your permission, like to leave it with the committee. I think it is a unique program.

(The article referred to follows:)

[From the Milwaukee Journal, Thursday, July 13, 1967]

CIVIC LEADERS ASK TO BUILD INTEGRATED AREA OF HOMES

(By Vincent Baldassari)

The committee of We—Milwaukeeans, a voluntary biracial group of businessmen and civic leaders, has proposed to the city a unique plan for a racially integrated project of single family homes in a near west side urban renewal area.

The committee has offered to form a nonprofit corporation to build about 150 homes for moderate income families in a six block area in the Kilbourntown 3 urban renewal area.

The corporation, tentatively named Parkside Village Development Corp., would negotiate to buy from the city a site bounded by N. 20th, N. 17th, W. McKinley and the alley south of W. Galena.

PROPERTIES ACQUIRED

The redevelopment authority has started acquiring property in the area and expects to have title to the entire six blocks, possibly wihin a year.

The plan is to clear this blighted area and build about 150 three-bedroom homes with 1,000 square feet of living space each on lots with 60 feet of frontage, according to Elmer L. Winter. He developed the proposals for We—Milwaukeeans, Winter is president of Manpower, Inc., and chairman of the civic group's housing committee.

SPRING START PLANNED

"The average earnings of those who will live in Parkside Village will be in the $5,000 to $9,000 category," Winter said.

The suggested timetable is to clear the land for four model homes to be started next spring. If at least 70 orders and deposits are received, construction of 70 more homes would be started in the fall for occupancy in early 1969. Further construction would depend on the success of this first stage.

The project would be run on a co-operative basis. Each homeowner would become a member of the co-operative, would have to have an acceptable credit history and a down payment ranging from $250 to $350.

Mortgages would be insured by the federal government and would carry a 3% interest rate. The homes would cost about $13,500, including lot and improvements.

"The plan has an excellent chance of succeeding," said Lawrence S. Katz, state director of the federal housing administration office here. Katz worked closely with Winter in developing the plan.

"It will be the first time, in my knowledge, that an entire project of single family homes has been built to replace blighted homes in an urban renewal area," he added.

STUDY FINDS DEMAND

FHA studies in the area show there is demand for such homes in the area, Katz said, especially from families to be displaced by other renewal projects.

The project area, which is populated mostly by Negroes, borders on neighborhoods which are heavily white, Katz said. This offers a good opportunity for integrating the project, he said.

"Almost 1,000 white families will be relocated by spot clearance in the Midtown renewal area to the west," Katz said. The area also is served by two integrated schools—McDowell (50% Negro) and West Division high school (60% Negro).

Katz praised We—Milwaukeeans as "a group of civic motivated individuals . . . bringing good housing into being and coming up with a solution of re-use, open space and elimination of crowded housing conditions."

COULD EXPAND PROJECT

Winter said that if the project proved a successful way of redeveloping the area, the corporation would "just keep on building." He said the project could

be expanded since 75 acres of the 108 acre Kilbourntown 3 renewal area were designated for residential development.

The federal government approved the Kilbourntown project in May and authorized a federal grant of $8,735,000. The city will pay nearly $4,000,000 as its share.

Kilbourntown is bounded roughly by W. Galena, W. State, N. 20th and N. 14th.

The Parkside Corp. plans to buy the land from the redevelopment authority at about $1,250 a lot. An eastern management firm called the FCH Co., which is experienced in handling privately sponsored renewal projects, would be retained to plan, build and sell the homes for the corporation.

A 6% interest rate on a construction mortgage, insured by FHA, would be arranged through a local bank for the first four model homes. The corporation would provide $25,000 in "seed money" for the models, Winter said.

Monthly payments by the new homeowners are expected to be about $110 a month.

The project must be approved by the redevelopment authority, the common council and the federal department of housing and urban development.

The proposal was approved by the board of We—Milwaukeeans last week and presented to Richard W. E. Perrin, city development director, Monday.

Winter said 12 representatives of We—Milwaukeeans would be selected to serve on a board of directors of the Parkside Village Development Corp. A treasurer would be selected, among other officers, to handle the funds of the organization which would be represented by long term loans made by interested parties.

Senator SMATHERS. You talk to your Senators from Wisconsin and we will see if we can get them to support this bill.

Senator KENNEDY. If this legislation was passed, would you become more actively involved in building low-income housing?

Mr. WINTER. Very definitely.

Senator KENNEDY. Your own company would become involved?

Mr. WINTER. Our own company. Certainly we would.

Senator SMATHERS. Thank you very much for a fine statement.

Our next witness is Mr. James Tobin, professor of economics, Yale University.

Mr. Kuh, do you care to come up at this time?

STATEMENT OF JAMES TOBIN, PROFESSOR OF ECONOMICS, YALE UNIVERSITY, NEW HAVEN, CONN.

Mr. TOBIN. Mr. Chairman, members of the committee, I come before you as an economist and as a citizen deeply concerned about our society.

Senator SMATHERS. Mr. Tobin, we know you have a much more illustrious background and your modesty does not let you make that part of the record. We would like to have that. Would you tell us about your previous experience with the Government, if any?

Mr. TOBIN. I was a member of the Council of Economic Advisers with President Kennedy in 1961 and 1962.

Senator SMATHERS. In addition to being a former member of the Council of Economic Advisers with President Kennedy, what other experience do you have?

Mr. TOBIN. In public service, I guess I can claim only having been in the Navy in the Second World War, and in the beginning of that, as a very young man, in the Office of Price Administration, in civilian supply.

Senator SMATHERS. All right, sir. Please proceed.

Mr. TOBIN. I do want to make a disclaimer now, which is that I am not a housing specialist, nor am I a specialist in the intricacies of tax law which are related to housing.

I am speaking from a general point of view.

Senator SMATHERS. After having made that statement, you do recognize that the problem of the ghettos and the slums is a general economic problem which bothers and hurts the Nation considerably, and that it must be met as a national problem.

Mr. TOBIN. Yes. I can see no task of greater national priority than a radical and speedy improvement of the urban environments where so many of America's poor people now live.

The persistence of slums in this wealthy and ever-wealthier country is a national disgrace, for which there is guilt enough for all of us, both in public and private life, to share.

Obviously, private enterprise and the free market, which have accomplished so many other tasks for this Nation, have not even begun to transform urban slums into decent residential neighborhoods.

The Federal Government has for decades provided a variety of incentives and subsidies for the building of homes, but these have not drawn private initiative and capital into supplying decent low-rent urban housing.

Meanwhile, very little publicly owned housing has been built. Many of the projects that have been built, public and private, have evolved into slums themselves. Although urban rehabilitation programs have greatly improved the physical appearance and economic vitality of many central cities, the slums they destroyed have been replaced with roads, stores, and office buildings rather than with residences. Too often the result has been the creation of residential slums elsewhere.

The bill before you proposes incentives for private corporations to erect or rehabilitate low-rent housing in urban poverty areas. This new approach need not replace other Federal efforts to increase the supply of low-rent housing. But it seems to me a vital and essential supplement to other programs if the total effort is to be at all commensurate with the need.

I propose now to comment on a few of the issues raised by this proposal.

1. I believe that governmental subsidy for low-rent housing in urban poverty areas is thoroughly justified on economic and social grounds. As an economist, I am generally skeptical of special subsidies, on the general presumption that things worth doing will pay their own way in a free market.

But we know that there are some undertakings with high social value but low prospective payoff to private investors; the benefits to the community are great but they cannot be captured in dollars-and-cents profits.

In these cases even the most pure and doctrinaire admirer of the free market system would recognize the need and justification for Government subsidy.

From a social point of view, there can be no question that investment in low-rent urban housing is woefully inadequate. Private investors do not find the profit prospects attractive, but these propects do not, of course, include the benefits of improved neighborhoods to

the whole community—in architecture and esthetics, in public health and sanitation, in reduction of crime and delinquency.

Moreover, a simple investor may be discouraged by the apparent hopelessness of the task—he cannot remake a neighborhood alone. But if several residential investments are undertaken simultaneously they will reinforce each other and alter the whole "tone" of the neighborhood.

Still another reason for low private investment is reluctance to assume unusual risks of property damage, arrears in rental payments, turnover, and vacancies. These risks are formidable for the individual, but much less costly when pooled over a large number of undertakings. It is entirely proper for Government to arrange this pooling and to help individual investors bear the risks.

In addition to its intrinsic handicaps, urban low-rent housing suffers in a relative sense from Government programs that tend to encourage suburban expensive housing. Mortgages are insured; special financial institutions to make mortgage loans are fostered; homeowners are allowed to deduct mortgage interest from taxable income, while receiving the yield on their investments in nontaxable form.

I certainly do not favor promiscuous use of Government subsidies of any kind—whether outright payments, tax credits, accelerated depreciation, or interest subsidies.

There are a number of such subsidies in existence which seem to me to have little justification, and there are many plausible proposed subsidies or tax incentives which I would recommend that you deny.

I can therefore understand the concerns of those who are trying to defend the tax base from erosion and the public credit from excessive use on behalf of private borrowers. But if ever a cause justified the suspension of these principles, we have it here and now in the overriding national importance of urban low-rent housing.

2. The forms the subsidy takes in this proposal are several: tax credits, accelerated depreciation, low-interest long-term loans, property tax abatement, insurance against loss.

A major, and certainly a desirable, innovation is that the subsidies are designed to encourage the use of private equity capital as well as Government loans in financing projects. This is the reason for giving tax credits and favorable depreciation schedules as well as interest subsidies, and for scaling these tax incentives to the degree of equity participation.

Personally, I would prefer to see the incentives for equity finance given entirely by a sliding scale of tax credits. The depreciation provisions of the bill seem unnecessary for this purpose, and I think it may prove awkward to have depreciation schedules which depend not just on the nature and lifetime of the asset but on how it is financed.

Let me say I don't believe these details about the manner in which the tax incentives are given are the important thing. The important this is to do it, and I am sure techniques that are appropriate to the task can be worked out.

Senator SMATHERS. We may have to try three or four different techniques in the fields which you just mentioned before we find the one that is actually best.

Mr. TOBIN. The returns to the private investor from the operations encouraged by this bill come essentially in the form of tax sav-

ings which he can realize fully only if he has sufficient taxable income from other operations.

This will be true of the large corporations whose expertise this bill is designed to attract into this field. I think that is very desirable.

At the same time, it may be desirable to provide somewhere in the total housing program of the Government comparable incentives in a form suitable for other investors. For example, if it were found feasible and desirable to encourage the home management corporations contemplated in this bill to take initiative, loss offsets against other taxable income would not be a useful device.

3. I particularly welcome the provisions of the bill encouraging the formation of these home management corporations by tenants and the early sale of the buildings to these associations.

Tension and conflict between tenants and landlords are an important source of discontent and strife in our cities. Most inner city residents do not have the satisfactions and responsibilities of owning their own residential property.

It is important to increase homeownership in the cities, even when large apartment buildings rather than single-family dwellings are involved. The bill will accomplish this objective for the buildings constructed under its provisions.

Consideration might be given to extending this promising device, the home management corporation, to existing buildings in the same designated urban poverty areas. The contemplated home management fund to be administered by HUD would, of course, have to be larger.

The subsidized loan provisions of the present bill could be extended to the making of loans directly to HMC's of demonstrated competence for the purchase and rehabilitation of existing buildings.

4. I am glad to note that although the bill proposes an income test for initial occupancy it does not force tenants to move out when their income rises. I think this is important. We should not create any more housing projects or neighborhoods where residence is per se a mark of poverty. We should be trying to build neighborhods where, eventually at least, there will be people of various occupations, ages, levels, and races.

Actually, in my opinion, we do not want "low-income" housing. We want low-rent housing. Someday, I hope, we will have enough of it so that it will not be necessary to ration it administratively, even by imposing a financial test on prospective applicants.

Someday, I hope, the incomes of city dwellers will be high enough so that they will be able to pay economic rents for housing accommodations of their own choice. An essential prerequisite is a vast increase in the quantity and variety of decent modern housing in urban poverty areas. It is because the approach of the present bill promises to contribute greatly to this development that I endorse it.

Senator SMATHERS. All right, sir.

Senator Kennedy?

Senator KENNEDY. I have no questions at the moment, Mr. Chairman.

Senator SMATHERS. I have no questions at this point, but I think your suggestions are excellent. As you can see, most of those which you make broaden the scope of the bill. It may be that we ought to do

it now, but it seems to me offhand that politically we should first get some legislation enacted.

Mr. TOBIN. I didn't mean that everything needs to be done in one bill or at one time.

This bill would be an important part in a total program.

Senator SMATHERS. We will now hear from Mr. Edwin Kuh, professor of economics and management at the Massachusetts Institute of Technology.

Would you tell us something about your background and experience?

STATEMENT OF EDWIN KUH, PROFESSOR OF ECONOMICS AND MANAGEMENT, MASSACHUSETTS INSTITUTE OF TECHNOLOGY, CAMBRIDGE

Mr. KUH. I started my Government service back in 1949 for 1 year, working for the Marshall Aid Mission in London. This is back in the days when the United Kingdom had a balance-of-payments problem.

I have also been a consultant to the Treasury at one time and a consultant to the Council of Economic Advisers.

My main interests are in fiscal policy, forecasting problems, investment behavior, and corporation finance.

Senator SMATHERS. You may proceed.

Mr. KUH. I would like also to incorporate some remarks of a colleague of mine at MIT, Prof. Bernard Frieden. He is one of the leading students on the problems of the cities. He has made some observations which carry the weight of an expert, while mine do not in specific detail:

Let me read and paraphrase from Professor Frieden:

> The Urban Housing Development Act of 1967 would make a valuable contribution toward improving living conditions in the neglected neighborhoods of our cities. It differs significantly from other Federal housing programs and should help to meet the needs of people who have not yet been housed adequately either by private developers or by public aid.
>
> Further, by offering incentives to attract private investment in the poverty areas, it promises to provide a large volume of new and rehabilitated housing. Many existing programs have resulted in only token amounts of housing which fall far short of what is needed if we are to honor the national commitment made nearly 20 years ago in the Housing Act of 1949—A decent home in a suitable living environment for every American family.

Professor Frieden then goes on to say that there are problems. One problem that he points out and documents, on which I will not go into detail here, was pointed out earlier by Senator Kennedy, which is it is the upper part of the poverty group and the lower-middle-income groups, not the lowest part of the poverty incomes which benefit from this bill.

He then goes on to point out, however, that even though it will not directly benefit the lowest part of the income distribution, it will benefit them indirectly. I think that is worth spelling out in some detail.

New construction will expand the supply of housing and will make available a number of existing units as their former occupants move to the new developments. The increased supply of vacant housing will enlarge the choices open to people who live in poverty areas.

Some of the vacated housing is likely to be reoccupied by lower income residents who will improve their housing conditions by moving. The increased supply of housing is also likely to ease housing shortages and inflationary pressures on rent level in crowded neighborhoods.

For those who can afford the new housing, the benefits will be more direct. And there will be a chance for those who live in slums to find good housing at rents within their means.

So even though the benefits are not direct, there are definitely some indirect benefits.

Then Professor Frieden points out that there are some risks and he is worried that the program might become a clearance program, a means of rehabilitating units that are in marginal condition but available at low rents, which could cause problems. The well-known problems of urban redevelopment in clearing too many houses is the potential danger.

He points out that this program is not a substitute for low-income public housing, and that also has been a matter of record. Professor Frieden suggests some positive recommendations for the consideration of your committee: To limit the amount of clearance undertaken as a result of this program, the legislation might require that a substantial proportion of each neighborhood take place on vacant land. That is one possible suggestion.

Alternatively, section 101(A)(4)(b) might be modified to require the developer to provide a substantially greater number of dwelling units than are taken for demolition or for rehabilitation.

Finally, he suggests that this program could also be made complementary with the rent supplement program.

These programs are not antithetical; they are complementary. This reinforces, if you will, the observations that Mr. Whitney Young made about the need for many of these programs in larger volume moving forward in step together.

This terminates my paraphrasing of Professor Frieden.

Senator SMATHERS. All right, sir.

Mr. KUH. As far as my own remarks, let me talk in a general way about the needs that this program will meet in a slightly different way than others have.

If this program does go through, and I earnestly hope it does, 1 million badly housed individuals living in the poverty areas of the United States will live in decent housing. The housing needs of this country, the fact of subsidizing housing which has been part of our law since the U.S. Housing Act of 1937, will be lifted up from the token level to a level of serious consideration. Much good work has been done, but the gap remaining is very great.

The main points I want to make are these: First, as far as needs go, a staggering 85 percent of the poorest third of the income distribution spend more than a quarter of their income on rent.

Senator SMATHERS. Eighty-five percent?

Mr. KUH. Eighty-five percent of the lower third of the income distribution spend more than a quarter. Twenty percent is considered by many experts in the field as tolerable.

In the top third, only 2 percent do. So in terms of the share of the budget consumed by housing, it is absolutely crucial, and it becomes more and more crucial the further you go down the income scale.

The second point I would like to make is that this has not been frittered away on luxury living. The fact is, again, that something like one out of three persons in the lowest third of the income distribution live in substandard housing.

Then you go up the income scale and there is much less substandard housing.

The last point I wish to make as far as need is concerned is about the Negro problem. I think this is worth stating in a little more detail.

In the urban areas, one out of four Negroes are in overcrowded dwellings. This was according to the 1960 housing census. Negroes have an overcrowding rate three times that of whites.

There is another depressing set of statistics I would like to call to your attention. We know that the Negroes have been rapidly flocking into the cities from many parts of the country. I wonder whether it is realized that this has been accompanied by an absolute deterioration in housing conditions in the following sense: Nonwhite families in substandard urban housing, the number in substandard housing in the decade of the 1950's, increased by 400,000. There were 400,000 more urban Negro dwellings in substandard housing in 1960 than there were in 1950.

Senator SMATHERS. Can I interrupt you right there? I asked Secretary Weaver when he appeared before the committee whether we were gaining ground or losing ground with respect to ghettos and slum housing in the city, and his response was that he thought we were gaining ground in terms of physical housing. But under additional questioning, he finally admitted that the numbers of people who were moving into the ghettos are actually outnumbering even this improved housing situation.

Am I to understand that from your studies it is your conclusion that in point of absolute numbers we are losing ground rather than gaining ground insofar as providing adequate housing is concerned?

Mr. KUH. This is not inconsistent with Secretary Weaver's remarks. We could be losing ground because of the very rapid population increase.

Senator SMATHERS. After all, if we are losing ground because of the population increase, you are still losing ground, as I see it.

Mr. KUH. I would be the last to deny that remark.

Senator SMATHERS. If you had, for example, 100 more houses built in the city of New York, Los Angeles, or wherever, you got a few more houses, that is true. But if you had 200 more poverty-stricken families, then you are actually losing ground.

Mr. KUH. I quite agree.

Senator SMATHERS. And that is your conclusion? Your conclusion is that we are losing ground, not gaining ground?

Mr. KUH. That is my conclusion.

I think it is useful to comment on something which has not been discussed so far as I know by the other witnesses, and that is the relation of this bill to the 1968 budget for housing and community development.

We know, by looking at the budget, that planned payments to the public for fiscal 1968 will fall to $1.81 billion from $3.92 billion in

the recently concluded fiscal year. This is largely for reasons connected with a reduction in purchases of mortgages by FNMA and the Federal Home Loan Bank.

This global retrenchment has been accompanied by much fanfare on a long overdue model cities program which, however, remains in the planning stage.

The model cities program, what I know of it could be a great thing, if the Congress will pass it, but it is a long run program and housing now is not a part of it as much as it should be.

According to the budget, public housing will be slightly increased. Unfortunately, urban renewal, which has many positive attributes, has been increased more than any other single program, but all too often this has destroyed more low-income housing than it has created, so that in terms of low-income housing this budget does not seem to be very strong at all.

I think, therefore, this legislation, which is aimed at construction now, is an admirable complement to the model cities program and other legislation.

I would like to make two suggestions. In fact, since my complete testimony is going into the record, to save time I would like only to make the one that I conceive to be far and away the more important of the two.

The more important one is that rehabilitation ought to be very heavily encouraged if we are going to get an abundance of adequate quality housing at the lowest cost. If we are to succeed at that, we will need different physical and financial standards for renovating houses than those standards we set for new construction.

Instead of the 50-year asset lives which are implied by the financing provisions in the present bill for all projects, much shorter physical lives and, hence, lower physical construction standards, should be acceptable for rehabilitation projects.

Unless this is done, rehabilitation is and will remain too expensive and unprofitable. A large volume of fair quality reconstructed housing is much to be preferred to elegant but nonexistent rehabilitated housing.

This seems to me to be a point that your committee could consider in its deliberations.

Senator SMATHERS. How about talking about the required rate of return.

Mr. KUH. Let me talk briefly about the required rate of return and then I will be able to conclude very swiftly.

According to the sample calculations presented in the bill, after-tax rates of return should fall in the range of 10 to 20 percent, but most of them will be in the 13 to 16 percent range. These profit rates are better than the average in manufacturing but are of the sort available in good manufacturing opportunities. It is hard to know the return that builders will demand in order to switch their activities into this field.

We can hope that the recent riots will not hinder entry into the areas designated by the bill and that prospective redtape will be minimized.

It is possible that the rate of return will have to be increased 2 percent or so, and that easier provisions will have to be made for passing on unavoidable cost increases to counteract these prospective problems.

Senator SMATHERS. Would you be in favor of having provisions in the bill which would authorize the Secretary of Housing and Urban Development to go up as high as 30 percent, which we have envisioned in real terms, a 30-percent return, to get them into this?

Mr. KUH. I find 30 percent somewhat high, personally.

Senator SMATHERS. You thing it is too high?

Mr. KUH. That is correct.

Senator SMATHERS. And it is your judgment that somewhere between 15 and 20 percent will be sufficient to get private enterprise to move into this area?

Mr. KUH. I suspect it may be toward the upper end of the range. I say that not from close personal knowledge, but from discussions I have had with people who are actively engaged in this field.

I would like to emphasize a point which Professor Tobin made.

Senator KENNEDY. When we talk about the 30 percent, we are talking about the 30-percent credit.

Mr. KUH. Excuse me, I misunderstood the question.

Senator SMATHERS. You and I understood each other, actually. What happened is that you are talking about overall return.

Mr. KUH. I am talking about the after-tax rate of return.

Senator SMATHERS. That is what I thought you were talking about. In other words, what will the man finally realize. That is what you are talking about.

Mr. KUH. Yes.

Senator SMATHERS. So when you add all of these things up, the credit and so on, what will it take, if I were a private businessman, or what would be the incentive I could see down the road that would bring me into the field of building this kind of housing rather than spending my time, energy, and so on in some other field?

Mr. KUH. I think the point I want to emphasize is that in the vicinity of the incentives of this bill there is a realistic prospect of businessmen coming in, but I want to accompany that by a warning, which is that even if they don't come in, it won't be the last opportunity but it will be an excellent opportunity missed, and the initiative will then, inexorably, go to the Government sector.

In other words, this is a generous bill, a very generous bill, and if the time comes where the private sector says, "No, even this is not enough," at that point I think the social pressures will become inexorable for Government action.

I am really saying that the private enterprise economy, which talks about its ability to meet the needs of this country, has an opportunity now to put up or shut up. If they don't put up roughly in the vicinity of the returns in this bill, they will have to shut up.

Senator SMATHERS. Some fellow said yesterday he got a statement out of the New Yorker, which said this bill is not based on somebody's great passion for social justice or anything; it is grounded on the American tradition of lust for more profit and passion for moneymaking—something of that character, which actually is what we think we need in order to get private enterprise into this field. They have to make a profit.

As you said a moment ago so well, what is it that will get them in there. We think this mix that we have is probably the right one to

finally get them into the areas where they are so much needed, irrespective of how well or how not well their social conscience has been attuned or developed.

Mr. TOBIN. May I make a comment on this?

Senator SMATHERS. Yes.

Mr. TOBIN. The kind of after-tax rate of return that you need to induce private investment in this area also depends on the degree of risk which you are asking the private investor to take.

One aspect of this bill does create an insurance fund which prevents actual losses, actual cash flow going below zero in any year. That is an insurance against terrible things happening which should diminish the required rate of return.

Another possibility along these lines that I alluded to briefly, and which was raised again by Mr. Kuh's remarks, is to the extent there are extraordinary risks in regard to property damage and so on, or that private insurance insurers think there are, then it might be that a way of getting around that, or a more efficient way of getting around that, is not just to offer a higher after-tax rate of return indiscriminately, but to engage in some kind of reinsurance or subsidy to insurance which would be similar in the bill to the abatement of property taxes.

Senator SMATHERS. I might say at that point that I would like to direct your attention to a bill which I am sponsoring and which Senator Kennedy is in favor of, concerning small business.

It is a small business protection bill which is now before the Banking and Currency Committee. It will provide Government cooperation and actually Government underwriting of certain losses which result from riots, vandalism, robberies, and so forth.

The fact is that these businessmen can't get insurance today. When they are victims of this kind of degradation they are out of business forever. It may be that in time we will have to take that particular bill and extend it to this type of an operation in the slum area, in the ghetto area, so that the investor would know that he is not someday going to wake up and find that his whole investment is gone by virtue of a fire or violence which, of course, he could not control.

You may proceed, Mr. Kuh.

Mr. KUH. I think in the guise of a general economist, I would like to support the remarks of Professor Tobin on the desirability in some circumstances to make special tax favors.

I am talking now about the types of criticisms which seem most likely to concern Treasury officials and the like. In general, these are not liked by economists or by tax authorities, but the fact is that these tax incentives have been used when the social objectives were thought to be of sufficient importance with the approval of tax authorities and economists.

In an emergency we will break the speed limit. When two reasonable propositions conflict, resolution must be arrived at by overriding the least pressing requirement.

In my opinion, and clearly in the opinion of the sponsors of this bill—and I hope of the country—this purpose is an overriding one and we should not be bemused by abstract principles of fiscal equity which, in particular cases, should be overridden in the interest of greater equity.

I would simply like to wind up by saying this: I hope this bill passes. I think the social agenda has been curbed much too long. I think this is more than a lack of compassion; I think it is the worst political and social nearsightedness.

Senator SMATHERS. Thank you.

Would you not agree that we should not just talk about this in terms of the social need? Although the social need is enormous, if we are not careful, people may get the idea that this is purely a social program to achieve a purely social end.

There are great economic benefits to the country by answering this social problem. Is that not a fact, in terms of employment, in terms of less crime protection, in terms of less crime incidence? Is that not true?

Mr. KUH. Yes. You are saying that we will make a better society, help to make a better society, and we will reduce a number of costs in this way.

Senator SMATHERS. Right. In other words, there are economic benefits to this, over and above the social benefit.

Mr. KUH. There are economic benefits over and above the social benefits; yes.

Senator SMATHERS. Senator Kennedy.

Senator KENNEDY. Did either one of you see the statement of the Treasury Department in connection with this legislation? If so, do you want to make any comment on it?

Mr. TOBIN. All I saw was the newspaper account of Mr. Barr's testimony. I haven't seen the full details. I think it is an example of what we are both talking about, to some extent; namely, the principle which understandably the Treasury and other tax people would try to defend, against the erosion of the tax base by special exceptions here and special exceptions there.

The general attitude on that that I would have to have is that you have to have some perspective about these things. It is not an absolute which has never been violated or never should be violated. We know it has been violated many times by legislation in the past.

I can't imagine a better cause and a more overriding purpose which justifies it than this one. I think it is quite misguided to stand on some kind of pure principle of the integrity of the tax base, which we haven't respected in the past consistently anyway, and to use that against a program of such merit, great merit.

In the last analysis, you certainly don't want to be promiscuous about trying to accomplish all kinds of legislative objectives by shooting holes in the tax law. We can all agree to that. But you have to judge these things case by case, and with some weighing of the so-called economic advantages and priorities.

Mr. KUH. I agree completely with what Mr. Tobin said. I wondered, as I read the newspaper account of what Under Secretary Barr said when he referred to the very narrow purpose for which this legislation was intended.

When I think that there is disaster assistance for tornado damage, and that tornadoes can hit one or two houses; how narrow can you get? Government assistance, be it out of the tax base or out of revenues, is often very specific.

Senator SMATHERS. Thank you, gentlemen, very much.

Senator KENNEDY. Mr. Chairman, we have some statements of individuals who have not come as witnesses, but whose statements and letters to the committee I think are very useful and very helpful.

I wonder if I could read excerpts for a couple of minutes of several of them.

Senator SMATHERS. All right.

Senator Kennedy is recognized for that purpose.

Senator KENNEDY. We have a statement from Mr. Lawrence Stone, professor of law at the University of California, and formerly Tax Legislative Counsel to President Johnson.

He has submitted a statement to the committee. He supports this legislation. He says:

> In my opinion, the urgency and monumental size of the problem that our Nation faces and which the bill aims at, the disgrace and injustice of urban slums, justifies the use of all available solutions including tax incentives.

Then he goes on to discuss the legislation in greater detail

Could we have that put into the record?

Senator SMATHERS. Yes.

Senator KENNEDY. Next is a letter to Senator Russell B. Long from Henry Ford, of the Ford Motor Co.

He says, "It may appear unseemly to mention costs and profits when urgent human needs are involved, but I am convinced that any approach which ignores these basic economic factors is doomed to failure. The profit motive is an immensely powerful force and useful guide to effective economic action. It must be maintained and brought to bear on the urban crisis. I believe that Senator Kennedy has incorporated this essential approach in his proposed legislation. These bills offer real hope of getting the business community deeply engaged in the fight against urban blight, without great cost to the Government."

Next is a letter from Mr. Harry R. White, executive director of the Sales Executives Club of New York, who states:

"To our way of thinking, this is the most sensible program anyone has yet come up with to solve an increasingly serious national problem."

There are a number of letters from mayors of various cities. For example, the mayor of Columbus, Ohio, writes, "I can report to you that the municipal officials in Columbus are greatly enthusiastic over the potential these bills have for eliminating basic causes of urban blight."

Next is a letter from the Business Development Fund, here in Washington. The director of it writes:

"S. 2100, this is a good idea and I would be prepared to stick my neck out and predict that it will produce new housing. It seems to me that the job of our Government is to provide a good climate wherein the dynamics of private enterprise and private investment can takeover and produce results. This bill would do just that."

Next is a letter from the Metropolitan Detroit Citizens Development Authority. The letter states:

"Both bills are imaginatively conceived and visionary, yet are pragmatic in approach."

Next is a letter from the Bendix Corp. It states:

"While it is difficult at this time to predict the extent of any company's future plant expansion, we would certainly endeavor to channel

a portion of our new projects, to the extent practicable, to such areas, assuming tax incentives were substantial and that the tax requirements were sufficiently definite to warrant approval of a particular project on a justifiable business basis with reasonable assurance of a successful venture."

Next is a letter from Prof. Frank I. Michelman, of the Law School of Harvard University.

Next is a letter from General Motors Corp., which says, "There can be no question that substantially reducing unemployment and providing better housing and transportation facilities, and improving downtown business areas are urgent problems in many if not most of our cities. They are of concern to all of us not only from a business but from a human standpoint. As the leading industrial nation, enjoying the highest living standards, we must be leaders in this area as well." The letter goes on to endorse the concepts of the bill.

Next are letters from the International Telephone & Telegraph Corp., and the Stauffer Co.

A letter from the Dreyfus Corp. states: "Your legislative proposals seem well conceived. You have made this seemingly ununderstandable problem of the afflicted areas understandable. Our research group feels the incentives offered are of sufficient proportion to stimulate the necessary business activity."

A letter from the Boeing Co., states: "The incentives provided in both S. 2088 and S. 2100 should make investment in poverty areas attractive."

A letter from the Union Carbide Corp. states: "These incentives offered in your proposed bills are very attractive and would constitute important considerations in making private investment decisions."

Perhaps if we could print these letters in the record, it would be useful to the committee. There are quite a number of other letters, however, that are also available to the committee and which I put into the record on the first day of hearings.

Senator SMATHERS. Without objection, we will make them a part of the record.

(The documents referred to appear in the appendix.)

Senator SMATHERS. Our next witness is Mr. Edward J. Logue, former development administrator for the Boston Redevelopment Authority.

STATEMENT OF EDWARD J. LOGUE, OF BOSTON, FORMER DEVELOPMENT ADMINISTRATOR FOR BOSTON REDEVELOPMENT AUTHORITY

Mr. LOGUE. Mr. Chairman, Senator Kennedy, I should perhaps begin by pointing out that I am a former administrator of the Boston Redevelopment Authority.

Senator SMATHERS. All right, sir. We are happy to have you no matter what your present employment or occupation is.

Mr. LOGUE. As a matter of fact, I am presently unemployed, but I don't expect to stay that way very long.

For the last 7 years, I have been the administrator of the Boston Redevelopment Authority, and for 7 years before that was adminis-

trator of the urban renewal and development program in the city of New Haven, Conn.

Senator SMATHERS. Are you a candidate right now for mayor?

Mr. LOGUE. Yes, sir; I am a candidate for mayor of Boston on September 26.

Senator SMATHERS. No wonder you don't expect to be unemployed very long. You are optimistic about the race.

Mr. LOGUE. That is right.

Senator SMATHERS. All right, you may proceed.

Mr. LOGUE. I have taken a day off from my campaign effort in an exciting mayoralty race to come down here, at Senator Kennedy's invitation, to testify in behalf of what I consider to be vitally important legislation.

It should be clear by September 1967, to all thinking Americans, that the cities of this Nation do not have the resources themselves to solve the urban crisis which has so dominated the headlines this summer.

The Senator's own eloquent statement when the proposals were submitted in July, and the other material which has been put out which has been made available to your honorable committee, make terribly clear how serious this problem is, if anyone needs convincing.

I know that as one who has been actively engaged n a broad scale for a dozen years in devising solutions to deal with urban problems, I am pleased to see the attention this crisis is at long last receiving.

In all candor, however, we must admit that attention is all it has received. The response from Washington to date on the urban crisis has been totally inadequate.

The resources are not being made available, the sense of priority of urgency and commitment has not yet developed to the degree that will be required to make any dent at all. The unpleasant fact is that the combined efforts of private enterprise and the Federal, State, and local governments are not staying ahead of the problem—they are not even keeping pace.

Each passing year of increasing affluence for the rest of America widens and deepens the gap for those who are left out of the mainstream of American society.

Our National Government is preoccupied with other problems—with a war in Vietnam for which there is no end in sight; with a space program that is clean, challenging, costly, and relatively noncontroversial.

We come to you thinking we understand the term "Great Society." The rhetoric of the Great Society has, from the beginning, outrun its performance capacity. There has been a striking and disappointing reluctance on the part of either the Executive or the Congress to admit that the level of appropriations they initially sought, let alone finally approved, was insufficient.

I think we would all be a lot better off if we would admit that the National Government is not yet ready to make a serious cash contribution to the solution of the urban crisis. That is why I think this matter before you is as important as it is.

If Washington was ready to say that until the war in Vietnam was over the cities were going to have to wait and that this was a useful time to consider new programs like the model cities program and to

try out other experimental programs, all the people in the ghetto, and the people outside who are also concerned, would know that Washington wasn't ready or prepared with the solution or the resources. The American people are ready to face the facts about a crisis if the facts are made clear to them.

We are not the kind of people who panic, but we have a lot on our minds, a lot clamoring for our attention and we are confused when the rhetoric and the resources are out of balance, as they are in Washington today.

We are even more confused when responsible representatives of the National Government insist on saying, as they did last week, that the cities of America do not have the capacity to absorb larger sums.

I can tell you from direct knowledge of dozens of cities across this Nation, that that proposition is not true. We in Boston have the immediate, I repeat, the immediate capacity to absorb a substantial additional amount of Federal funds and to use them effectively. Plans have been approved and they are sitting in a pipeline somewhere between Washington and Boston.

Please understand that I am not complaining about Boston's share. Compared to the rest of the Nation, we have done very well and we have no complaint, but isn't it time that the National Government came right out and said we can't get you the money you need and you know how to spend because of the war in Vietnam? That they refuse to do.

Let's look at our State government. It is quite clear that every time two or more Governors get together they pass a resolution saying, "Let's channel all Federal aid to cities through the States."

We at the local level might be a little more sympathetic to their plea if we had seen any initiative in solving ghetto problems coming from any of our Governors, but it is only since last July, when the mayors called attention to this lack of concern on the part of the Governors, that a few of them began to develop programs.

If we are talking about Government answers, and it is true, as I think it is, that the Federal Government is not going to put up the money this year, next year, or until the war in Vietnam is over, and if it is true that the State government is not going to put up the money, then we have to look at the city governments.

I would suppose that the proposition was barely arguable, not with your time. No American city I know of is big enough and strong enough and wealthy enough to resolve its urban poverty crisis out of its own funds. You can be sure we would like to—none of us enjoy coming down here with our hands out, but the facts are that purely local solution is not in the cards.

But there is another way and that is what I want to talk to you about in my testimony.

I want to pause and say that I hope that the impact of this very impressive array of testimony will not be too discredit programs already on the statute books. The urban renewal program is in my judgment a first-rate concept, the poverty program is a first-rate concept. I think the failures and the shortfalls in those programs are not attributable to the statutory provisions but to the complete underfunding and the resultant delays in processing, and confusions about priorities in the expenditure of very limited resources.

So I am not here to attack urban renewal, poverty, or anything like that.

I think we need the money for them. But I have come down here before other committees and said that many times. I don't think we are going to get anywhere with that theory.

I am here to say, from my own knowledge of Boston and other cities, that this urban crisis is worsening each year. We need to focus attention on the extent to which the private enterprise system has conked out. This legislation is to bring it back.

If you go through the ghetto areas that this legislation is concerned with, you see withdrawal over and over again, by all kinds and all parts of the private sector.

If you think of this in the ghettos in your own State, if you go around talking as I have to people, you will find a reluctance to take risks under the present set of rules.

I think it is time we faced, as Senator Kennedy has here faced, and as you, Mr. Chairman, in the remarks you made in July, when you joined in sponsoring this legislation, that it is time to get the private sector involved. It is easy to get the private sector involved in some pilot project where there is a lot of publicity and not much risk.

It is easy, I suggest, to get the private insurance sector involved in a billion dollar program when it is 100 percent insured. But to get private enterprise involved on any massive scale is something else again.

The experience that we have had over the years in trying to get the affluent to improve conditions among the poor in America have been permeated with an atmosphere of righteous charity. This kind of "do-goodism" has given a lot of well-intentioned people a lot of credit lines for civic service but it hasn't made much of a dent in the problem.

Furthermore, when we grudgingly get around to encouraging investment in the ghettos we tend to make the profits as slender and difficult to get as possible, and the administration of these programs, once enacted, time and time again has attempted to make them an unprofitable and complicated as possible.

I believe the National Government is responsible for this because the Congress has not understood that the profit system must work for higher profits inside the ghetto than outside; 221(d)(3) programs are good examples of that.

I believe the National Government is responsible for this because the Congress has not understood that the profit system must work for higher profits inside the ghetto and outside. If I am correct, and the record would indicate that I am, that Federal funds are not going to be available in quantity, then we must devise ways and means to get the private sector into the ghetto on as broad and busy a scale as possible. This has never been tried before.

What we have to do is to ask ourselves, "What's the most effective way to channel private money and private talent into urban poverty areas in every way that can be useful? How can we get the profit big enough in urban poverty areas to make private enterprise compete for the opportunity to do something there?" That is the approach we must take.

I believe it is the approach which underlines S. 2100.

I would suppose it would be clear to all, without the need for proof, that the incentive profit margin cannot be added onto the cost of goods or services being furnished in the urban poverty area. You can't put it on there because there isn't any market when the price goes up, and it just won't happen.

Therefore, we must find another way to channel this investment. I was somewhat amused in reading Secretary Barr's reluctance to be part of this solution.

We have found in the past in adpating the Internal Revenue Code to serve some economic or social objective. I recognize that the purists—I noticed Mr. Bittker has come around. He started initially being reluctant to see this social objective served. He considered it carefully and came out with the idea that there was an opportunity and a responsibility here. There are so many special interests being served today by various provisions of the Internal Revenue Code. I think it will do no harm, for a change, to serve the special interests of the poor, as Senator Kennedy proposes.

We cannot write them off and we cannot forget them.

This is the timely importance of Senator Kennedy's legislation. It proposes in the two key areas of housing and industrial development to amend the Internal Revenue Code to make it a partner in the effort to eliminate these urban poverty areas.

Senator Kennedy's legislation has addressed itself to two of the major areas of concern: housing and employment.

His proposals for housing are concrete, are practical imaginative and readily workable. I feel that, if adopted, they would make a major contribution to the solution of the housing problem in urban poverty areas.

I noted in Secretary Weaver's testimony before this committee that there was a reluctance to have this new program. I think it is time we had a little competition. We have public housing programs, we have 221(d)(3) programs. I say let's have this Kennedy program and have a competition to see which can do the fastest, the most, at the cheapest cost to the poor to provide decent housing. There is room for all.

The problem is big enough so that all solutions should be welcomed. The important thing here is to give private enterprise the opportunity on its own initiative to get started and get something done because it has been made profitable.

The key to this proposal is, of course, the use of low-interest loans, tax credits, and accelerated depreciation. These are the tools that we have used to encourage American private investment abroad in underdeveloped nations. Isn't it time we used these same tools to develop the underdeveloped urban areas of America?

A decent home is a thing that all Americans aspire to, and too many Americans are without. I think Senator Kennedy's proposals deserve a try. I am confident they will work. I would welcome then in Boston and I am sure that they would be welcomed in hundreds of other cities as well.

If the Department of Housing and Urban Development is hostile to them, let's give the responsibility to somebody else—a little competition isn't the worst way in the world to get things done.

I would urge just three things for your consideration in this legislation. As you come to mark it up in committee, I would hope that every

time you had a chance to choose for more or less profit you would choose for more; every time you saw a control which you could drop, you would drop it.

Three or four hundred thousands units are not enough to solve the problem but they are enough to indicate the workability of this approach. Three or four hundred thousand units on this experimental basis could teach us much, and if the program turns out to be the success I think it can be and must be, then the demand will go up and I am confident that Congress will respond.

So I urge you to give this chance to private enterprise to show what it can do to create low-cost housing in the parts of the Nation that need it the most.

I would like to say you support the notion, as Whitney Young did earlier this morning, that this be focused in the poverty area, and that this investment be channeled into the poverty areas where the need is the greatest.

We all know that the cycle of poverty can be broken only if something is done about employment as well as housing and education, and yet we know under the present rule private enterprise is reluctant to invest in job opportunities and job training in urban poverty areas.

The same principles apply here as apply in housing, and Senator Kennedy has used them well. We have our full share across America of industrial development commissions which rapidly acquire their own wrapping of redtape. The opportunity that exists here is to get the Internal Revenue Code amended to encourage private enterprise to get in the act. Again, the tools of investment tax credit and accelerated depreciation can make the difference.

Jobs should be brought to the gheto. We should do everything we can, with all the imagination we can command, to make it easy to find stable employment, because it is only when employment is available and the training to qualify for the job is available, that we are going to have alternative to hanging on the corner waiting for something to happen.

I am not one of those people who believes in guaranteed incomes. A guaranteed income system for America is an image of failure. It is a statement on the part of most of America that there are some people who can never fit in—for whom we can't find work—and therefore we will hand the most painless dole possible.

I don't think that system will be healthy for the individuals who supposedly would benefit and I don't think it would be healthy for the rest of America.

Therefore, I applaud Senator Kennedy's efforts in his industrial investment legislation to make it more profitable for private enterprise to offer employment and training inside the slums and outside.

If there is a big enough return to private enterprise for doing it, I think private enterprise can find a way to employ the unemployable, and that is what this legislation is all about.

I would welcome this legislation in Boston. We could use it as soon as it was available. It would make a difference now. Again I would urge that if you consider the legislation, if you change it, you make it simpler—put on less control, more postauditing if you like, but see how simple we can make it and how much profit we can put into it.

I am prepared, at least to some extent, to answer any questions that you members of the committee may have about this legislation from the point of view of someone who has worked to find solutions to these problems in the urban poverty areas for some years.

I can tell you that these programs will work in Boston, that we could put them to work quickly and they could do a lot of good.

We have people in the Boston community who know how to respond to this kind of incentive and who would be eager to do so, and once we got it rolling we would begin to get that other major benefit of effective private enterprise, which is that one good thing follows another.

I am confident that if we could put these programs to work in the urban poverty areas of Boston, not only would they achieve the objectives the legislation sets forth, but they would have a multiplying and leverage effect.

If the community began to have more confidence in itself and in its capability to solve its own problems, we would find more and more people interested in preparing themselves for work and in taking advantage of training opportunities to achieve a higher level of skills; we would find city services getting spruced up and schools catching the spirit of hope.

There is so much to be done—why have we waited so long to encourage our private enterprise system to get in there and pitch? In all the rest of America when we want to get something done, we turn to private enterprise to do it and we are not disappointed.

I have had experience with many different kinds of private enterprise participation in programs in urban poverty areas. I have found a willingness to be helpful, a desire to see something accomplished, but I have seen successful performance only when it is possible to make a profit.

This Nation is facing a choice. We can make the urban poverty areas a battleground where civil disorder arises out of despair and suppression of protest is the result. That is not the way I would like to see America go. That way will not work. Let's try to make it easy for private enterprise to help. The Government can and must do its share and it must do more, but let's give the private system a chance to help, too.

We have these areas in Boston and they would be better off today if this legislation were on the books and we were pushing for the construction of this housing and the promotion of this industrial development.

This legislation would offer the kind of constructive alternative America is looking for, that our cities are desperate for. Senator Kennedy has become a leading student of these problems and has taken his work into the field. He has launched impressive programs in the major urban poverty areas of Brooklyn, and they are making a difference.

I had some small role in that work. I can say to you that this legislation before you this morning will make a tremendous difference in the ghettos of America if it is acted upon promptly, and then if it is administered sympathetically. I hope that somehow or other, Mr. Chairman, a sense of urgency can be found, a sense of the vital

importance of getting the private sector, which has been so far entirely out of this problem, into it with both feet.

I don't think we want it out of patriotism, I don't think we want it out of charity or sympathy. The private enterprise system responds to the profit motive. The way to get that profit motive is through the Internal Revenue Code.

Although I can understand the reluctance of Secretary Barr to get involved in these policy decisions, he and his colleagues at the Treasury are already involved in so many public policy decisions that it wouldn't hurt to get them involved in the ghettos, too.

Thank you.

Senator SMATHERS. Thank you very much, Mr. Logue.

Senator KENNEDY. Thank you very much for your testimony. It will be very helpful.

Senator SMATHERS. Our next witness is Mr. George C. Shattuck from Syracuse, N.Y.

STATEMENT OF GEORGE C. SHATTUCK, SYRACUSE, N.Y.

Mr. SHATTUCK. I am from a city with a population of about 210,000 people.

Reading the material sent to me by Senator Kennedy's office in Syracuse, I thought it would be incumbent upon me to come down here and offer a few suggestions about this bill as related to small cities the size of Syracuse, N.Y.

I think in several respects some changes would be in order so that cities the size of Syracuse can partake of the very fine benefits of Senator Kennedy's and Senator Smathers' bill.

No. 1, I think the requirement for 100 minimum units is probably well appropriate to New York City and other large cities, but I think as far as Syracuse is concerned, it will not do us much good.

I think the economics that may have dictated 100 for New York are not present in Syracuse. I think 40 to 50 units would be completely applicable to Syracuse, N.Y.

I think you give some consideration to a flexible scale and the number of units needed to qualify.

Senator SMATHERS. That is a good suggestion. We will give more consideration to that particular point.

Mr. SHATTUCK. Thank you, Senator Smathers.

My second one is as a lawyer in Syracuse, which I am, I am a little familiar with the procedures needed to get approval of a Federal and a State project. If something can be found to simplify procedures, I think it would go a great way toward helping. If an area could be designated as a qualifying area, by Washington, of course, without further specific Washington approval of individual projects, I think, again, you would open the door to many investors and builders who just can't get through all the red tape that you have to go through.

Senator SMATHERS. We concur in that also.

Mr. SHATTUCK. The next point is the accumulated earnings tax under section 531 of the Internal Revenue Code, may, in my opinion, bar many corporations from making this kind of an investment.

If you have a large publicly held corporation, there is no problem. But you can have a large privately held corporation which, if it invested in an inactive business, such as we are contemplating here, the Treasury boys would be in very shortly and say, "What are you doing that for? You are accumulating earnings here and we are going to slap a penalty on you."

So if some expression could be inserted, either in the committee notes or in the law itself, that under the accumulated earnings tax this would be considered an active business, I think you would go far toward broadening out the people who could make this type of investment.

Senator SMATHERS. That is also a constructive suggestion. We will look into that.

Mr. SHATTUCK. My final point is to commend the concept of this type of legislation. For every lawyer or businessman who understands FHA financing or urban renewal types of situations, there are probably 100 or 500 who understand tax concepts.

This, I think, is the greatest thing about this bill, that you may have hundreds of businessmen, lawyers, and accountants in a city like Syracuse who understand very well what a 10-year writeoff means or a 20-year investment credit. They can get their clients into this.

If you start talking with concepts like urban renewal, they are out of it before they even get started.

I would again commend the concept of this. I have respectfully been passed, hopefully with the suggestions I have made.

Thank you very much.

(The statement referred to follows:)

PREPARED STATEMENT OF GEORGE C. SHATTUCK, SYRACUSE, N.Y.

URBAN HOUSING INVESTMENT ACT

Thank you for the opportunity to address your committee. I have studied the summary of the Urban Housing Investment Act furnished to me by Senator Kennedy's Syracuse Office and I entirely favor its purpose and concept. As a resident of Syracuse, New York, I can see that something extra is needed to spark the revitalization of our downtown residential areas. This legislation may be it!

A recent report of our Community Chest stresses our great need for low rent housing, especially housing for large families. Aside from structural deterioration we have a just plain shortage of such housing in Syracuse. Our inner-city area is typified more by old and over-crowded house structures than by the large apartment tenements you find in cities like New Yrok.

I think the tax and financing incentives in the Urban Housing Investment Act could go far in helping the people and government of Syracuse to "bring back" this downtown area and help the people living there. As presently proposed, however, the Act would do little to help Syracuse. Here's why:

1. *The 100 Unit Requirement.* For a City like New York, a 100 unit base may be quite logical from the standpoint of site acquisition, construction and operating costs. For Syracuse, with fewer potential investors and a different cost structure, 40 or 50 units may be entirely feasible. You might have four investors at 50 units for every one who could take on 100 units. What we need in Syracuse is low cost houses, not "housing". Where one, two or three family structures are concerned, it would be most difficult to assemble 100 units.

I suggest that the minimum of units be lowered to 40 or 50 for apartment structures and still further for house-type structures. I further suggest that house-type structures need not be contiguous. If an investor or builder could rehabilitate ten two and three family houses in Syracuse and still comply with the Act, he would be doing a lot of good in return for his tax benefits.

2. *Federal Approval.* Many federal programs involve complicated forms and procedures and a long wait for approval. Why not have the individual project approval come locally—once overall federal approval of the area and project was obtained. This would place on the City the burden of dealing with Washington. A small investor might have the cash and "know how" to build and operate the housing but not for finance planning studies and the expert counsel needed to get the project ready.

Individual approval at the local level would make the whole procedure more flexible, speedier, and less expensive.

3. *Housing Code Standards.* The maintenance of high upkeep standards should be enforced by making a certificate of compliance with local standards a requirement to obtaining the tax benefits in any given year.

4. *Subchapter S Provision.* The use of Subchapter S of the Internal Revenue Code to permit corporate investment is a fine idea. I suggest that for this purpose Subchapter S be modified to let trusts and other corporations be stockholders and to permit more than ten stockholders to join in this type of investment.

5. *Investment Credit Carryover.* The description of the Act did not mention a carryover provision for the initial tax credit. A carryover would greatly help the builder who had a loss or low income during the year of completion.

6. *Accumulated Earnings Tax.* A statement that such an investment was an active business under Section 531 I.R.C. would create a great incentive for private corporations to make investment in low rent housing. Lack of such a provision might make it risky for a close corporation to make such an investment even if its management wanted to do so. The Internal Revenue Service may well interpret such an investment as evidence of an unreasonable accumulation of earned surplus. Without an expression on this point, I fear that use of the Act will be limited to publicly-held companies.

CONCLUSION

The best thing about the Urban Housing and Investment Act is that it employs tax concepts which are understood by many thousands of businessmen, builders, lawyers and accountants. By keeping it relatively "simple" you will insure broad participation by people who could not afford to penetrate the mysteries of urban renewal type concepts. By providing for *local* approval of individual projects you will insure speed and adaptability to local conditions.

May I suggest that further hearings on this legislation be held in several medium-sized to small cities like Syracuse. Alternatively, public officials, builders, and representatives of construction unions in such areas should be specifically invited to comment in Washington.

Senator SMATHERS. Those are most constructive suggestions.

Senator KENNEDY. I do not think we had focused very sharply on a community of the size you refer to.

Mr. SHATTUCK. The focus here seems to be on the large cities, as it should be, but let's prevent the small cities from getting into the plight of the larger ones.

Senator KENNEDY. And some of them are covered by the legislation. You have made some very good points. We have been talking about the bigger cities rather than our smaller communities. We must also meet the problems of these smaller entities—especially in the housing and unemployment areas.

Thank you for your testimony.

Senator SMATHERS. Mr. Ziegler, would you identify yourself?

STATEMENT OF STEPHEN ZIEGLER, ATTORNEY, YOUNG, KAPLAN & EDELSTEIN, NEW YORK, N.Y.

Mr. ZIEGLER. I am Stephen Ziegler, an attorney in private practice, a member of the firm of Young, Kaplan & Edelstein, in New York City.

Senator KENNEDY. And you have had a good deal of experience and background in the tax field?

Mr. ZIEGLER. Yes, sir. My firm advises business firms on the tax consequences of various transactions. I have lectured before the Practicing Law Institute in New York City on several occasions.

I am the author of several articles published in tax periodicals. I have written several letters to the Internal Revenue Service, the Treasury Department, regarding proposed legislation and regulations which have been acted upon.

I am the author of a chapter of the American Law Institute, American Bar Association book on the Revenue Act of 1964.

Senator SMATHERS. You may proceed.

Mr. ZIEGLER. I would like to discuss briefly an example which was presented to the committee earlier in the hearings concerning the supposed windfalls available under the bill. The example reminded me of the old chamber of horrors teaching method in a law school, in which a law is extended out to its furthest extreme in order to show the most extreme result and possibly to criticize that extreme result.

Actually, however, the results in the example read to the committee are not extreme at all. They are rather moderate. The example involved an investor who constructed a project at a cost of $1 million. The funds were supplied 100 percent by this investor.

In other words, he did not get any Government loan whatsoever. In the example it was assumed that the investor held the building for the full 50 years of its life and that he didn't make any sale of it. He took full advantage of all the tax provisions in the bill.

I have taken this example and made the correct computations as to the amount of money that the builder would earn and the amount that the Government would lose under the bill. The fact is that the builder made a profit over the 50 years of only 7.5 percent. This is lower than the profit which a builder could have made if he had put his money into a conventional apartment house.

Indeed, if this were the only possibility under the bill, the builder probably wouldn't have invested at all. However, as we shall see later, the builder does have possibilities under the bill and, indeed, probabilities of making a far more significant but not an unreasonable profit.

In this hypothetical example which was presented as a case of milking or windfall, the total cost of the project to the Government over 50 years was about $960,000. If the Government were to attempt to achieve a similar rental level for a project constructed under the rent supplement program, the cost would be almost three times as large, or about $2.6 million, over 50 years.

In point of fact, the builder would not hold the project for 50 years as he did in this example. In view of the way that the builder constructed, his profit would be far more substantial if he makes an early sale of the building to a cooperative consisting of the tenants of the building.

In this case, his yield, assuming he sells after 5 years, would go up to about 18 percent. Such a yield may be sufficient to interest private enterprise in this program. Interestingly, as the builder's yield goes

up, the cost to the Government goes down. The earlier that the builder sells to a tenants' cooperative, the fewer years in which he will be charging off depreciation deductions against his income.

This means that the cost to the Government is less. It is a key feature of the bill that the investor has an incentive to sell quickly and thereby reduce the cost to the Government.

Assuming that the builder makes such a sale after 5 years, the cost to the Government, total, of the building goes down to about $760,000. Once again, this is about one-third of the total cost of achieving the same rent levels under the rent supplement program.

I would like to introduce into the record of the hearing a table showing the 50-year cost of achieving a rent of $82 a month. The example rests upon a building of 120 units, having aggregate costs of $1,500,000.

This example is based upon the detailed computations in a memorandum submitted to these hearings, which are available for all to check. It compares the results to the Government, what is the cost, over 50 years of achieving a rental level of $82 a month.

An important assumption which is made in this chart is that after 10 years, the builder sells the project to a co-op consisting of the tenants in the building.

Senator KENNEDY. Have you copies of that?

Mr. ZIEGLER. We have only the original, sir.

Such a sale at the end of 10 years is an avisable cost for the builder of a certified project under the bill because he makes more money that way than if he continues to hold it.

With regard to a 221 or rent supplement project, the builder has no choice. If he sells at the end of 10 years he can preserve a rate of return of about 8 to 9 percent.

On the other hand, if he waits, his rate of return will go down substantially. Indeed, after a while it will go below 3 percent.

This is one of the reasons why Professor Berger indicated this morning that a great many investors are not interested in 221. Indeed, why an investor who carefully calculates what will happen to him in the future, a prudent, careful investor, may shy away from the program.

On this assumption of a sale to the tenants' co-op at the end of 10 years the results in total cost, interest cost, rent supplement cost, income tax cost, of achieving this rent of $82 a month, are as follows: Certified project under the bill, $1,624,000; rent supplement program, $4,046,000. A combination of rent supplement plus a below-market interest rate loan under 211, $2,523,000.

It is worthy of note that as between the rent supplement program and the rent supplement plus 221, the cost to the Government is lower if the two programs are combined.

However, under the law as it presently is on the books, this can only be done to the extent of 5 percent of the rent supplement program.

Once again, however, the important conclusion is that the cost under the bill is substantially lower than the cost under either of these two programs.

(The chart referred to follows:)

50-YEAR COST OF ACHIEVING RENT OF $82 PER MONTH

PROJECT OF 120 UNITS, COSTING $1,500,000

	S. 2100-certified project, 20-percent equity investment	Rent supplement program	Rent supplement plus 221(d)(3) BMIR
Rent supplement	(1)	$4,000,000	$2,018,000
Interest subsidy	$912,000	(1)	459,000
Local real estate tax abatement	415,000	(1)	(1)
Income tax costs (assuming sale to tenants co-op at end of 10 years)	297,000	46,000	46,000
Total cost	1,624,000	4,046,000	2,523,000

[1] None.

Note: Yield, S. 2100-certified project, 12.51 percent; rent supplement or 221, 8.12 percent.

Senator SMATHERS. Thank you very much, Mr. Ziegler.

Senator KENNEDY. Could I ask one question before you leave?

The combination you have discussed involves a 20-percent-equity investor and a sale to the tenants after 10 years. If you had a larger equity investment, or the sale at a different period of time, would that increase the expense to the Government substantially?

Mr. ZIEGLER. No, sir; that would not increase the expense to the Government substantially. The reason for that is this: Among the expenses of the certified project in this table is an interest subsidy of $912,000. If the builder finances the entire project by himself, the Government saves that interest subsidy completely.

Of course, we have to give the builder a larger tax incentive to make up for the loss of the subsidy. But the two balance each other out. This is a feature of the bill which increases tax incentives as the builder puts up more money.

Senator KENNEDY. So no matter what combination you have of equity investment, depreciation, or sale to the tenants' cooperative, no matter what the combination of those three elements might be, the cost is still going to be substantially below the cost of producing comparable low rentals under rent supplements or 221 (d) (3) plus rent supplements?

Mr. ZIEGLER. Yes. No matter what the builder's equity investment, ranging from 20 up to 100, whether he sells to a co-op of the building shareholders or whether he holds the building for 50 years, or whether the building remains in private hands but is sold several times over the 50 years, the total cost under the bill is substantially less than the cost under either the rent supplement program or the rent supplement plus 221 (d) (3).

The detailed computations underlying this conclusion are set forth in the memorandum submitted to the hearing.

Senator SMATHERS. To whom did you submit that?

Mr. ZIEGLER. That was submitted on Thursday, Senator.

Senator SMATHERS. At the time Mr. Caplin testified?

Mr. ZIEGLER. It was submitted the day before, on Thursday.

Senator SMATHERS. We want to be sure we have it. In any event, that has been admitted to the record.

(See p. 119.)

Senator SMATHERS. Senator Kennedy, do you wish at this time to make a statement, in light of the fact that we are going to conclude these hearings at this point?

Senator KENNEDY. I will defer to the Chair.

Senator SMATHERS. This does conclude the hearings on S. 2100. We have had witnesses testify from the Federal Government and from other branches of government.

We have had Senators, mayors, administrators at various levels. We have had a large number of witnesses from the academic world. We have had an impressive group of witnesses from the private or business sector of our economy.

We have had homebuilders in that sector. We have had contractors. Today we have had private citizens who are knowledgeable in this field testifying.

We have had witnesses representing organizations, they and their organizations being greatly concerned in this field of social progress.

I think it is a fair statement that no one could have sat here for these 3 days and listened to the testimony of these witnesses without having been enormously impressed that there is a great and growing problem, that there is a great and urgent need to meet that problem, and while it is primarily located in the bigger cities of the Nation, such as New York, Philadelphia, Chicago, and Los Angeles, nonetheless it is a problem which in point of fact exists in cities that are not as large as the big cities. It is a nationwide problem.

It is a problem that deserves the attention of everybody throughout the Nation, at every level.

It was made clear during these hearings that this problem is not only a social problem but an economic problem, and that if our country is not to rot and decay from within, to put it graphically, then something needs to be done in the very immediate future to attack this problem which is gnawing a our vitals.

No one could sit here and listen for 3 days to the witnesses who have testified without being impressed with the fact that our present programs, while they are of good intention, while they are working in some respects, are nonetheless not meeting the problems.

They are hit and miss in nature. They are spasmodic and sputtering. There is not enough being done even with them. But totally, the solutions that have thus far been offered are grossly inadequate. Nobody could sit here and listen for 3 days to this great array of witnesses which we have had without coming to the conclusion that this problem demands immediate attention by the Congress of the United States, and yet those of us who serve in the Congress and know the temper of the Congress cannot help but realize, as a practical matter, that the Congress is not going to do a great deal with respect to appropriating large sums of money for additional public housing units.

It is not going to appropriate large sums of money for an expansion of urban renewal, even though that program is needed, as all these programs are needed.

It is not, in point of fact, going to support greater Government projects. That is not the temper of the Congress today.

We already know we are going to have a $29 billion deficit resulting from activities which the Government has previously undertaken,

because of a slowed-down economy in some respects, and more particularly because of the efforts which we are making in Vietnam.

It would be unrealistic to believe that the answer to the problem of urban rot and blight, and the consequent crime and uneconomical activity which results therefrom, is going to be answered by additional appropriations from the Congress this year.

There is only one solution to those particular problems that these witnesses could see, and those of us who have listened to them can see. That solution is that we enlist, somehow, the great capacities and the great talents of our private sector in this particular area.

As I have said previously, this is the worth and the genius of the bill, S. 2100. It can do the job, and it can do it much less expensively than any of the programs we now have.

The only way we know, being realists, being pragmatic about it, that we are going to get the private sector to come into this particular program is to give them an incentive, a financial incentive. They have to make money.

As one witness said today, we have to give them that kind of an opportunity which would encourage them to take their talents and their money out of some other field, so to speak, and put it into this particular field of building houses in slum areas because they can make more money in this particular field than they could in some other field.

This is what we seek to do. This is what this bill seeks to do.

As I said, I don't believe that anybody could listen to the witnesses we have had before us, and we have invited all kinds—we could have had many, many more—nobody could have sat here and listened without being enormously impressed with the fact that this particular solution is the only solution.

I am convinced that we could take hearings like this out around the country, go to smaller cities, such as Syracuse, to Jacksonville, Fla., to Omaha, Nebr.—we could go throughout the length and breadth of this land, and I believe we would be amazed at the uniformity of opinion that we would get throughout this country, from every sector of our economy.

They would say, "This is the way and the only way to approach the problem of eliminating ghettos and slums throughout our land."

We could do that. We may have to do that, because it may be that we do not yet have the support within the Senate of the United States and the Congress of the United States to get the bill passed.

We can educate the people of the Nation as to what this bill is all about. They know about the need, they know about the urgency of it, but I don't know how well they know about this solution which has been offered.

In any event, this could have been done. It may yet have to be done.

As has been said, this is an idea whose time has come, because this is the only idea that offers a practical solution to this very real, urgent problem. I cannot help but believe, however, that time is running out on us.

Senator Kennedy, Senator Pearson, Senator Ribicoff, and I, as sponsors of this particular measure, will have to put our heads together to see exactly how it is that we are going to get it before the Senate. But get it before the Senate we will. The Senate will have

an opportunity in some fashion or another to vote upon this idea. I cannot help but believe if all the Senators had been permitted to hear this testimony as we have been, that they would be as convinced as we now are that this is not just the best solution; as a matter of fact, it is the only solution.

So we conclude these hearings. I hope that many people will have the opportunity of reading them. It is eminently clear, if the people read this record, if they examine the problems, and compare those items offered as solutions or prospects of meeting the problem in the immediate future, they can only conclude that the Senate bill, 2100, is the only realistic, practical answer which has been offered thus far.

Senator KENNEDY. Could I associate myself with the remarks of the chairman? I think the legislation has been supported by people of all political persuasions across this country. It has been supported by people from the various economic sectors of the country—businessmen, financial figures, and bankers—and by those in the academic field.

It seems to me that S. 2100 should be seriously considered. We can argue and battle about the details of these matters for the next 10 years, but in the meantime, as you, Mr. Chairman, have said so eloquently, our country will disappear from within, it simply will rot from within. We can and must do something.

This legislation obviously makes sense. It is inexpensive. It will get the job done. I think we should bring it to the serious consideration of the Congress of the United States. I would hope that the administration would reconsider its position and come in and support it.

Senator SMATHERS. Thank you very much.

The committee stands adjourned.

(Whereupon, at 1:15 p.m., the committee adjourned.)

APPENDIX

STATEMENT BY WILLIAM F. MAY, CHAIRMAN, AMERICAN CAN CO.

Mr. Chairman, I greatly appreciate the invitation of this distinguished Committee to express my view with respect to S. 2088.

The approach set forth in the Bill to stimulate investment in poverty areas thereby creating new jobs and income is both imaginative and sound. Its challenge to private enterprise, as both an opportunity and an obligation, is one that I would hope American business would readily accept.

I can't speak for American business in its entirely. As an individual businessman, however, I consider S. 2088 to be the most potentially productive approach yet offered to this country's mounting urban problems.

The Bill obviously seeks to remedy what many American businessmen consider to be a primary fault with our poverty efforts; the failure to involve the direct action of the private enterprise system.

I subscribe to what Senator Robert Kennedy has referred to as a new partnership against poverty involving the government and its people, business and labor, and the poor themselves.

I also endorse the proposition that the Bill does not require the creation of new government departments or agencies; new systems of welfare handouts nor great, new amounts of government spending.

The key to industry involvement, however, is that portion of S. 2088 that calls for tax incentives designed to enable private enterprise to make investments in the urban poverty areas.

The co-sponsor of this Bill, Senator Pearson of Kansas, has suggested that the tax incentives it would provide industry in attacking urban poverty would represent a catalytic element—not control. He further suggested that this catalyst would be supplied at relatively little expense. The tax credits, accelerated depreciation, and tax reductions accorded industry, he added, would be compensated for by reduced welfare payments, new tax revenues on higher earnings and increased industrial productivity.

Senator Pearson indicated a keen appreciation of the private enterprise system. He acknowledged that private corporations, after all, are responsible to their stockholders. They are willing to tackle the problem, to invest, to employ, to train and to produce. But such involvement cannot be completely without economic return.

Specifically, as to S. 2088, the American Can Company, would, I assure you, be influenced by tax credits, accelerated depreciation or other special consideration in choosing the locations for future investments in plant and equipment. The extent to which we could participate in programs of job-training would be largely determined by the effects foreseen of such programs on the Company's profit position.

In short, our economic responsibility to our stockholders must be balanced against our social responsibilities in determining how much we might spend on such programs. This is not to overlook the fact that, in training men and women, we would provide for our own future staff of qualified workers and executives.

I personally lean toward accelerated depreciation as a prime incentive for industry to invest in physical establishments, although tax credits also are attractive and effective. If made applicable to "intangibles," such as training costs, they certainly will provide added incentive to industry to share in solving social problems.

I also would suggest a possible need, not covered in S. 2088, for some inclusion of the governmental power of eminent domain in the total program of finding new locations for industry in areas where social troubles demand it. The power of the investment dollar is great, to be sure, but its power and effectiveness can be doubled when teamed with the judicial application of government authority to attain desirable ends.

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There is something else I wish to mention, as having occurred to me in my study of these problems. That is the need to prepare more young people from diverse backgrounds for performance in the executive and junior executive levels of industry. Often what is implied here is a college or university education coupled with special training of one kind or another. But I am sure that the American Negro and other citizens of minority groups in this country are not interested in having more jobs made available in the city dump, on the sanitation crew, in the sculleries, or on the shoe-shine stands.

If some means could be found to offer increased incentive to industry for executive-level training, as opposed to un-skilled or semi-skilled technical training, it is certain to fill a growing need for industry as well as satisfy the aspirations of many who feel the route to the top is simply not open to them.

May I conclude by saying that the situation in many of our major cities already has degenerated to the point, I fear, where years and years will be needed to reshape moral attitudes, the family structure, and public acceptability of what must be done to restore the American dream to the American city. The intent of S. 2088, however, appears to be a realistic approach to the problem involving the "results-oriented" approach of American business.

It has considerable merit, and I believe it could gain the support of the majority of American industry.

THE NATIONAL PAPER TRADE ASSOCIATION, INC.,
New York, N.Y., September 7, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: Thank you for your August 30 letter pertaining to the two bills which you have introduced for private investment in urban poverty areas.

Speaking personally, and not for the members of the Association I represent, I'm delighted that a Senate leader has come to the conclusion that the one sure way of accomplishing objectives is to involve the business community.

It seems to me that one of the major causes of our urban difficulties and disturbances is the result of too much thinking and too little planning, at both the college faculty and governmental levels. The results of efforts to remove poverty over the past few years have been high expectations, but extremely slow progress, due to governmental confusion and indecisiveness.

Now, at last, you have thought of the business community, which so often is ignored by legislators until everything else has proved ineffective.

I thoroughly agree with you on all three of the premises which you outline in the second paragraph of your letter, particularly the third one. If the proper incentives and inducements are offered in private business, the extremely difficult task of solving urban problems will be made easier.

Unfortunately, I am highly inexpert on the subject of urban housing. I wouldn't presume to make suggestions for changing or improving your bills, because of that fact.

The adequacy of the incentives incorporated in the bills would be best known by those who will become directly involved, and I defer to them insofar as comments and observations are concerned.

A reading of the two bills leads me to believe that for the first time, we have a concrete approach toward at least making a start to solving urban problems. But, of course, better housing is only a first step. What are we going to do to get some of the poverty people, who have little or no education and apparently little ambition, to become qualified to do something useful? The menial jobs which these people are presently qualified to handle are going begging, and yet these people claim that all they want is more jobs. How can they hold jobs that pay higher wages when they aren't qualified by education or motivation?

What I'm trying to say is that I think that better education of the younger people is an absolute requirement for improved conditions, and that better housing is simply one phase of a most complex and difficult problem.

Please accept my best wishes for the acceptance of your programs.

Cordially yours,

GLENN LEACH,
Executive Vice President.

TAX COUNCIL OF THE ALCOHOLIC BEVERAGE INDUSTRIES,
New York, N.Y., August 31, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

MY DEAR SENATOR: The information detailing the provisions of the bill jointly sponsored by you and Senator Pearson is appreciated.

Certainly the blighted areas of our cities present the greatest challenge to the ingenuity and compassion of the American people.

It is clear that the solutions to the urban problems hold the concern of most of us who represent the business community but, frankly, many are not impressed by the practicality of steps thus far taken. It is apparent that the respective cities cannot provide the funds necessary to finance an effort commensurate with the need. As you know, the New York Constitutional Convention has debated the merits of unlimited municipal taxing authority. The delegates overwhelmingly disapproved the proposal. I sincerely believe the action taken by the Convention was sound. The pockets of high taxation which would result from the exter[illegible] of taxing power would further the serious imbalance presently plaguing our major [illegible]. This imbalance, the poor vis-a-vis the middle and high-income citiz[illegible], is prompte[illegible] in part by taxation which causes an influx of the former and a withdrawal of the latter.

The major problems of the cities have not bee[illegible] pa[illegible]ned there; they have been brought to their pre[illegible]nt peak by the migration of the desperate underprivileged. Therefore, financing their solutions by local governments is not practical.

At the same time, many of us are sincerely disturbed by the continued extension of Federal authority in areas traditionally controlled by the state and local government. This extension obviously follows Federal financing through grants-in-aid. We who are so disturbed would naturally look with favor on greater involvement of the private sector in new programs.

While I do not readily favor tax incentives, I recognize they must be considered under certain conditions. Having concerned myself with the urban problem to some extent for the past two years, I have concluded that the incentives proposed by you and Senator Pearson are warranted. Were I to undertake a program of this nature I might possibly suggest some alterations but I am greatly impressed by the proposals you have made.

Sincerely,

CHARLES W. BRYANT.

NATIONAL ASSOCIATION OF INDEPENDENT INSURANCE ADJUSTERS,
Chicago, Ill., September 7, 1967.

Subject: Bills for private investment in urban poverty areas.

Hon. ROBERT. F. KENNEDY,
U.S. Senate Office Building.
Washington, D.C.

SIR: Thank you for your letter of August 31 enclosing [illegible] of the Congressional Record of July 12 and 13, 1967, wherein are cont[illegible]d your remarks in presenting the subject bills and [illegible] verbatim wording of same.

As a registered Republic[illegible] [illegible] happy to see an influential Democrat recognize the need to involve, heavily, the resources and talents of private investors, whether they be business entities or individuals, in the effort to rehabilitate urban poverty areas, which are festering sores, rapidly enlarging and spreading an infection throughout the body of the nation.

As a matter of public policy, this approach should and must be undertaken insofar as government cannot do it alone regardless of the amount of time taken or the dollars spent.

Obviously the business community only can be helpful in the one instance through additional investment in expanding facilties but, in the second instance, the doors will also be opened to millions of Americans via investments in organizations designed specifically to enter the low-cost housing field.

I wish you success in this effort and thus, also, the nation as a whole.

Sincerely,

BRUCE H. SMITH.

FREIGHT FORWARDERS INSTITUTE,
Washington, D.C., September 8, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: Thank you so much for your letter of August 28, 1967, and the enclosures with regard to the two bills, S. 2088 and S. 2100, which you have introduced, designed to afford relief in the present urban crisis.

I have read both enclosures from cover to cover, and find that both propositions have a great deal of merit and one would hope that you will find a sympathetic Congress, as well as business community, toward an approach to the problem as you have visualized it.

Inasmuch as our expertise is mainly directed to transportation and its various ramifications, I feel that we are not in a position to really analyze the technical and procedural adjustments which would be necessary to implement these proposals. However, I shall keep in touch with these proposals with a great deal of interest, and if I may be of service, please call upon me.

Sincere good wishes.

Yours very truly,

R. J. RIDDICK,
Executive Secretary.

FEDERAL INSURANCE CO.,
New York, N.Y., September 8, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

MY DEAR SENATOR KENNEDY: Your letter of August 14 concerning the two proposals you have made providing incentives for private investment in urban poverty areas has been received, and the specific proposals have been carefully studied.

Federal Insurance Company is a New Jersey Fire and Casualty company and under New Jersey law is restricted as to the type of investment it is permitted to make. The ownership of real estate other than for company use is not permitted, and the purchase of equities in new companies is limited to a very small percentage of total assets. In addition since it may become necessary to pay large losses promptly, it is important that Federal have a liquid position to enable it to make such payments. These considerations remove us from considering, in any major way, the type of investment your proposals suggest.

This Company, and the Fire and Casualty industry generally, have a keen interest in the objectives you have in mind, namely the stimulation of private investment in urban poverty areas. The problems of providing appropriate insurance protection to such new investment in these areas must be solved if economic rehabilitation is to be achieved. The property insurance industry is represented on and working with the Advisory Panel on Insurance Protection to the National Committee on Civil disorder appointed by the President in an effort to develop a cooperative effort between private companies and the Government to overcome these problems. and I can assure you we will do our best to arrive at a constructive solution.

Very truly yours,

WILLIAM REES.

E. I. DU PONT DE NEMOURS & COMPANY, INC.,
Wilmington, Del., August 29, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate, Washington, D.C.

DEAR SENATOR KENNEDY: Thank you for inviting our comments on your proposals to encourage private investment in urban poverty areas. The need to accelerate efforts in the housing area and to develop job opportunities is readily apparent and deserves the attention not only of the business and industrial community but all segments of our society.

Here in Delaware community leaders are working closely with business and industry to accomplish this objective, and we share your view that involvement of the private sector of the economy is essential. Undoubtedly similar activity

is taking place in many other states and communities. The fact that such broad effort is now being concentrated on the problem is encouraging. For example, in addition to your proposals, Senator Percy has communicated with us in behalf of his Housing bill, and of course the Administration has a number of ambitious programs under way. As to whether these latter proposals are sufficient of themselves to achieve an adequate solution. I cannot say; but I note the concern in your letter that they are not. It would seem to me, however, in the course of hearings on your Housing bill, which I understand are now scheduled during the month of September, there would be opportunity for a definitive discussion of the whole range of undertakings in the housing field with a view to establishing policies and practices likely to bring about the greatest measure of success and achievement.

In the area of industrial investment the range is more limited, at least in so far as the Du Pont Company is concerned. The technology of our production simply does not lend itself to the location of new plants in cities because of the hazards involved and because of the other requirements such as water, transportation, etc. I recognize that there may be other industries which might better be able to locate facilities in urban poverty areas, but they certainly can speak for themselves.

On the broad question of tax incentives, both for housing and industrial development, I would raise the general question as to the likelihood of Congressional approval for legislation at the present time in light of our defense expenditures abroad and the fact that a tax increase is now pending. My understanding is that the Treasury Department and the tax-writing committees of Congress would be somewhat reluctant to authorize this type of legislation now, despite its obvious worthiness. If conditions should permit a reduction in our fiscal financial commitments abroad, particularly in Vietnam, there would undoubtedly be greater opportunity for applying more funds to domestic needs. I join with you in the hope that this will come about in the early future. Meanwhile let me again assure you that we in Du Pont are both aware of and deeply interested in whatever steps can be taken to improve and advance opportunities for education and training and the development of realistic job opportunities in poverty areas.

My associates and I appreciate the interest which you have taken in communicating with us and if we have further comment or suggestions I shall not hesitate to be in touch with you again.

Sincerely,

C. H. GREENEWALT, *Chairman.*

METROPOLITAN HOUSING AND PLANNING COUNCIL OF CHICAGO,
Chicago, Ill., August 29, 1967.

Senator ROBERT F. KENNEDY,
Senate Office Building,
Washington, D.C.

DEAR SENATOR KENNEDY: You were most thoughtful to send us copies of your bills to provide tax incentives for private investment in industry and housing in blighted areas.

Please bear in mind that our organization is a non-profit, non-partisan citizen group which does not have funds for investment or construction.

We can say, however, that our organization is wholeheartedly in favor of the tax incentive approach. In fact, this is one recommendation we are developing for a national action campaign to solve the problem of urban decay. We will send this document to you as soon as it is in finished form.

We will appreciate receiving ten copies each of S. 2100 and S. 2088 for detailed analysis, and will be pleased to submit our comments to you as soon as possible.

Sincerely yours,

DOROTHY D. RUBEL, *Director.*

OFFICE OF THE MAYOR,
Jersey City, N.J., August 24, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: Thank you for your kindness in briefing me on your two new proposals to spur private investment in urban poverty areas. I support both measures fully and without reservation.

Your proposal of incentives for the construction of low-income housing in urban poverty areas is a most welcome one. Recently, after many years of inactivity, the New Jersey Legislature approved a somewhat similar proposal for middle-income housing.

Your program, if adopted, and New Jersey's new program would, I believe, enable us to make a greater effort in the area of greatest housing need: for low and middle-income persons.

I personally endorse your first bill, providing tax incentives to private business for making major investments in poverty areas, and our city would be willing—within the limits of very restrictive state taxing policy—to provide local level assistance.

As a practical matter, however, I feel this program has received a perhaps-fatal setback at the hands of the urban rioters this summer. It will take some time, I'm afraid, before private business again entertains seriously the idea of capital investment in urban slum areas. However, as your proposal may shorten that time, I again endorse it.

With all best wishes, I am,

Sincerely,

THOMAS J. WHELAN, *Mayor.*

FORT LAUDERDALE, FLA., *August 8, 1967.*

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: I am in receipt of your letter of August 4th in regard to the possibility of using private funds to assist in the redevelopment of some of the areas in our City.

I have not had a chance to have the bills analyzed, but I wish to assure you that, as an individual, I would make every effort to assist private enterprise in the construction of these projects.

I agree with you completely that every area available should be explored. To assist private industry to come to our City, with the aid of Federal money, as a loan, is the best solution I can think of.

It is my feeling if citizens have the interests of their City at heart they would prefer to cure their ills—each and every one of us in our own City—by combining your ideas of lending Federal funds to us so that we may participate in securing the removal of all of these areas.

These are my own sentiments and I am stating them to you as my own thoughts.

Very sincerely yours,

EDMUND R. BURRY,
Mayor-Commissioner.

CITY AND COUNTY OF DENVER,
Denver, Colo., September 6, 1967.

Hon. ROBERT F. KENNEDY,
Senate Office Building,
Washington, D.C.

DEAR SENATOR KENNEDY: Thank you for writing me on August 4, requesting my comments on your two Senate bills which would encourage private investment in urban poverty areas, to help create new jobs, and the construction of low-income housing units in these areas. I am in full agreement with your objectives, a feeling that I am certain is shared by every mayor of every major city in the nation. I regret having taken so long to write, but the subjects covered by your measures are so critical that I wished to have members of my administration study them with care before responding. This response encompasses the thoughts and recommendations of my staff as well as my own.

I believe that the use of tax incentives to private business to create jobs for the poor is highly desirable. Having said that, I recognize that such a program requires extensive safeguards to prevent abuses.

Unless your bills have been thoroughly discussed and concurred in by leaders of organized labor, I can foresee potential problems. First in the area of cutbacks, where union contracts with seniority provisions exist, and second, in order to be eligible for incentives buildings must be built in the poverty area

and two-thirds of the contractor's work-force must come from the target area. This would seem to me to pose some problems in obtaining the skills required, unless some kind of waivers or extensive modification of apprenticeship programs are obtained from the unions. This goes right to our employment problem in poverty areas, and the need for employment statesmanship on all sides will have to be exercised.

Your suggested 25% tax credit on wage costs would appear to pose some additional problems. On the surface it seems to give a competitive advantage over existing businesses already operating in the poverty areas. This could conceivably exert a downward pressure on wages in established enterprises in an effort to overcome the labor cost disadvantage. Doubtless you have considered these and other potential problems and have arrived at solutions. I feel that we must have strong Labor support and participation if an employment program is to succeed. I believe that your basic concept makes a great deal of sense, and that a thoroughly workable program should evolve.

Your housing proposal comes to grips with local needs for new and rehabilitated housing for lower-middle and middle income families more realistically than most programs I have examined. For the first time in recent years a realistic loan fund of $3 billion over a six-year period has been proposed. The 2 per cent interest on 50-year loans would be more effective than any other action in reducing monthly housing costs for occupants. I wonder if you have considered a sliding scale of interest charges from zero to the going rate based on the need of the applicant. Such a formula would appear to have merit, if administratively feasible.

I can readily understand your recommendations for local tax abatements, as part of the formula for achieving low monthly costs. I am advised that a State Constitutional amendment would be required in Colorado for such an incentive to be legal in the case of privately owned and operated housing. As a matter of fact the Colorado Legislature this year withdrew tax exemption for non-profit housing for the elderly, sponsored by churches, labor unions, and other responsible non-profit groups. Most cities are so hard-pressed for operating funds under present archaic local tax structures, that any local tax abatement is considered a hardship. An alternative that I have seen presented a number of times is to assess full taxes against even low-rent public housing as well as non-profit low-interest privately constructed housing, with Federal subsidies to the projects increased to cover 80 to 90 per cent of the tax assessments, in order to maintain low monthly charges. To be sure, this would increase Federal contributions, but the Federal government is the only body with elastic taxing powers based on an equitable formula of ability to pay.

I am intrigued by the several tax incentive provisions in your bill. Your suggested tax credit ranging from 3% to 22% of the cost of a project, depending on the investor's equity, should attract very large sums of equity capital. Coupled with special depreciation incentives and capital gains tax advantages, private developers should definitely turn their attention to providing homes for families of relatively low income. I note that occupancy charges are to be set to yield a 3% return on the initial equity. I would be interested in knowing the estimated returns on net investment, when the initial equity is related to the tax credit, and to large amounts of depreciation in excess of the income from the property which can be offset against other income which result in significant tax savings. I am not saying that this is too high an incentive to secure housing that is so desperately needed by the American people, but I feel that the public should know what that price is.

It is my understanding that under your measure rents would range from approximately $70 to $100 monthly, and would be aimed primarily at families with annual incomes of from $3500 to $6500. This, admittedly, is the area of greatest housing need. However, it does not lend itself to housing families of very low income, or to serving as a substitute for low-rent public housing, unless it could be used to house a substantial number of families receiving aid under a vastly expanded rent supplement program. Which brings me to my final comment.

The bills you propose would, in my opinion, provide an effective supplement to, and not serve as a substitute for existing housing programs. For example, I do not subscribe to the criticism that the low-rent public housing program has failed. With amendments that have been included in recent years it provides the best and only effective housing tool for persons of very low income. While in some instances the location, design and administration is subject to criticism, on balance

it has been a helpful program. Since 1950 this program has been crucified by the Congress, and its authorizations and appropriations have been too little and too late. Under existing laws it can be built so that it does not create ghettos of the very poor, and it can be designed to upgrade neighborhoods where it is built. It meets a critical need for persons and families whose incomes are too low to qualify for private housing built under existing or proposed programs which grant tax incentives, tax abatements, and under-the-market financial terms with lengthened periods of amortization.

Recently enacted housing programs under FHA sections 221(d)(3), 221-h, and 213 cooperatives, have been so limited by Congressional authorizations to prevent an adequate test of their effectiveness. The Rent Supplement Program, which I believe has great merit, will be seriously handicapped by under-financing, even if Congress should approve the $40 million appropriation which the President has recommended and which the Senate Committee on Appropriations has approved.

Your proposed bills represent a call that is loud and clear for dynamic action in the field of jobs and housing for families of low and moderate income. These tools are essential if today's crisis in our cities is to be met squarely and overcome. You have stated the objectives, and presented a framework on which to build. I applaud your leadership and assure you of my wish to cooperate in helping to establish a public-private partnership which is essential to achieving our mutual goals.

With personal regards and best wishes.

Very sincerely yours,

TOM CURRIGAN, *Mayor.*

FRESNO, CALIF., *September 6, 1967.*

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: It is without equivocation that I endorse the three premises that underlie your two bills, "Industrial Investment in Urban Poverty Areas" and "Investment in Housing in Urban Poverty Areas." Poverty is certainly no small problem, and coping with it, as we are becoming painfully aware, has to be a total community effort with government, private enterprise and citizens working together on many fronts. I applaud your approach in proposing ways to tap the tremendous resources and energies of private enterprise in coping with our urban problems.

A review of your two bills raises a couple of questions and uncovers some problems as they apply to Fresno and possibly to other cities, especially cities in California. I will make no attempt to deal with the complex tax incentive proposals, as I am sure you have available more knowledgeable tax people than we have here in Fresno. In regard to the industrial development bill, there would probably be little difficulty in Fresno utilizing this program should it be enacted, and we would be most happy to get some substantial industrial development located in our slum-ridden West side. However, I question whether the requirement for a firm to provide 50 new jobs is a realistic one. Fresno has a metropolitan population of approximately 250,000 (161,000 within the city limits). A great majority of our firms employ from 15 to 50 people. Due to the size of our metropolitan area and the greater availability of firms in the 15 to 50 employees range, Fresno would be more able to obtain new industrial development in its poverty areas if the minimum was 25 new jobs rather than 50. Perhaps chances of getting involved with an unstable firm might be a bit greater, but the chances of increased employment would be enhanced if smaller firms could benefit from the tax incentives. Also, a number of firms employing 25 to 50 persons each would provide a more solid economic basis than just a few employing 50 to 100.

In regard to the low income housing investment bill, the private enterprise incentives are certainly needed. I wonder though whether we would be encouraging de facto segregation through this program if it is enacted, that is, if the private low-income housing projects are constructed on as large scale as some public housing has been and since a great percentage of our poor are Negroes. Also, though it is noted that the Secretary of Housing and Urban Development must approve development plans and would have some control over not subsidizing poor management practices, will the accelerated depreciation provisions en-

courage shoddy construction which will last only ten or twenty years and will good management be insured regarding property maintenance?

I was glad to see that provisions have been made not to penalize tenants who begin to rise above their neighbors in terms of income and to train tenants in the skills needed to operate home management corporations.

One big problem I would like to point out involves the provision which requires local property taxes to total not more than 5% of total rents. Although the difference between the normally expected tax return on projects constructed under this program and that received under the reduced rate can be reimbursed in part through the tax abatement fund and in whole if the state provides matching funds, local governments in California cannot legally establish differential tax rates. Getting legislation that would allow differential tax rates could be difficult. Even if differential tax rates could be levied, there would be an enormous problem in obtaining the cooperation of overlapping taxing bodies to coordinate tax rates to achieve a 5% level. This is a unique and interesting proposal, but I wonder if it is realistically obtainable.

Also in regard to this provision, what if the State does not supply the matching funds to allow 100% tax reimbursement? Local governments cannot afford substantial tax losses, especially since improved housing probably requires a broader range and higher level of urban services. California of late has not been extremely cooperative in supplying matching funds. This can be seen in the administration's refusal to provide the 10% matching funds for the college work study program.

I hope these comments prove of value to you. Best of luck in your efforts to get private enterprise more involved in the war on poverty.

Yours very truly,

FLOYD H. HYDE, *Mayor.*

LANCASTER, PA., *August 14, 1967.*

Hon. ROBERT F. KENNEDY,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR KENNEDY: I have reviewed your proposed bills with my staff and I feel that, to date, they are the best proposals which have been submitted for involving the private sector of the economy in an attack on the twin problems of urban housing deterioration and poverty.

It has fast become part of our conventional wisdom that the problems of urban poverty can only be solved through the active participation of our private enterprise system. While this is no less true for having become something of a cliche, I feel some of the proposals which have been made to this end are ill-conceived; a case-in-point is Senator Percy's low-cost home ownership bill. While the legitimacy of the goal pursued by this bill is beyond question, I feel certain provisions are self-defeating and positively harmful. The autonomous nature of the quasi-public corporations this bill would institute would, I think, work to frustrate rather than augment a coordinated attack on the poverty cycle.

Secretary Weaver has observed that Senator Percy's bill fails to adequately involve local government. This is a legitimate criticism. An attack on a problem as complex as poverty demands, as both you and Senator Percy have recognized, the utilization of the resources of both the private and public sector, but it also demands maximum administrative coordination in this effort. Deep-rooted urban problems have best been attacked by the integration of policy that a strong mayor system allows. Likewise, any attempt to involve the private sector must provide for coordination of policy with the priorities of the public sector if it is to avoid self-defeating administrative fragmentation. This is a lengthy way of saying that I feel that your bills achieve the necessary participation of private enterprise without sacrificing the ability to mount a coordinated attack on povery.

By way of commentary on the specifics of your bills, I am sure that Lancaster would be anxious to participate were they to become law. While our unemployment rate is relatively low, both in general and among our urban poor, there remains much room for improvement. Your bill providing tax incentives for industrial location in urban ghettos would undoubtedly rectify to some extent this problem. It is your housing bill, however, that would be of greatest advantage to Lancaster. Surveys that have been taken and direct contacts with out urban poor consistently indicate that poor housing is the issue which evokes the most concern.

I feel that your bill would provide a mechanism for inducing the massive infusions of capital that are needed to achieve the goal of decent housing for all.

I am sure that Lancaster would be able to offer local assistance to interested investors. The necessary abatements in the tax laws (which must be changed by state legislative action in Pa.) would undoubtedly cause short run fiscal hardships, but it would be a price worth paying for decent housing and in the long run it would probably result in significant savings in certain areas. Moreover, at least some of the tax revenue would be realized by the City, whereas present public housing programs result in a total loss of tax revenue with only slight compensation through payments in lieu of taxes.

One provision of your bill which I feel is particularly praiseworthy is the staggered relocation procedure. One of the most serious faults of present urban renewal programs is the social dislocation that results from the disruption of stable neighborhood patterns, as Newark's recent disorder has testified. By minimizing this dislocation, your bill would allow for the retention of some sense of community instead of further reinforcing the isolation and alienation of the urban poor. Given the present impenetrability of the outlying suburbs, this is a worthy, if only stopgap, goal in relation to urban poverty.

Hopefully, it would be possible to integrate your bills with other local programs relating to poverty so as to mount a coordinated attack on the problem.

I hope to see the translation of your proposed bills into public policy. If there is any way that I can be of further assistance, please don't hesitate to contact me.

With best regards.

Sincerely,

THOMAS J. MONAGHAN, *Mayor.*

OFFICE OF THE MAYOR,
St. Louis, Mo., August 14, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate, Washington, D.C.

DEAR SENATOR KENNEDY: I have received the two bills for private investment in urban areas which you introduced in the Senate last month. I am very favorably impressed by both bills and am in perfect agreement with the goals of both of them.

Unless I am mistaken about the details of the bills, I find the following lacunae:

(1) In the bill to provide tax incentives to private businesses which would make major new investments in the urban poverty areas, it seems that no provision is made for those businesses which would expand their present operations in the central city. Yet 85 per cent of business expansion comes not from the location of new industries within the central city, but from the expanding of existing businesses and industries.

(2) In the bill that provides incentives for the construction of low-income housing units, there is no provision for the dispersal of the ghettos into the surrounding suburbs or unincorporated areas. I recognize the problematics of this desideratum, but until there is the dispersal of the ghetto through freedom of residents and the availability of low-income housing outside the confines of the central cities there will be the continuing dichotomization of the non-white ghettoized central city surrounded by the white noose of the affluent suburbs.

Your emphasis upon the involvement of private enterprise is highly appreciated. Your knowledgeable and persuasive case for the use of tax credits for private industry locating in slum areas is extremely pertinent .

I am very interested in the passage of these bills and assure you that if they are passed I will do all in my power to have them implemented in the City of Saint Louis. Your conjoining the bills with implementation through the Department of Housing and Urban Development seems highly judicious.

Would you please send me ten copies of each bill? Thank you.

Sincerely yours,

A. J. CERVANTES, *Mayor.*

CITY OF DETROIT,
August 14, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate, Washington, D.C.

DEAR SENATOR KENNEDY: We in Detroit have been following with great interest the two bills which you have introduced, S. 2100 and S. 2088. They strike at the heart of the problems of any ghetto, whether it be in Detroit, New York, Chicago or elsewhere.

We have seen the need to introduce new jobs in the ghetto as well as the need for replacing or completely rehabilitaing 80,000 homes.

In a position paper dealing with our recent riots and our ghetto problems which we recently developed for the Michigan delegation, we put ourselves on record as being highly in favor of your two bills. If the bills are passed, we strongly intend to participate in the new programs they represent.

In terms of helping industrial concerns to get started in poverty areas, we have set up the Detroit Metropolitan Investment Development Corporation which has about $200,000 in funds available for construction loans. Once a program is mounted, we may be able to increase its capital through further donations by business.

In terms of housing, we would be in favor of granting the necessary tax abatements for which we would be reimbursed in part by the Federal government. We are, however, limited by State law to an abatement that amounts to 10 percent of shelter rent or to the taxes that were paid previous to renewal of a site which is to be used for low or moderate income families. This law would have to be amended unless you increase your in lieu payment of taxes from 5 to 10 percent.

The fact that you would also match State contributions to make up for the loss of taxes may lead to our State's funding of this portion of the State Housing Act which was passed but never funded.

If there is any weakness in your bill, it is that it was primarily designed to promote low rentals and it does not lend itself easily to individual home ownership.

In closing, let me say that both of these bills are imaginative and important elements in combating the problem of the ghetto. I certainly will support them.

Very truly yours,

JEROME P. CAVANAGH, *Mayor*.

CITY OF DAYTON, OHIO,
OFFICE OF THE CITY COMMISSION,
August 17, 1967.

Hon. ROBERT F. KENNEDY,
Senate Office Building,
Washington, D.C.

MY DEAR SENATOR KENNEDY: Members of my staff and I have studied with considerable interest your two proposals for legislation relating to the overwhelming problem of business development and housing supply in urban centers.

I want, first to commend and hopefully encourage you for an imaginative, yet realistic and courageous approach to some legislative help for us all.

Among my initial reactions is a strong recognition of the fact that combined efforts of local and federal government with private enterprise will be absolutely necessary to begin to solve these massive problems. It would be my feeling that the city of Dayton would not only be interested in some such development process, but would probably be in a position to take advantage of it more readily than many communities. This opinion is based partially on our knowledge of the diversity of our local industry and the increasingly difficult task of expanding or locating any new development in the central city due to scarcity of open space.

There have been occasions in the recent past when we have given thought to some type of special incentive to private business and have found ourselves somewhat stymied by statutes of the State of Ohio. Obviously national legislation would take into account such provision in the various states and ease the way for cities to do some things that they are now unable to do.

I am likewise inclined to feel that legislation directed toward relieving the urgent housing need in poverty areas would receive enthusiastic support from our community. One of the major innovative proposals in our Model Cities Application, which we hope will be one of those approved in the near future, is a kind of program for extra long term, low cost loans for private home construction and for repair.

The people in our Community Development Department have not yet had an opportunity to study the material you sent to me but I will give them that opportunity and suggest that they may communicate with your staff regarding it. I wanted, however, to respond as quickly as possible because we feel rather strongly in Dayton that we have all of the problems of the modern American

city, but in manageable proportions; suggesting that effective solutions can be found and shown in our city. Your companion proposals seem to have a number of ingredients that would indicate great potential for helping solve two of the major ills.

Yours very truly,

DAVE HALL, *Mayor.*

OFFICE OF THE MAYOR,
Oakland, Calif., August 16, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: I was most interested in receiving copies of your two bills relating to private investment in urban poverty areas. The approach seems most constructive and would certainly benefit the City of Oakland. I offer my support to your efforts to gain approval of these bills and would like to know of their progress in the United States Senate.

As a practical reality it is necessary to provide the kind of incentives offered in your legislation to encourage investment in our economically depressed areas.

Sincerely,

JOHN H. READING, *Mayor.*

CITY OF PHILADELPHIA,
August 18, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: I have reviewed the Bills which you recently introduced in the Senate to aid in the solution of two of our most pressing urban problems, namely, jobs and housing.

In my opinion, both Bills represent excellent attempts to get at the root causes of these problems and to mobilize the full resources of American society in eliminating them. The basic idea of involving private enterprise by providing adequate economic incentives—particularly tax incentives—would appear essential to any approach. It was out of this connection that the City of Philadelphia suggested a Resolution to the recent meeting of the National League of Cities on this very point.

I am also in complete agreement with the position taken in both Bills that the thrust of both jobs and housing programs must be in the areas of greatest need, those areas presently occupied by the poor. Despite our most diligent efforts to provide equal opportunity to live and work anywhere, we must face the fact that a large number of people will be living in their present neighborhoods for many years, and we must help them where they are.

With specific regard to the proposed Urban Housing Investment Act, we would applaud the emphasis on rehabilitation of housing dwellings upon which Philadelphia is banking heavily in its attempt to provide adequate housing for the lowest income families through our public housing program. I am concerned, however, about the recommendation of adding yet another administrative unit within the Department of Housing and Urban Development. While I would agree that the F.H.A. has not served the low-income segment of our population well, I am not certain that an entirely new staff would be better able to administer your program without serious delays and increased internal competition with other administrative units of the Department.

I also must express some concern that the goal of the program—that of providing two and three bedroom units in multi-family buildings at "less than $100 a month"—does not really strike at the heart of the low-income housing problem, at least as it is felt here in Philadelphia. Our greatest need is for units suitable for large families of low income—families often only able to afford rentals of $40 to $70 a month, if they are not to be deprived of other equally important needs, such as food and clothing.

Finally, with regard to the suggested reduction of local real estate taxes with partial reimbursement from the Federal Government, this would be likely to be of little help here in Pennsylvania, where the Constitution has been interpreted to forbid the granting of such tax concessions. This would probably be the case in several other jurisdictions, as well.

Despite these relatively minor concerns, let me again congratulate you on the legislation which you have developed, and express my full support of it. If I can be of any further assistance, please let me know, and I and my staff will offer our full cooperation.

With all best wishes and kindest personal regards, I am

Sincerely yours,

JAMES H. J. TATE, *Mayor.*

S. S. KRESGE CO.,
Detroit, Mich., August 23, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: The bills enclosed with your letter of August 10 have been reviewed with great interest. The constructive proposals embodied in each bill obviously warrant the full attention of the Congress.

Since our company is engaged solely in retailing, which is expressly excluded from the scope of the bills, perhaps it would not be appropriate for us to express a judgment as to their effectiveness, but we would endorse without qualification their stated purpose.

With best regards and all good wishes,

Sincerely,

HENRY CUNNINGHAM.

EATON YALE & TOWNE, INC.,
Cleveland, Ohio, August 21, 1967.

Senator ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: Thank you for sending me copies of your talks on "Industrial Investment in Urban Poverty Areas" and "Investment in Housing in Urban Poverty Areas."

In Cleveland, we are highly aware of the problems that you are trying to solve and perhaps I have an interest beyond the average because of my association with the Cleveland Development Foundation and the Cleveland Foundation, two non-profit organizations which have financed studies of the Hough Avenue problems ad nauseam to paint the picture but without the power to clear it up.

You will undoubtedly agree that other factors besides the housing situation are involved in this situation: for instance, the Cleveland Development Foundation with nearly two million dollars of seed money contributed by industry in this area launched as its first project the Garden Valley Development designed to provide low cost housing for the underprivileged people in this area. This is when we discovered that education and motivation must go along with and even precede the investment of large funds in physical equipment and I am certain that this same situation applies to our Hough area and perhaps to most run-down neighborhoods in the large cities.

I wish that private enterprise could participate in line with your proposals and as far as Cleveland is concerned, I can promise you that industry and private funds will cooperate to the nth degree should your bills pass into law.

Congratulations for making the effort.

Sincerely,

JOHN C. VIRDEN.

NATIONAL PAINT, VARNISH AND LACQUER ASSOCIATION, INC.,
Washington, D.C., September 6, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

MY DEAR SENATOR: This is in reply to your letter of August 29th, in which you enclosed copies of the two bills you introduced recently to help solve the present urban crisis by providing tax incentives to encourage private enterprise to make major new investments in business property and low income housing units in the urban poverty areas. You invited comments and any suggestions for improving these bills.

As an association executive and as a spokesman for the paint, varnish and lacquer industry, I concur with the basic premises underlying these two bills, and, particularly, with the proposition that the present government programs need to be supplemented with a maximum effort by private enterprise. I agree that this full participation of private enterprise can be achieved much more readily if the tax incentives you propose are made available to the business community.

While I have not yet had an opportunity to analyze your two bills in detail nor to discuss these measures with any of our members, the provisions of S. 2088 and S. 2100 do appear to be sound public policy and a positive step forward in our battle to halt the worsening slum conditions in our nation today. The National Paint, Varnish and Lacquer Association is deeply concerned with this problem and feels strongly that slum areas can be alleviated only with proper tax incentives. Similar tax incentives to encourage individuals to repair and maintain their property will be highly effective in preventing countless other areas from deteriorating to slums.

The NPVLA already has gone on record in strong support of such legislation, i.e., a bill introduced earlier this session by Rep. Casey of Texas (H.R. 358) to allow a tax deduction up to $750.00 to a home owner for repairs and improvement to his property. A similar bill has been introduced by Rep. Halpern (H.R. 11155) and a related bill by Senator Carlson (S. 288). Enactment of this legislation would not only benefit the depressed building industries (including painting, papering, carpentry work, plumbing, electrical work and roofing) but also would stimulate the economy and create new jobs. More than twenty-five industry and trade groups have endorsed this legislation; and, we enlist your support as well.

In view of the foregoing, I feel confident that S. 2088 and S. 2100 will receive the full support of the more than one thousand members of the NPVLA located in forty-six states throughout the country. I shall have a member of my staff keep in touch with Mr. Curzan or Mr. Walinsky in order to keep apprised of further developments in this matter.

Sincerely yours,

ROBERT A. ROLAND,
Executive Vice President.

OAKLAND, CALIF., *September 13, 1967.*

Senator ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.:

We strongly endorse your bills to foster private investment in urban poverty areas. It is gratifying that last year's crisis of the cities' hearings in which Oakland participated have been distilled into S. 2088 and S. 2100. The bills will cure many current defects. If a statement can assist, please advise.

JOHN B. WILLIAM,
Executive Director, The Redevelopment Agency of the City of Oakland.

CELANESE,
New York, N.Y., September 5, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

MY DEAR SENATOR: Thank you for your very thoughtful and provocative letter of August 14 concerning the bills to encourage private investment in urban areas. I am sure that business leaders throughout the nation will share a deep interest in these proposals.

As I believe your bills demonstrate, there is no single incentive program which would guarantee a sufficient solution. I am therefore impressed with the many-faceted approach you have taken. For example, I am sure many people misunderstand why industries do not necessarily locate in areas where there are presently hundreds of unemployed people. The plain fact is that with today's technology there is no such thing as a general labor market. Hence, industry must plan for manpower training and I agree with you that it is wise to include that kind of incentive program.

There must be a national commitment to the solution of the job problem—from labor, from business, as well as government. Hopefully, spokesmen on these matters will continue to emphasize the need for such totality.

Companies of our size have long recognized a responsibility to participate in the affairs of the public sector, including efforts to solve social problems. These efforts, I believe, should continue to be in the context of normal business activities and problems. While this imposes certain restrictions upon us—restrictions inherent because of the type of business we operate—we realize the challenges and opportunities exist.

I hope you will continue to keep business people informed and involved in work toward resolving our national problems.

Sincerely,

HAROLD BLANCKE.

GENERAL FOODS CORP.,
White Plains, N.Y., September 5, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate, Washington, D.C.

DEAR SENATOR KENNEDY: I have reviewed with great interest the bills you recently introduced in the Senate attacking the problems of our urban poverty areas. These are undoubtedly the most critical domestic problems facing the nation, and their solutions demand the combined resources of government and business. General Foods, like all business, has a vital stake in the solution of these problems. These urban poverty areas have an impact on the homes and families of many GF people, as the New Rochelles, Mt. Vernons and Chicagos are close to our major installations.

Our attack on urban poverty areas must not neglect conditions in rural America. The feeling of despair that overshadows some of our rural areas forces migration to the cities. The assault on hard-core unemployment and inadequate housing cannot have its hard-earned gains lost by our failure to correct a part of the problem at its sources.

The tax incentives for businesses making new investments in these urban poverty areas should create new employment. These provisions will have a greater impact in certain industries than others, and I am sure this was recognized in the drafting of this legislation. The high volume to value relationship characterizing our products is reflected in the sizable land needs for our processing facilities. The lack of available land in our urban poverty areas and the relatively high cost where it is available would probably lessen the impact of these tax incentives on our investment decisions. The necessity for major rail and truck facilities for the movement of large volumes of raw materials and finished product and the demands placed on utilities and sewerage facilities would also be major considerations. Labor intensive industries, where the extra tax deduction of 25% of wages paid to previously unemployed persons would be of major significance, would find this factor influencing their investment decisions a great deal more than companies like GF where processing labor represents a relatively small part of cost of goods.

The characteristics of General Foods products and facilities are such that these tax incentives would not influence our investment program as currently planned. This is due to the nature of our business, and while I cannot speak for other industries, it does seem that these same incentives would have a material impact in high labor intensive businesses whose space needs could be met in our urban areas.

Your housing bill attacks the problem of inadequate housing. The incentives set forth undoubtedly reflect the thinking of leaders in this field, and neither I nor my staff have the knowledge and experience to assess them. We have not participated in any real estate ventures and do not have the management skills or fiscal resources to make use of these incentives. While I certainly endorse the objectives of your proposed legislation, any further comment on the specifics of this bill would be speculation on my part.

I share your concern for the pressing problems facing our urban areas today and agree that the combined forces of government and business must search out solutions. I have been focusing the attention of management on these problems and hope that our efforts in employment, training and education will have some impact on these urgent national situations.

Sincerely,

C. W. COOK.

NEW YORK, N.Y., *September 5, 1967.*

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: In response to your request for comments on S. 2100 and S. 2088, I would like to indicate strong support for the principles contained in both of these bills. The private enterprise system has long been neglected in government spending efforts to the detriment of the tax payers. If education is the key to the solution of poverty in the long run, then jobs certainly are a solution in the short run.

S. 2088, while necessarily complicated, may contain a serious deficiency by requiring that two-thirds of the employees reside in the poverty area or be unemployed. If this factor were reduced to one-half or less, there would be a greater possibility of success for the employment venture.

The retraining feature is an excellent one, and coupled with the "multiplier" effect, this legislation is most commendable and we wish you success in its passage.

Sincerely,

PETER W. SMITH.

THE CHASE MANHATTAN BANK,
New York, N.Y., August 23, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR BOB: Thank you very much for your letter and the copies of the two bills you have introduced in the Senate for private investment in urban poverty areas.

The principles you point out as underlying these bills are certainly of vital importance, and I think you have some very useful and interesting ideas for implementing these principles. A number of associates and I are presently studying a broad range of related concepts and proposals. Until I have had an opportunity to arrive at a clearer overall view from these examinations, I feel it would be very difficult to offer the sort of meaningful commentary I know you would want on your own bills. I will, however, give very close attention to your proposals and let you know if I have any observations that might be of assistance.

Meanwhile, I greatly appreciate your thoughtfulness in writing and in giving me this opportunity to comment on these important bills.

With kind regards,

Sincerely,

DAVID ROCKEFELLER.

GROLIER, INC.,
New York, N.Y., September 1, 1967.

Senator ROBERT F. KENNEDY,
Senate Office Building,
Washington, D.C.

DEAR SENATOR KENNEDY: I was pleased to receive your letter of August 10 dealing with the two bills for private investment in urban poverty areas which you introduced in the Senate.

Our Company, Grolier Incorporated, is in the field of publishing encyclopedias and reference works, and unfortunately the business we are engaged in does not fit in the program envisaged by your bills. Despite this fact, I am keenly interested in the approach you are taking, since it is my firm belief that any healthy solution to the urban poverty problem is through the initiative, help and resourcefulness of private business.

There is in my opinion no substitute for the zeal and enthusiasm that the businessmen can instill in the individual. In my experience this has been markedly absent in government projects. Self-help is the key and core of any rescue effort, and this is precisely what you are proposing in these bills.

It may be that when we go the way of the government project group the individual surrenders himself to complete reliance and dependence on what is to him an all-knowing power, without the realization that the aggregate judgment of the many small people, when stimulated, is vastly superior to opinions and

conclusions of the bureaucrat who, through sheer necessity, operates in a restricted area lacking breadth and scope. I have seen many examples of this situation in dealing with the governmental regulatory agencies.

Let me commend and congratulate you on your vision and wisdom in pioneering in this present approach. You can count on my wholehearted support.

Sincerely,

FRED P. MURPHY,
Chairman of the Executive Committee.

AGWAY, INC.,
Syracuse, N.Y., August 25, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: The following comments are in response to your letter of August 14 to Harold G. Soper, Chairman of the Board of Agway Inc. In that letter, you requested comments on two bills you recently introduced in the Senate, both of which are designed to encourage private investment in urban poverty areas.

Agway is a regional farmer cooperative and as such has a central objective of improving the lot of farm people in the area it serves. The nature of its business precludes investment in urban areas except in very rare instances where such investment contributes to its ability to serve its farmer patrons. This, however, does not mean we are not vitally interested in urban problems and measures designed to alleviate those problems. All of us—farm oriented and city oriented alike—must be interested in the problems of both the farm and the city. The country cannot afford narrow farm or city partisanship.

The bills you introduced to give incentives to private businesses to make job-creating investments in urban poverty areas and to invest in new housing in these areas are a step in the right direction. The emphasis on use of private business is well placed. The goal of improving the job situation and living conditions of our urban poor is commendable and the proposed legislation should provide a relatively economical contribution to progress toward that goal.

These bills should be enacted, but only as a part of a more comprehensive attack on the problems you seek to solve. I submit that the problems of urban poverty and rural poverty should not be considered independently. Our urban poor often can be traced to rural areas and this involves interregional migration. If the lot of the present inhabitants of urban slums is significantly improved, you can be sure there will be others to take their places. It is just as important that investment in job creation and living conditions be encouraged in relatively rural areas as in the highly urbanized areas. Only if the rapid migration is slowed will the urban areas be able to make lasting progress in solving their slum area problems.

We appreciate the opportunity to present our views on these important questions and hope you will find them helpful.

Sincerely,

C. C. DENNIS,
Director of Economics.

THE NEW YORK BANK FOR SAVINGS,
New York, N.Y., August 25, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate Office,
Washington, D.C.

DEAR SENATOR KENNEDY: You recently forwarded to me copies of your bills which would encourage private investment in urban property and requested my reaction to these proposals. I realize that you have probably received a great number of comments in response to your letter but the following observations, made from the point of view of a mutual financial institution, may be constructive.

First, I strongly concur with your belief that the resources of private enterprise must be employed, if urban areas are to be adequately upgraded. Such private efforts should supplement the maximum program which the government itself can put forth.

Second, I believe that you are correct that low rental housing can be produced only by a combination of a low mortgage rate and real estate tax abatement.

Third, I am impressed by other provisions of the bill which are imaginative—such as the concept of "Home Management Corporations", "relocation assistance" in well defined terms, eligibility requirements, etc. One question with respect to the latter: Can a private owner effectively police the earnings of tenants and enforce rent increases based on income improvement?

Fourth, one of the most interesting parts of your proposal is the concept that an investor would be required to accept a return of 3% on his equity and in return would receive tax credits ranging upward from 3%. Essentially, there are four major groups who might wish to participate in this work—(1) Charitable organizations (including limited dividend companies). (2) Financial institutions such as insurance companies, savings banks and pension funds, (3) Business corporations, and (4) Professional builders.

It seems to me that neither charitable organizations nor mutual financial institutions would benefit from a tax deduction. The unfortuate fact is that such financial institutions have relatively little taxable income under today's conditions of high interest rates for depositors and policyholders.

It is, of course, all to the good if the large business corporation can be induced to enter the low cost housing field. But, as the President of a large mutual savings bank, which is vitally interested in the whole problem, I find myself asking "How can we do our part?"

If it is true that we seem unable to fill a role as builders and owners, could we assist as mortgage lenders?

May I make a suggestion?

The bill now provides that the Federal National Mortgage Association is authorized to purchase the 2% mortgages in an initial amount of $500,000,000. This naturally means that the Treasury must raise this very substantial sum. Would it be advantageous to provide that the mortgage could be sold to a private lender and that the Treasury would be authorized to supplement the interest payments? In other words, the Treasury could determine the going interest rate on mortgages and thereupon add to the 2% paid by the owner. If the Treasury added 4% the resulting 6% mortgage could be sold to private lenders through normal channels. The drain on the Treasury would be very much reduced.

An alternative, which would be similar to the tax incentive proposal in your bill, would be to make the mortgage interest tax-exempt, similar to a municipal bond. There seems to be some precedent for this in tax-exempt Housing Authority bonds. This arrangement would permit the Treasury supplement to be substantially less.

If the foregoing suggestions are of any interest, I would be glad to set them forth in further detail and would be happy to respond to any request that you may have.

Sincerely yours,

ALFRED S. MILLS, *President.*

PITTSBURGH PLATE GLASS CO.,
Pittsburgh, Pa., September 1, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR KENNEDY: This is in reply to your letter of August 11. We have conducted an initial review of the two Senate bills which you introduced having to do with private investment in urban poverty areas. We certainly concur that there is a great need both for government action and for private action in seeking solutions to our present urban crisis. Recognition of the role that business must play in this area is constructive.

Incentives such as tax credits, accelerated depreciation, and special deductions could affect investment decisions. As location decisions are made in the development of a company's capital investment program, consideration should of course be given to numerous factors, including the ideas embodied in S. 2088 and S. 2100, along with other proposals that may be advanced.

As you have probably already noted from the Congressional Record PPG Industries, along with a few other major Pittsburgh companies, recently announced a decision to assist substantially in financing a new, limited profit development corporation which will purchase, rehabilitate and either rent or sell hundreds

of residences per year in the Pittsburgh area. We feel that there is a great potential in this type of development corporation for a fruitful cooperation between private interests and government at all levels, in the attack on the problems of deteriorating housing in our urban areas.

Thank you very much for the opportunity to comment on your proposed legislation.

Sincerely yours,

R. F. BARKER, *Chairman of the Board.*

THE MERCHANTS ASSOCIATION OF KANSAS CITY,
September 8, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR KENNEDY: I have read with considerable interest sections of your bills which intend to provide an increase in construction of housing in poverty areas.

First, I am primarily interested in the proposal that provides for the participation of private enterprise in these efforts. I think most of the plans in the past have not utilized this most important function.

Secondly, for ten years I have been preaching the theory that the central area of cities needed new housing if they were going to compete with the explosion to the suburbs and the tremendous increase in shopping centers. To have our central cities be put in the position of being second-grade to high-grade shopping centers is like throwing your assets away.

From these two factors alone I am certain that your bills will receive support from the majority of business men who believe in the private enterprise theory. I want to commend you for thinking of these factors when you produce these two measures.

If I can be of help to you in promoting these interests, it will be a pleasure.

Yours sincerely,

W. G. AUSTIN, *Manager.*

THE GILLETTE CO.,
Boston, Mass., September 8, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR KENNEDY: Reference is made to your letter to Vincent C. Ziegler in regard to Senate Bills 2088 and 2100. Mr. Ziegler will be out of the country for an extended period of time and has asked me to respond to your letter.

The bills that you propose recognize the need for further national commitment of public resources to operate in conjunction with an attractive investment climate for private capital. If we are to resolve the complex urban problem, it must be within a framework that stimulates investment in the intercore city or ghetto because it is "good business." In the final analysis, it is the private sector and a healthy business climate that will provide the jobs and the job training necessary to reduce the numbers of urban poor, and then sustain an economy in which they can progress.

We commend you for this creative and imaginative approach, but would like to point out that the application of your legislation (S. 2088) does not appear to relate to our particular type of operation. We have invested many years of technical talent and experience to mass produce quality consumer products. It has been necessary to concentrate large numbers of employees and equipment into an integral complex of fabrication, assembly and the many supporting auxiliary services necessary in a mass production program. We could not possibly fragment our production programs at this time, and space requirements have restricted warehouse expansion in a concentrated urban area.

The recognition that the Federal Government must play a more meaningful role cannot be denied, and we as a company will continue to be sensitive to our community needs by active participation and investment in the resolution of social and civic problems in each area in which we function.

Both of your bills warrant further study not only by this company, but by all business activity, in order that a broad national awareness can be developed.

The methods suggested could stimulate business investment and involvement heretofore considered to be outside the scope of normal business activity. I have requested the Greater Boston Chamber of Commerce, with whom we work very closely, to examine your proposals further.

We appreciate your interest in seeking the views of our company.

Sincerely yours,

D. M. DE HART.

URBAN HOUSING ASSOCIATES,
Columbus, Ohio, September 12, 1967.

Re: S. 2100.

Finance Committee,
U.S. Senate,
Washington, D.C.

GENTLEMEN: After a complete examination of the subject proposed Senate bill, I respectfully submit my unqualified endorsement.

The essence of this bill is to motivate larger corporations to assist in the development of low-income housing.

We need private industry to help solve the problem of low-income shelter in our country. Private industry needs profits in order to survive, profits either in taxable dollars or in tax shelters. It has been demonstrated that the existing programs in low-income housing have not been sufficiently attractive to cause great amounts of risk capital to be invested by private enterprise.

In the course of our activities as Real Estate Consultants, we are repeatedly encountered with this problem. The non-profit sector, such as churches, civic groups, which are organized to develop low-income housing, have little or no capital to invest; and, as a result, what begins with strong enthusiasm typically results in disappointment, only for the lack of capital. In each case where we have been able to attract larger corporations (builders and developers) to participate in the low-income housing field, where capital is expended, where administrators with proper economic orientation have been involved in a project, it has been brought to a successful fruition. Clearly, we need the larger entities to become involved, to expend capital, to provide either technical personnel or funds for the payment of technical personnel and to adequately research, plan, and coordinate low-income housing projects.

The investment credits, the ten-year accelerated depreciation, the waiver of capital gains when the project is held for ten or more years, the long-term amortization, and the provisions for the conversion of building tenants into management corporations, are inducements to the development of safe, decent, and sanitary housing for low-income families.

The concept is imaginative, progressive, economically and socially justified; and, if properly applied, could serve as a mechanism for private enterprise with government assistance to make some progress to alleviate the major problems of our cities.

We are firmly convinced that private enterprise, without incentives as set forth in S. 2100, will not answer the challenge that low-income housing presents. We are further convinced that it is government's obligation to provide these incentives so that private enterprise, while receiving reasonable and competitive profits on investment, can help alleviate an ever-pressing and omnibus social condition.

To crystallize my endorsement of this type of government and private sector participation in solving a problem, I respectfully present that low-income housing is the greatest unfilled market of any part of the economic needs of our country. This need is not being filled by private enterprise because there is not sufficient economic justification for risks in capital investments. If provisions are made by such far-reaching legislation as those which S. 2100 can provide, then I believe that private enterprise will become vigorously involved in meeting the demands of this market.

The tax abatement section of the bill is a major step to involve the cities and states, by underwriting a portion of real estate tax cost. This feature can reduce rents, making good housing available at a cost many can afford.

Low income housing is a social problem. However, S. 2100 can do much to attract the private sectors' help, as well as an opportunity to earn profits while performing a service for the common good.

The present need for low-income housing has reached its present proportion, not entirely because of a lack of funds or programs, but largely to a lack of motivation on the part of those who could implement the programs. When private enterprise is motivated by a reasonable and competitive profit, all facets of any given industry will impel with great force, "a get the job done" attitude.

Give private enterprise the "tools" and the incentives to apply their proven ability. These "tools" and incentives are incorporated in S. 2100.

Respectfully submitted.

ANTHONY F. MOLLICA, A.S.A.
JAMES P. SMILEY.

NATIONAL ASSOCIATION OF BROADCASTERS,
Washington, D.C., September 12, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: Our Secretary-Treasurer, Mr. Revercomb, has requested me to respond to your letter to him of August 29th. I appreciate this opportunity to comment on the proposals which you have made recently for the encouragement of private investment in urban poverty areas.

In my opinion the three premises underlying the measures which you have introduced are sound. Certainly unemployment must be eliminated and full participation of private enterprise is essential to a solution of the urban crisis.

Your proposals are very imaginative and appear to have great merit. Tax incentives and low interest loans should offer very realistic encouragement to business enterprise to create new jobs and to construct new housing in low income areas.

Although our Association has taken no position on legislation concerning these subjects, I shall call the attention of our members to it.

Again I want to thank you for your consideration in writing to the National Association of Broadcasters.

Sincerely,

PAUL B. COMSTOCK.

UNIVERSITY CIRCLE DEVELOPMENT FOUNDATION,
Cleveland, Ohio, August 29, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR: You were thoughtful to send me the two Senate bills that you have introduced to induce private investment in urban poverty areas. I have read sketchy news media reports on these measures previously and appreciate the opportunity to examine them carefully.

While we are a non-profit corporation chartered to the development of Cleveland's cultural center it is not possible for us to invest directly in the poverty areas. This is not to say however that we do not have a substantial interest. The Cleveland Hough area abuts University Circle on our northwestern boundary, and we strongly feel that our cultural hub can only reach its full potential if the neighborhoods that surround it are strong and viable. We feel that what strength we have should be shared with these neighborhoods. As evidence of this conviction we have for years been acquiring lands for educational and medical purposes. These acquisitions qualify the City of Cleveland for $2.00 matching Federal credits for each $1.00 we spend. This is under the Section 112 provision of the Housing Bill.

To date we have generated $15,000,000 in such credits for use in the Hough community under the University-Euclid urban renewal project. We have been appalled at how little has been accomplished with these funds. Barely a dent has been made in the eradication of poverty neighborhood conditions.

We feel that straight traditional government action on this front has failed, and a new approach, such as the type you propose must be tried.

It has been demonstrated in Cleveland that the industrial and commercial community does have an interest in these problems, and I believe the incentives that you propose will cause them to become involved, and on a large and meaningful scale.

We will watch with interest the progress of your proposals. Should more information on our experiences be helpful please let me know.

Sincerely,

NEIL J. CAROTHERS, *President.*

EASTERN GAS & FUEL ASSOCIATES,
Boston, Mass., September 14, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate, Washington, D.C.

DEAR SENATOR KENNEDY: I was very impressed with the information you sent me on the two bills which provide incentives for business investment in urban poverty areas. There is no question in my mind that your proposals will add a unique and needed dimension to the tools which are available for solving the tragic plight of our cities.

As you point out in your speech, private enterprise builds almost all housing, but the vast need for housing in the inner city is not being met simply because the economics of housing development there is not attractive to business. The federal programs now available, such as 221-d3, have not begun to fill the need and, in many instances, without rent supplements or other rent cost abatements, cannot be offered at rates to accommodate the really poor.

I have been involved in housing and urban renewal matters for a number of years now, and have found that the problem, as you so adequately state, is that we are unable to produce the cubage of residential sections necessary for housing the poor at a cost they can afford. There seems to be two reasons for this.

In the first place, the financial carrying costs put the units out of range of the poor. Here your 2 percent interest rate, with 50-year financing to give a 3.2 percent constant, and your abatement of taxes go a long way toward solving this problem. As a matter of fact, our financial people looked at the figures on a number of 221-d3 housing projects in the Boston area and found that with only these two changes—the financing and abatement of taxes—rents would be $20 to $30 cheaper per month. Or to put it another way, rents would be $240 to $360 less per unit per year.

Secondly, as I pointed out earlier, most businessmen have felt it not advantageous to invest in such ventures because they promise, at best, an extremely low rate of return and quite possibly no profit at all. Here I find that the provisions in your bill—tax credits, a fast depreciation write off, the "corporation conduit" change in sub-Chapter S, the capital gains provision on all resales, and particularly the insurance fund—should substantially answer business' hesitation in becoming involved in urban housing for the poor.

Furthermore, the home management fund is a novel and needed instrument. More often than not, sponsors of 221-d3 housing have not fully understood the management costs.

Your proposal sensibly recognized that management and maintenance are major problems of all rental properties, particularly in the case of tenants whose experience has only been with landlords who provide little of each.

The home management fund, which would allow for organizing the tenants into management corporations to provide management and maintenance functions at a fee to the project, is a self-help effort, which should cut down considerably on management costs as well as assisting in the economics. Also, it would develop pride among the tenants in their living quarters and surroundings. Sponsors of 221-d3 in the Boston area with whom we have discussed the proposal are quite enthused with this aspect of the bill.

In connection with upkeep of the project and surrounding areas, you might consider sponsorship of a program for federal-state incentives for municipal services. For example, each time a city had received approval from HUD for a housing project it would then be eligible for a direct grant from the state and federal government to support extra municipal services for the project and surrounding areas. Of course, here one would have to include the standard government maintenance of effort clause, and the proportion of federal-state funds would have to be determined. In any event, this would provide direct assistance to cities for needed municipal services—police, garbage and trash collection, maintenance, street cleaning, lighting, beautification, recreation, etc.—which, with a declining tax base, all cities are in dire need. Also, it would act as a buffer to decay and an enhancement to neighborhood pride.

I was pleased to read that both the industrial development and housing proposals call for the tapping of various federal funding sources to concert services

and programs. I hope that the administrators of this program, if approved, will make the coordination of various services one of their major concerns since it is a very important aspect of the program.

I think our firm would be seriously interested in becoming involved in the programs. Of course, no two investors calculate profitability of potential investments in exactly the same manner. However, the time value of money, that is the length of time between initial investments and return cash flow, is significant. When simple rates of return and time values are equated, prospects built under the housing proposal would be equal to our rate of return for new projects if the investment credit were raised from 3 percent to 7 percent for the first step. Progressively, I might suggest that the credit could be raised an additional 1 percent for each 5 percent increase in equity. The final percentage for a 100 percent equity investment would be 23 percent. The 7 percent starting figure for the first holder would be the same as the proposed credit allowance on all expenditures for constructing industrial property under the industrial investment bill.

It might also be advantageous to allow a ten-year investment credit carry over in the housing bill instead of the regular seven-year carry over. This too is allowed for in the industrial investment bill and would act as an additional minor incentive to businesses which require high capital expenditures to keep up with automation or technological improvements and who may not be able to utilize such credits within the regular carry over period.

One question that will probably come up during the bills' discussion is whether adding more complexities to our tax code is the proper way of going about a program such as this. Some might say that a more facile way would be to grant outright subsidies similar to a grant program through OEO or other domestic agencies. I would opt for the former since we have a long history, since Wilson at least, of bringing about social change through alteration of our tax structure. While it would be an important and useful process to evaluate thoroughly our terribly complex tax structure and make it less complicated, the problem we are now facing in our cities calls for immediate action. We can't delay. Furthermore, the alienation which we are now witnessing, albeit the result of centuries of prejudice, comes down in the final analysis to the fact that all our citizens are not sharing in the blessings of our economic and social system. One way, and a way which you explain so well in your summaries of the bills, is to bring private enterprise into the ghetto. It's a tool that hasn't been used enough and it should be. I congratulate you on your progressive legislation.

In connection with this, you may be interested in the extremely favorable and successful response to a first-of-its-kind project just set in motion jointly by Boston Gas Company and the Boston Redevelopment Authority. This is a Home Improvement Center in the Charlestown section of Boston where Boston Gas Company supplies not only gas but electricity. At this BRA center, the Gas Company has designed and installed, with the cooperation of some companies in the home building field, a "house within a house" displaying a variety of ways of home improvement inside and out. In the same Center are BRA rehabilitation and financing information personnel available to Charlestown residents wishing to rehabilitate their homes under the federal program. This provides an attractive, all-embracing, one-stop facility where a home owner can get all the specific information and help he needs to go forward with the project. So far as we know, and in the belief of Edward J. Logue, former Boston Redevelopment Administrator here, it is the first example of joint public-private effort of this kind.

I enclose some editorial comment on this from the Boston Herald Traveler and Christian Science Monitor.

With best of personal regards.

Cordially yours,

ELI GOLDSTON.

STATEMENT OF SENATOR WILLIAM PROXMIRE, ON BEHALF OF AMENDMENT 312 TO S. 2100, BEFORE THE SENATE COMMITTEE ON FINANCE

DEPRECIATION OF SLUM PROPERTY

I appreciate the opportunity to submit this statement in support of Amendment 312 to S. 2100. The amendment, which I introduced on September 13, would deny the benefits of depreciation on Federal income taxes to property owners who fail to maintain their property in accordance with local housing codes.

This proposal was recently advanced by the Mayor of Boston, John F. Collins, when he testified before the Banking and Currency Committee on housing legislation. Mayor Collins testified on behalf of the National League of Cities. The suggestion to deny tax benefits ot slum landlords was also made by the Architects Renewal Committee in Harlem, Inc., in testimony presented to the House Banking and Currency Committee in 1966.

I believe the denial of tax benefits to slumlords who persistently violate housing codes can be an effective inducement to better housing in the urban ghettos. The Senate Banking and Currency Committee has been striving for years to insure that Federal housing programs are not rendered ineffective by lax code enforcement. In 1964 the Committee inserted a provision in the Housing Act which required an effective code enforcement program to be a part of the community's workable program. Beginning in July 1967, the Secretary of Housing and Urban Development, in certifying a community's workable program, must also determine the community has an adequate program of local code enforcement.

It is, therefore, national policy on the part of the Federal government to encourage adequate code enforcement activities on the part of local governments. I believe that the proposal to deny Federal tax benefits to code violators is in keeping with this national policy. It would strengthen the hands of local officials and provide for a more effective program of local code enforcement.

I have, therefore, introduced this amendment to S. 2100, Senator Kennedy's tax incentive housing bill. The amendment would amend section 167 of the Internal Revenue Act requiring that before any deductions for depreciation of any real property could be allowed, the owner of the property would have to certify the property is not in violation of any law, code, or regulation which is required to be in effect as part of the community's workable program. Thus, this amendment to the Internal Revenue Act would strengthen the provision contained in section 101(c)(2)(A) of the Housing Act of 1949.

In order to illustrate the working of this proposal, assume a slum building is purchased for $200,000. Of this amount, the owner may pay $80,000 in cash and finance the other $120,000 by a mortgage. Let us further assume that the interest on the mortgage, taxes, utilities and other expenses come to $25,000 per year, and that the yearly rentals come to $45,000 per year. Thus, the owner would earn $20,000 per year on his original cash investment of $80,000. If the useful life of the building is 20 years, under the straight line depreciation method he could deduct $10,000 against his income and pay taxes on only $10,000. Thus, depending upon the owner's tax bracket, he could save from $2,200 to $4,800 on his tax bill through the depreciation deduction. Thus, the denial of this benefit could be a material inducement in persuading the owner to spend the $1,000 to $2,000 needed to maintain the property adequately.

Very often local penalties range from $50 to $100 for code violations. These are the quicker the write-off. Thus a landlord who regularly makes needed repairs consequently ignored. However, the denial of Federal tax benefits is a much more powerful potential loss. It would make an owner think twice before he would let his property run down.

It might be argued that it is improper to use the tax system to accomplish social or economic objectives. This argument might be valid if the existing Internal Revenue Code was neutral in its effect. However, a good case can be made that the Federal tax code itself provides a built in incentive to the continued operation of slum property. One careful student of the effect of our Federal tax laws on slums has concluded that our tax laws increase the profitability of operating slum housing, encourage inadequate maintenance expenditures, and discriminate against new construction as an alternative real estate investment. In developing a case for a thorough reform of our real estate tax laws, the same author concluded: "The case is one in which the tax itself is actively contributing, in the operation of certain of its provisions, to the propagation and persistence of socially obnoxious conditions. If that is so, the logically compelling place for remedial action is with the tax itself." [1]

How do Federal taxes breed slums?

First of all, the depreciation policies of the tax code encourage irresponsible maintenance. A real estate investor normally seeks to write off his investment as rapidly as possible. The shorter the remaining economic life of the structure,

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[1] Arthur D. Sporn, *Income Taxes and the Growth of Slums*, 59 Columbia Law Review 1026, 1063 (1959).

the quicker the write-off. Thus a landlord who regularly makes needed repairs undermines his case for a shorter estimated building life and a faster write-off. There is a built in incentive not to make repairs.

Second, the accelerated depreciation provisions of the Code permit an investor to_write off a property much faster than the actual decline in market value. However, it is then possible to sell the property to another investor who can obtain an additional round of liberal depreciation deductions. Moreover, the profit to the original investor is taxed at favorable capital gain rates. These tax provisions encourage a perpetual series of short term investors who seek only to milk the property of its tax benefits. A tax system which encourages short term ownership and prompt disposal is hardly conducive to sound maintenance policies.

Third, the tax provisions favor investments in used buildings as opposed to new construction. The shorter estimated life on used property permits more rapid tax write off of the initial investment. Thus the depreciation provisions weaken the incentive to increase the total supply of housing through new construction.

Fourth, the code prohibits depreciation deductions for the cost of land and land clearance expenses. Such costs are a substantial and growing percentage of total new construction cost. Although the same provisions apply to used property, the investor has much wider latitude to allocate the cost of the investment between the land and the structure. Naturally the more he can allocate to the structure, the greater his depreciation deduction. Land acquisition and preparation costs are a matter of record on new construction projects, but are a matter of judgment on used property. Thus a real estate investor seeking to maximize his tax advantages is given one more incentive to invest in used property rather than new construction.

In view of the biases in the tax code which work to perpetuate slums, I believe it is entirely reasonable to use the same tax code to help correct a problem which it, in part, has helped to create. By conditioning depreciation tax benefits upon adequate maintenance practices, we would merely remove one of the incentives to irresponsible maintenance which the tax code itself fosters. My proposed amendment would thus neutralize and offset a pernicious effect of the code.

My amendment would also bring the tax code into harmony with the Housing Act of 1949, as amended. It is somewhat anamolous for the Federal government to require effective local housing code enforcement as a condition of Federal aid, while at the same time, undercutting such enforcement through the Internal Revenue Code.

I believe our entire real estate tax policies need to be thoroughly reexamined and updated. I am hopeful that the Department of the Treasury will give adequate consideration to this problem when it prepares its recommendations for tax reform to be submitted later in the session. But in the meantime, I believe my proposal would do much to redress the imbalance our tax laws have created.

Statement of Lawrence M. Stone, Tax Legislative Counsel Under President Johnson, Professor of Law, University of California, Berkeley, Calif.

I am glad to support S. 2100, The Urban Housing Act of 1967 and to offer suggestions for improvement of its tax incentive provisions. Through a variety of means, S. 2100 seeks to engage the resources and energies of private investors in the construction and rehabilitation of low and moderate income housing in urban poverty areas. One of the principal incentives would be a series of federal income tax benefits aimed at allowing such investment to earn competitive rates of return. My comments deal only with these tax incentives and are directed at three principal questions: (1) Is it appropriate to use tax incentives to accomplish the aims of the bill? (2) Are the tax incentives used in S. 2100 the best tax concessions that can be used to attain its goals? (3) Do these tax incentives avoid the serious defects and dangers normally associated with tax incentives?

In my opinion the urgency and monumental size of the problem that our nation faces and which the bill aims at, the disgrace and injustice of urban slums, justifies the use of all available solutions including tax incentives provided that:

(a) Such tax incentives will be effective to accomplish the goals;
(b) Will not be wasteful or less efficient than other *possible* approaches;
(c) Will not result in unnecessary windfalls to private investors and

(d) Will be limited in time and *measurable* in terms of cost so that they will continue in existence only after Congressional review.

While tax incentives are frequently proposed as the solution to many of our social and economic problems, rarely do the proposals satisfy tests such as these. The numerous tax incentives and preferences already in the Internal Revenue Code are often inefficient, ineffective, and the cause of misallocation of resources in our economy. However, this does not mean that we should adopt an inflexible rule that would rule out use of our tax system to accomplish those goals for which it is the best available tool and where the tax incentive can be tailored to avoid waste or windfalls and is limited in time and measurable in cost.

I believe S. 2100 meets most of these tests and can be modified to meet all of them. I therefore support the bill. I am, however, assuming that adequate evidence in support of the bill will be presented that will demonstrate its effectiveness in attracting private investors, its financial feasibility and the absence of other methods equally feasible but less costly.

The tax incentives offered by S. 2100 would be available only to those who are certified by the Secretary of the Department of Health, Education, and Welfare. This is an important safeguard usually absent from most tax incentives proposed or existing. Furthermore, the construction or rehabilitation must take place in urban poverty areas. Private enterprise does not normally invest in these areas. This is an additional safeguard to insure that these tax benefits go only to those who are acting as a result of the bill. The bill is therefore not wasteful in the sense of benefiting unintended recipients.

The bill has a limited life, namely 15 years. This plus the fact that the Congress will have to provide other necessary direct Federal funds that are part of the program, insures that S. 2100's system of tax incentives will not endure in our tax system long after they have ceased to be required or to serve any purpose. If the tax incentives are extended to projects after the first 15 years, it will be because Congress has reviewed the program and decided that it warrants extension.

The tendency for tax incentives once enacted to endure without review is one of the most serious defects of the use of the tax system for incentive purposes. S. 2100 avoids this defect.

Finally, the bill effectively limits profits of private investors through control over both rental charges and possible gain through sale or exchange of the property. The latter is achieved through the option granted to home management corporations owned by tenants to purchase each of the properties at a price equal to the remaining mortgage plus the investors' original equity. This to a large extent eliminates possibilities of windfall profits and therefore further safeguards against windfall tax savings.

SUGGESTED MODIFICATIONS

However, I do have suggestions for changes which I believe might make the tax incentives more effective in achieving the goal of attracting private investment while at the same time making them more acceptable from the viewpoint of sound tax policy.

The bill provides three basic tax incentives which I will not describe in any detail. The first is a sliding scale investment tax credit against the cost of qualified projects. This provides the investors with a credit against their tax liabilities in the year in which they acquire the property ranging from 3 to 22% of cost in the case of the first holder and 2 to 22% for subsequent holders. Second, drastically shortened lives can be used for tax depreciation purposes. This would result in extremely rapid tax writeoffs of the properties and produce tax losses to be deducted from other incomes of the investors. Finally, potential gains realized on sale of such properties would either be exempt from tax in the case of sales to a home management corporation or subjected to only a capital gains tax on the excess of the sales price over remaining loan which could be substantially less than the true gain on the sale where the property has been depreciated below the amount of the remaining loans outstanding. (There are also other provisions designed to make the use of so-called Subchapter S corporations possible for investments in qualified housing. These are of lesser importance and raise no problems.)

It is unlikely that these projects will earn taxable income in view of the rental charge limitations. The tax benefits are therefore intended to offset tax liabilities of the investors attributable to income from other sources. This is certainly

true of the investment tax credit and the losses that will result from the rapid depreciation. The exemption of (or very limited taxation of) gain on sale of such properties is merely designed to prevent the loss or reduction of the previous depreciation benefits.

The bills, therefore, encourages only those taxpayers who have substantial tax liabilities from other sources. Thus, exempt organizations, such as foundations, pension trusts, churches or universities would find the tax incentives of no interest. These possibly important sources of private funds would be beyond the attractions of the bill.

In the case of the depreciation benefits, the value of the depreciation losses will vary with the tax bracket of the investor. Thus, to an individual in the 70% bracket, the tax saving would be worth 70 cents for each dollar of loss; 48 cents to a corporation with income above the $25,000 level and no investment credits; and possible as little as 24 cents to a large corporation with heavy investment credits available (the corporation would be in the 48% bracket but could use its investment credit to offset up to one-half of its tax liability, thereby reducing its effective rate of tax to 24%). The effective tax rates of many other industries also vary from the norm—commercial banks, insurance companies, oil producers and so forth.

Two conclusions emerge from these differences in the value of the depreciation losses to different taxpayers. First, if the incentives of the bill are made sufficiently attractive to lure investors whose effective rates are low, windfalls will probably be produced for those with higher marginal rates. Second, the costs of the bill (revenues lost) will be very difficult to measure. Therefore it would be difficult to ever evaluate or review the program and to judge its efficiency. Both of these are serious defects.

Many of these problems might be reduced or eliminated if it were feasible to modify the tax incentives of the bill as follows:

a. Provide *annual* tax credits in lieu of the depreciation benefits. These annual tax credits could be based on the equity of the investors and the remaining loan and geared to bring the rate of return on the investment to any desired level after loan amortization payments.

b. In order to make the tax incentives available equally to all potential investors regardless of whether they are exempt from taxation or not, or regardless of their effective rate of tax, the tax credits offered, both the initial and annual credits, should be available either to offset existing tax liabilities or, if none, they should serve as the basis for a tax refund. Thus if an exempt pension plan invested in qualified housing, it should receive a tax refund in the amount of the available investment credit. Since all investors would receive the credit regardless of tax liabilities, the precise revenue costs of the bill would be determinable quite easily.

c. Since the properties will most likely never produce taxable profits, little, if anything, would be lost if the profits from the operation of qualified properties were simply made tax exempt. With regard to gain or sale, rules similar to those contained in the bill could probably be adapted to this approach.

If an approach such as that outlined were feasible, it would, in addition, to alleviating problems already mentioned, have the tremendous advantage of simplicity. The tax provisions of the bill while imaginative and skillfully drawn, are extremely sophisticated and complicated. A simple tax credit system designed to bring the rate of return up to desired uniform levels would be easier to comprehend, easier to take account of and therefore likely to attract more investors—especially those not having the benefit of highly sophisticated tax advisors.

I hope that these comments and suggestions will be of help to the Committee.

FORD MOTOR CO.,
Dearborn, Mich., September 15, 1967.

HON. RUSSELL LONG,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR MR. LONG: I am writing this letter for submission in the record of the hearings by the Senate Finance Committee on two bills introduced by Senator Robert Kennedy and a number of co-sponsors: S. 2088, the Urban Employment Opportunities Development Act; and S. 2100, the Urban Housing Development Act. Both proposals are intended to provide incentives for private industry to

get fully engaged in the fight against urban poverty, a goal to which I am deeply committed.

In meeting our nation's problems, there are some things government can do best, some things industry can do best and some things that can best be accomplished through partnership between government and industry. Expanding urban employment opportunities and increasing the supply of low-cost urban housing are two areas where partnerships is obviously the most effective approach.

As a member of the steering committee of the Urban Coalition, I have endorsed that organization's Statement of Principles, Goals and Commitments (copy attached). This Statement recognizes that American cities are now facing a grave crisis, and calls for the dedication of all necessary resources, both by the government and the private sector, to meet the challenge as rapidly and effectively as possible.

The businessmen who have endorsed the Statement of the Urban Coalition, have committed themselves to help deprived citizens to become productive members of the nation's work force. We have pledged to provide expanded job-training and employment for urban residents and managerial assistance and basic investment in urban development.

Fulfilling this commitment will necessarily involve additional costs to business. In my judgment, however, busines will not and cannot make its maximum contribution to the fight against poverty if its role is viewed as primarily a charitable one. The primary role of business in reducing poverty is to provide jobs, and in order to do this it must stay in business and prosper. We cannot expect broad business response to this challenge unless programs are developed that are consistent with the basic responsibility of business management to control costs and earn profits.

It may appear unseemly to mention costs and profits when urgent human needs are involved, but I am convinced that any approach which ignores these basic economic factors is doomed to failure. The profit motive is an immensely powerful force and useful guide to effective economic action. It must be maintained and brought to bear on the urban crisis. I believe that Senator Kennedy has incorporated this essential approach in his proposed legislation. These bills offer real hope of getting the business community deeply engaged in the fight against urban blight, without great cost to the government.

The enormous task of rehabilitating depressed urban areas will require a reordering of our national goals and a major commitment of resources. Large new programs undoubtedly will have to be undertaken by the Federal, state and local governments. However, if private industry becomes more fully engaged in this effort, governmental spending can be somewhat reduced. Furthermore, the cost of tax incentives would be offset by the reduced welfare payments and increased tax collections resulting from the creation of more and better jobs, increased construction activity and stabilized land values in depressed areas.

I am not an expert in housing and therefore cannot discuss S. 2100, the Urban Housing Development Act, in detail. I believe, however, that the bill is headed in the right direction when it proposes to give private industry adequate financial inducements to move vigorously into the law-cost housing field. I understand that other proposals before the Congress have this same objective, and some of them may also have merit. Whichever approach is chosen, I feel strongly that prompt action must be taken to motivate the private housing industry to build more low-cost housing in depressed urban areas.

In this connection, I hope the Congress will also review current policies and practices which make it difficult for private industry to respond to the housing needs of the poor. For example, outmoded building codes and union restrictions on new techniques and equipment raise building costs and often make it impossible to build low-cost housing at a profit. To the extent that these obstacles are overcome, the need for tax incentives would be reduced.

Another merit of this approach is that it would encourage private construction of low-cost housing wherever it is needed. Although the housing needs of the cities are urgent, most of the poor do not live in cities. Moreover, if low-cost housing is confined mainly to blighted city areas, one result will be to encourage the growth and perpetuation of urban ghettoes. For these reasons, I hope the Congress will try to find ways of encouraging private construction of low-cost housing not only in cities but throughout the country.

With regard to S. 2088, my endorsement of Senator Kennedy's approach can be more specific. Ford Motor Company has, of course, broad experience in plant site selection, hiring and job training. I believe that S. 2088 takes a most promis-

ing approach towards the problem of improving job opportunities for the urban poor.

The key to the success of any program to create jobs in depressed urban areas is to establish incentives which are sufficient—but only sufficient—to compensate businesses for the special risks and costs of locating within those areas. Senator Kennedy's proposal for tax incentives appears to me to create an appropriate inducement to business, at minimal cost to the government. I believe it will encourage a large number of employers to locate facilities and provide more jobs in depressed urban areas.

There are, however, a number of specific problems in connection with S. 2088. Among the most troublesome is the bill's limitation of tax incentives to employers who will hire a minimum of fifty workers. In my opinion, smaller facilities will frequently offer the best opportunities for employment in depressed areas; indeed, the establishment of large plants may not be feasible because of lack of acreage, high land cost, high local taxes, inadequate transportation, etc. On the other hand, our experience shows that there are large opportunities for the establishment of automotive diagnostic centers and repair facilities, television repair shops, and other job-creating businesses that would not ordinarily employ as many as fifty workers.

We recognize that the minimum employment requirement, along with the ban on aid for retail establishments, was inserted in order to avoid giving new facilities an unfair competitive advantage over stores already in the area. In our opinion, however, this worthwhile objective should be achieved through other techniques that would not seriously limit the creation of new job opportunities.

Some other difficulties with S. 2088 include the following points:

1. Further thought should be given to the bill's requirement that the companies must employ a high percentage of people who live in the depressed area. This could encourage people to move into such areas, which are already overpopulated, or could discourage some employes from moving to homes in other parts of the community.

2. It is obviously undesirable for the tax benefits to be continued beyond the point when they are justified. Indefinite continuation of employment incentives could lead to artificial economic communities and to the kind of economic and social separation between poor people and others that the bill is intended to eliminate. Perhaps the period of inducement in each area or to each new business operation should be limited.

3. For the same reason, and also to provide needed help for the poor who do not live in cities, the Congress should consider limited-duration tax incentives for employers to hire and train disadvantaged persons without regard to the location of the business.

4. The program should contain incentives to upgrade the skills of workers within a reasonable period of time.

5. Consistent with important features of S. 2100, consideration should be given to the abatement of local real and personal property taxes, and provision should be made for recovery of demolition and site clearance costs through depreciation. Otherwise, the high cost of land in urban renewal areas, combined with the high tax rates in most cities, could be a major obstacle to the location of plants in blighted areas, especially since less expensive land, subject to lower tax rates, is usually available in suburban areas.

In listing these difficulties with S. 2088, I by no means intend to qualify my enthusiasm for the bill's basic approach. I believe it offers real promise of meeting one of the nation's most critical needs.

By taking time for these hearings, in the midst of an extremely busy schedule, your committee has demonstrated its recognition that America can no longer delay effective action to solve the critical problems of its depressed urban areas. I hope that legislation in this field will be enacted promptly.

Very sincerely,

HENRY FORD II.

STATEMENT OF PRINCIPLES, GOALS, AND COMMITMENTS—EMERGENCY CONVOCATION: THE URBAN COALITION

We are experiencing our third summer of widespread civil disorder. In 1965, it was Harlem, and the disaster of Watts. In 1966, it was the Hough area of Cleveland, Omaha, Atlanta, Dayton, San Francisco and 24 other cities. This summer,

Newark and Detroit were only the most tragic of 80 explosions of violence in the streets.

Confronted by these catastrophic events, we, as representatives of business, labor, religion, civil rights, and local government, have joined in this Convocation to create a sense of national urgency on the need for positive action for all the people of our cities.

We are united in the following convictions:

We believe the tangible effects of the urban riots in terms of death, injury, and property damage, horrifying though they are, are less to be feared than the intangible damage to men's minds.

We believe it is the government's duty to maintain law and order.

We believe that our thoughts and actions should be directed to the deep-rooted and historic problems of the cities.

We believe that we, as a nation, must clearly and positively demonstrate our belief that justice, social progress, and equality of opportunity are rights of every citizen.

We believe the American people and the Congress must reorder national priorities, with a commitment of resources equal to the magnitude of the problems we face. The crisis requires a new dimension of effort in both the public and private sections, working together to provide jobs, housing, education, and the other needs of our cities.

We believe the Congress must move without delay on urban programs. The country can wait no longer for measures that have too long been denied the people of the cities and the nation as a whole—additional civil rights legislation, adequately funded model cities, anti-poverty, housing, education, and job-training programs, and a most of others.

We believe the private sector of America must directly and vigorously involve itself in the crisis of the cities by a commitment to investment, job-training, and hiring, and all that is necessary to the full enjoyment of the free enterprise system—and also to its survival.

We believe the sickness of the cities, including civic disorder within them, is the responsibility of the whole of America. Therefore, it is the responsibility of every American to join in the creation of a new political, social, economic, and moral climate that will make possible the breaking of the vicious cycle of the ghetto. Efforts must be made to insure the broadest possible opportunity for all citizens and groups, including those in the ghetto, to participate fully in shaping and directing the society of which they are a part.

This Convocation calls upon the nation to end once and for all the shame of poverty amid general affluence. Government and business must accept responsibility to provide all Americans with opportunity to earn an adequate income. Private industry must greatly accelerate its efforts to recruit, train, and hire the hard-core unemployed. When the private sector is unable to provide employment to those who are both able and willing to work, then in a free society the government must of necessity assume the responsibility and act as the employer of last resort or must assure adequate income levels for those who are unable to work.

EMERGENCY WORK PROGRAM

This Convocation calls upon the Federal Government to develop an emergency work program to provide jobs and new training opportunities for the unemployed and underemployed consistent with the following principles:

The Federal Government must enlist the cooperation of government at all levels and of private industry to assure that meaningful, productive work is available to everyone willing and able to work.

To create socially useful jobs, the emergency work program should concentrate on the huge backlog of employment needs in parks, streets, slums, countryside, schools, colleges, libraries, and hospitals. To this end an emergency work program should be initiated and should have as its first goal putting at least one million of the presently unemployed into productive work at the earliest possible moment.

The program must provide meaningful jobs—not dead-end, make work projects—so that the employment experience gained adds to the capabilities and broadens the opportunities of the employees to become productive members of the permanent work force of our nation.

Basic education, training, and counseling must be an integral part of the program to assure extended opportunities for upward job mobility and

to improve employee productivity. Funds for training, education, and counseling should be made available to private industry as well as to public and private nonprofit agencies.

Funds for employment should be made available to local and state governments, nonprofit institutions, and Federal agencies able to demonstrate their ability to use labor productively without reducing existing levels of employment or undercutting existing labor standards or wages which prevail for comparable work or services in the area but are not less than the Federal minimum wage.

Such a program should seek to qualify new employees to become part of the regular work force and that normal performance standards are met.

The operation of the program should be keyed to specific, localized unemployment problems and focused initially on those areas where the need is most apparent.

PRIVATE EMPLOYMENT, ASSISTANCE, AND INVESTMENT

All representatives of the private sector in this Urban Coalition decisively commit themselves to assist the deprived among us to achieve full participation in the economy as self-supporting citizens. We pledge full-scale private endeavor through creative job-training and employment, managerial assistance, and basic investment in all phases of urban development.

The alternatives to a massive and concerted drive by the private sector are clear. They include the burden of wasted human and physical potential, the deterioration of the healthy environment basic to the successful operation of any business, and the dangers of permanent alienation from our society of millions of citizens.

We proposed to initiate an all-out attack on the unemployment problem through the following steps:

In cooperation with government, to move systematically and directly into the ghettos and barrios to seek out the unemployed and underemployed and enlist them in basic and positive private training and employment programs. We will re-evaluate our current testing procedures and employment standards so as to modify or eliminate those practices and requirements that unnecessarily bar many persons from gainful employment by business or access to union membership.

To create a closer relationship between private employers and public training and emergency employment programs to widen career opportunities for our disadvantaged citizens. To this end, we will proceed immediately to promote "Earn and Learn Centers" in depressed urban areas that might well be the joint venture of business, labor and local government.

To develop new training and related programs to facilitate the early entry of under-qualified persons into industrial and commercial employment.

To develop large-scale programs to motivate the young to continue their education. Working closely with educators, we will redouble our efforts to provide part-time employment, training, and other incentives for young men and women. We also pledge our active support to making quality education readily accessible to deprived as well as advantaged young people.

To expand on-the-job training programs to enhance the career advancement prospects of all employees, with particular emphasis on those who now must work at the lowest level of job classifications because of educational and skill deficiencies.

We pledge to mobilize the managerial resources and experience of the private sector in every way possible. We will expand part-time and full-time assistance to small business development. We will strive to help residents of these areas both to raise their level of managerial know-how and to obtain private and public investment funds for development. We will work more closely with public agencies to assist in the management of public projects. We will encourage more leaders in the private sector to get directly and personally involved in urban problems so that they may gain a deeper understanding of these problems and be of greater assistance.

We pledge our best efforts to develop means by which major private investment may be attracted to the renovation of deteriorating neighborhoods in our cities. We will explore and encourage governmental incentives to expedite private investment. We will develop new methods of combining investment and managerial assistance so that the residents may achieve a leadership position in the development of their areas.

HOUSING, RECONSTRUCTION, AND EDUCATION

This Convocation calls upon the nation to take bold and immediate action to fulfill the national need to provide "a decent home and a suitable living environment for every American family" with guarantees of equal access to all housing, new and existing. The Urban Coalition shall, as its next order of business, address itself to the development of a broad program of urban reconstruction and advocacy of appropriate public and private action to move toward these objectives, including the goal of rehabilitation and construction of at least a million housing units for lower-income families annually.

This Convocation calls upon the nation to create educational programs that will equip all young Americans for full and productive participation in our society to the full potential of their abilities. This will require concentrated compensatory programs to equalize opportunities for achievement. Early childhood education must be made universal. Work and study programs must be greatly expanded to enlist those young people who now drop out of school. Financial barriers that now deny to youngsters from low-income families the opportunity for higher education must be eliminated. Current programs must be increased sufficiently to wipe out adult illiteracy within five years.

This Convocation calls upon local government, business, labor, religions, and civil rights groups to create counterpart local coalitions where they do not exist to support and supplement this declaration of principles.

This Convocation calls upon all Americans to apply the same determination to these programs that they have to past emergencies. We are confident that, given this commitment, our society has the ingenuity to allocate its resources and devise the techniques necessary to rebuild cities and still meet our other national obligations without impairing our financial integrity. Out of past emergencies, we have drawn strength and progress. Out of the present urban crisis we can build cities that are places, not of disorder and despair, but of hope and opportunity. The task we set for ourselves will not be easy, but the needs are massive and urgent, and the hour is late. We pledge ourselves to this goal for as long as it takes to accomplish it. We ask the help of the Congress and the Nation.

This statement was unanimously adopted by members of the Steering Committee and their representatives at a meeting Wednesday, August 23, 1967. Mr. Roy Ash and Mr. Theodore Schlesinger were unable to attend or to be represented.

SALES EXECUTIVES CLUB OF NEW YORK,
New York, September 7, 1967.

Hon ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: We were delighted to receive your letter of August 30 concerning the two bills you have proposed for private investment in urban poverty areas.

To our way of thinking, this is the most sensible program anyone has yet come up with to solve an increasingly serious national problem.

As a matter of fact, we are considering shelving a project to provide consumer information for residents of ghetto areas in order to give our full support to your bills.

Your program recognizes a fundamental fact of American history—that when private enterprise is properly motivated, it can perform wonders. It has made America the great economic power it is today. It can build a greater America for tomorrow by removing our greatest national blight and adding productive new producers to our economic mainstream.

With 3,500 members, ours is the largest business organization in your constituency holding regular luncheon meetings. Our members are the top management executives of companies that would benefit from your bills. And, being master salesmen and communicators, they could add the weight of their influence to passage and implementation of your bills.

Sincerely yours,

HARRY R. WHITE,
Executive Director.

CITY OF COLUMBUS, OHIO,
OFFICE OF THE MAYOR,
August 18, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: I have read your two bills which are designed to increase investment in urban poverty areas. I have also circulated these bills to members of my staff for their review.

I can report to you that the municipal officials in Columbus are greatly enthusiastic over the potential these bills have for eliminating basic causes of urban blight. We have in Columbus for years had a vigorous urban renewal program. However, your bills would stimulate privately built low-income housing and the creation of new industrial jobs which would make our program many times more effective.

Sincerely,

M. E. SENSENBRENNER, *Mayor.*

BUSINESS DEVELOPMENT FUND, INC.,
Washington, D.C., September 7, 1967.

Subject: S. 2088 and S. 2100.

SENATOR ROBERT F. KENNEDY,
Senate Office Building,
Washington, D.C.

DEAR SENATOR KENNEDY: This will acknowledge receipt of your letter dated August 28, together with the enclosures covering the subject Bills that you have introduced.

First, I want to commend you and your colleagues for the very excellent introductory statements that were made and reported in the Congressional Record. Most of my activities are in the field of foreign economic affairs and all I can say is we could use this refreshing type of new approach in our foreign aid program. The role of private enterprise has been neglected far too long. Far too many of our policy makers seem to have forgotten that private enterprise has been the keystone of our economic progress and development.

I offer the following comments on the two Bills that you have introduced.

S. 2088, this is a dynamic approach to a major problem that is facing our country. I am certainly not qualified to make any specific prediction as to what results will be attained by S. 2088. There are many intangibles involved in this program and I would certainly endorse its adoption if, for no other reason than to give the businessman an opportunity to play a role that has been traditionally effective and is the heart of our democratic system.

S. 2100, this is a good idea and I would be prepared to "stick my neck out" and predict that it will produce new housing. It seems to me that the job of our government is to provide a good climate wherein the dynamics of private enterprise and private investment can take over and produce results. This Bill would do just that, although the degree to which it would be effective is of course, difficult to access in advance. Undoubtedly, results will differ by area and no one can predict at this stage, that S. 2100 would clear up slum conditions but this bill is certainly pointed in the right direction.

Sincerely,

JOHN K. EVANS.

METROPOLITAN DETROIT CITIZENS DEVELOPMENT AUTHORITY,
Detroit, Mich., September 11, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: Attached per your request are my views on your bills seeking to bring the resources of private industry to bear on the urban crisis.

Both bills are imaginatively conceived and visionary, yet are pragmatic in approach. The profit incentive reaches out of these bills in a fashion to foster

human development, just as oil depletion allowances foster natural resources development. Walter Reuther often says, "that the problem in solving our ghettos is that those who have the commitment do not have the resources and those who have the resources do not have the commitment." Your package of legislation is a major step forward in overcoming that problem.

Please forgive my delay in responding to your letter of August 30, 1967, but I believed the legislation required more than just a cursory look.

Sincerely,

EDWARD J. ROBINSON,
Executive Director.

VIEWS ON SENATOR KENNEDY'S LEGISLATION

THE URBAN HOUSING DEVELOPMENT ACT

In Detroit, it is estimated that at the current rate of total government investment, it will take conservatively 40 years to rebuild our blighted neighborhoods. It may take 60 years.

Urban America estimates that 215,000 dwelling units will be needed in Metropolitan Detroit by 1980. The current rate of dwelling unit starts will produce 140,000 by 1980.

In Detroit, men of vision like Walter Reuther, Mayor Jerome Cavanagh, Walker Cisler, Henry, Ford, James Roche, Archbishop John Dearden together with the other leaders of the community formed the Metropolitan Detroit Citizens Development Authority with the primary purpose of increasing the supply of low and moderate cost housing by creating an effective partnership with government for nonprofit and profit sponsors of housing. Current Federal law regulating both areas is inadequate to the task.

In the City of Detroit there have been no developers who have taken advantage of the turn-key approach to 221–D3 projects. Senate Bill 2100, the Urban Housing Development Act, provides a legislative breakthrough in bringing the resources of the private sector to bear on the urban housing crisis.

It provides a basis for involvement that no responsible capital group or organization can dismiss lightly. If, in the Detroit area, this legislation only provided an additional 500 low and moderate cost units a year, it would be immensely successful, and I believe it will do at least that.

The legislation strikes a balance between a development for profit incentive and a development of a community with individual ownership as a desirable result. Further, the legislation insures that local residents will have a voice in the structures that will be built in their area, which I believe not only accrues a benefit to the public at large but to the private developer as well. The provision for a new Low-Income Housing Administration is particularly noteworthy and I can cite a few examples of what we do not know about this segment of the housing market.

Without wishing to jeopardise the legislation, there is one area that may be worth some thought and that is the area of technological advance. Here again, if we are to successfully overcome our housing problem, massive amounts of money must be expended on research and development. The federal budget for low-income demonstrations, I believe, is about 1.6 million a year. Greater investment is needed by the government, but an even greater investment is needed by the private sector. While this bill provides some incentive for technological advance by virtue of the fact that if the developer can reduce his costs he may be able to increase his equity and thus receive the greater tax benefits, it is not enough. Rents of from $70 to $100 are still too high and when added to utilities consume too great a percentage of low-income families yearly income.

As an added incentive for private business to invest in Research and Development, I would suggest a 25 percent tax credit for every dollar expended for housing technological research in addition to the existing deduction. And with the passage of this and other housing legislation, the market will develop to allow business to tool up, with this resulting new technology, for mass production on a scale that will insure our ability to produce low cost, quality dwelling units.

The Urban Housing Development Act is a dynamic piece of legislation and we cannot afford to let it gather dust in the burial place of scrapped legislation.

In 1960 the Economic Advisory Committee stated that urban centers are primarily employment centers. In the past decade in the Detroit area the very care of our urban center has witnessed an erosion in employment opportunities as businesses fled to the suburbs to expand and to avoid the high taxes of the center city of the metropolitan complex or as businesses failed and were not replaced. The retail businesses remain a shabby visage of their once proud images as the amount of disposable dollars in the neighborhoods dwindled. The people who remain, who do so because of some handicap or simply because of lack of good employment opportunities, border on the poverty line—if not economic poverty then environmental poverty.

A group of young businessmen in Detroit who call themselves the Urban Dynamics Institute have been working with a team of graduate sociologists from Michigan State University under the leadership of Dr. Christopher Sower, sociologist. They have spent over a year studying and analysing a poverty area in the central city. Their findings thus far, indicate that blight is a mental attitude before it is a physical reality—that a negative perception on the part of residents of the area leads to deterioration of the area. The first negative reaction begins when plants and employment profit centers begin moving out of the area. The rest is downhill.

This bill, while providing jobs for previously unemployed individuals—a salutory feature—does more than that. It will bring about a positive attitude that things are going to improve and in so doing overcome the most compelling fact of poverty—despair.

Several features of the bill are exceptional in their concept. The first is the meaningful training which trains an individual for a specific, guaranteed job. The second is the special deduction of an additional 25 percent of the salaries paid to all workers hired as a result of this act. I have always believed that tax incentives were a proper method for stimulating employment. For example, what would be the employment gain and economic benefit to the nation, if individuals, who employed domestic workers, gardeners and chauffeurs at satisfactory salaries could deduct the salaries and fringe benefits of these workers from their income?

What would be the immediate employment gain if all employers could deduct an additional 25 percent of salaries and wages of net new employees hired in the fiscal year?

This feature in Senator Kennedy's bill is long overdue as an employment stimulation.

The bill is sound legislation and provides another answer to the urban problems confronting us.

THE BENDIX CORP.,
Detroit, Mich., August 23, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: This will acknowledge receipt of your letter of August 14, 1967 relative to the bills which you have introduced in the Senate to provide business with tax incentives to encourage industrial investment in urban poverty areas.

We share your concern as to the necessity of finding solutions to the critical problem of creating new jobs in the urban poverty areas. As a Detroit based company, the management of The Bendix Corporation is especially aware of the necessity of industry and government joining together promptly to find answers to this urgent problem.

With respect to S. 2100, inasmuch as The Bendix Corporation is not engaged in any phase of the housing or construction industry, it would seem inappropriate and not helpful to you for us to comment specifically on this bill. In general, however, we do indeed subscribe to the necessity of enlisting the resources of American private enterprise in the physical reconstruction and rehabilitation of housing in urban poverty areas.

S. 2088 utilizes a system of tax credits, increased deductions for wages paid, and rapid depreciation to encourage industrial investments in the poverty areas. We agree that if new jobs are to be created and thousands of workers trained

for employment in poverty areas, private industry must share in the effort. We also agree that because of the high economic costs involved in locating in such areas, industry must be given substantial incentives to justify management in approving such projects. Certainly the utilization of the tax incentive mechanism could provide a most effective tool to this end.

In our judgment, S. 2088 in principle represents a highly commendable proposal for attacking a most serious problem. We believe that every effort should be made to encourage construction of new plant facilities in, or perhaps reasonably adjacent to, urban poverty areas. Proximity to employment is, as you suggest, a basic factor in the equation. While it is difficult at this time to predict the extent of any company's future plant expansion, we would certainly endeavor to channel a portion of our new projects, to the extent practicable, to such areas, assuming tax incentives were substantial and that the tax requirements were sufficiently definite to warrant approval of a particular project on a justifiable business basis with reasonable assurance of a successful venture.

Therefore, in the event that legislation is enacted providing for substantial tax incentives for industrial investments in urban poverty areas, we will certainly give very serious consideration to such projects and encourage our divisions and subsidiaries to participate, where practicable. We would trust, however, that the legislation as finally enacted would be as definite and as free from latent interpretative ambiguities in later administrative implementation as possible. An outstanding example of a successful tax incentive program of this nature is, of course, the depletion allowance for the oil industry; here all the requirements are laid down clearly in advance and are definitely understood by all concerned.

While we concur in the basic purposes of S. 2088, we are concerned that the value of the program might be lessened for us as a practical matter by certain of the restrictions and limitations involved. We have in mind, for example, such things as the mandatory requirement for public hearings; the ten year condition; the various standards to be prescribed in the future; the generality as to the scope of the reports to be filed; and the apparent rigidity of the legislative requirements in certain respects, irrespective of the particular factual circumstances which may be present in a given case.

Section 2 of the bill, for example, appears to be susceptible to a number of varying interpretations. Thus, Section 2 prohibits the granting of any incentives in the case of any enterprise "relocating from one area to another". Section 2 permits incentives "for expansion" through the establishment of a "new" industrial facility if it will not result "in an increase in unemployment" in the area of original location. However, as a practical matter, a satellite facility is often established by a manufacturer to handle a lack of plant capacity at the original location. In such cases the usual effect would not be to increase unemployment over a reasonable period although it might do so temporarily. Section 2 contains such general language that a management might properly be concerned that subsequent interpretative implementations as to its particular situation might raise doubt as to the propriety of particular eligibility certificates. We would suggest that Section 2 be reworded to simplify the language and to remove the possibility of any interpretation that might appear to conflict with the fundamental objectives of the bill.

The definitions in Section 3 appear generally workable. However, we feel that limiting the term "qualified jobs" to mean "new employment positions which did not exist prior to the time of requesting certification from the Secretary, either at the industrial or commercial facility or in any other part of an enterprise operated by the person receiving a certificate of eligibility" may cause problems. For example, in the case of a large corporation with numerous divisions and subsidiaries, it is difficult to envision "new employment positions which did not exist" somewhere in the enterprise, particularly in the case of new satellite plants, for example mentioned above. Certainly a skeleton cadre of workers and supervisors is normally transferred from their current work to begin operations at any new location at least for a limited period.

With respect to reports, Section 102 states that the Secretary may by regulation require any corporation to whom a certificate of eligibility is issued "to file such reports from time to time as he may deem necessary" in order to carry out his functions under the law. It is possible that the burden of complying with such regulations, not otherwise specified, could be costly and burdensome on a corporation in view of the already very specific limitations and provisions of the bill itself.

Section 101(f) requires the Secretary to keep interested and participating federal, state and local agencies fully apprised of any action taken by him under this Section. In this general connection, it would seem to us that there should be some provision relative to handling of confidential disclosures made by the participating enterprise with respect to trade secrets and other confidential information involved, particularly as to the products to be manufactured and the marketing plans.

We very much appreciate the opportunity to comment on these legislative proposals which, we believe, constitute a substantial step forward in the solution of this urgent problem.

Sincerely,

A. P. FONTAINE.

LAW SCHOOL OF HARVARD UNIVERSITY,
Cambridge, Mass., September 11, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate, Washington, D.C.

DEAR SENATOR KENNEDY: I would like to offer my support for S. 2100, the bill you have introduced for the purpose of stimulating private investment in low-cost housing in urban poverty areas.

Although I cannot claim any expert understanding of the economics of the housing industry, it does seem clear to me that you are right to conclude that drastic improvement of housing conditions in our city slum and ghetto areas is critical in any serious effort to break the grip of urban deprivation; that the proportions of this task far exceed the capabilities of Government programs except on a scale which all would find unacceptable; and that the job, therefore, will remain undone unless private enterprise can be stimulated to undertake it and particularly unless government supports and incentives are forthcoming which correct the bias, introduced by past and present government housing programs and income-tax laws, favoring investment of private capital in suburban and luxury-type urban construction. It seems to me that your bill is well designed to accomplish these objectives.

Some features of S. 2100 which seem especially good to me are those which (1) encourage rehabilitation as well as new construction; (2) require that housing be constructed within the slums and ghettos, so that occupants need not be torn from their neighborhoods, and those neighborhoods can receive the economic and community-building boost associated with new housing construction; (3) require co-ordination through consultation with local officials and neighborhood residents, without granting either group an absolute veto (except in the unlikely event that the city decides to refrain from *all* participation); (4) permit economically successful tenants to retain their housing in the neighborhood; and (5) accommodate the economic necessity of property-tax concessions with the city's urgent need to preserve and expand its tax base. A particularly creative and promising feature, I think, is the strong support for tenant-controlled management groups.

Yours very truly,

FRANK I. MICHELMAN,
Professor of Law.

GENERAL MOTORS CORP.,
Detroit, September 8, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate, Washington, D.C.

DEAR SENATOR KENNEDY: Thank you for the opportunity to review your proposed bills directed to the problem of urban renewal.

There can be no question that substantially reducing unemployment and providing better housing and transportation facilities, and improving downtown business areas are urgent problems in many if not most of our cities. They are of concern to all of us not only from a business but from a human standpoint. As the leading industrial nation, enjoying the highest living standards, we must be leaders in this area as well. Renewal of our cities and their facilities where necessary, must be planned and developed so that our urban areas will serve as standards for the world. You will understand that we in Detroit feel this keenly and I am serving as a member of the New Detroit Committee recently formed by Governor Romney and Mayor Cavanaugh. The purpose of this Com-

mittee is to plan and coordinate the reconstruction of Detroit's riot-damaged areas and from a long-range standpoint to provide improvements in education, low-income housing, job-training, employment and other underlying causes of disturbance.

As I understand your proposals, S. 2088 would provide tax incentives for investment in new industry established in slum areas designated by the Department of Housing and Urban Development, as well as assistance for training employes from these areas. S. 2100 would provide mortgage capital through the Federal National Mortgage Association, as well as tax incentives, for construction of slum housing units. The tax incentives would include tax credits, accelerated depreciation, and other special allowances.

We have reviewed your proposed legislation with interest. The proposals reflect a detailed study of the problem and advance many thought-provoking ideas. Investments of this type have not been a part of our program in the past. Whether or not the proposals would provide some avenue for the Corporation to participate would, of course, require a careful examination after enactment.

We would certainly agree with the three premises set forth in your letter and in particular feel that private enterprise has a role in the maintenance and development of our urban centers. In this connection, what we in General Motors have been doing has and will have an important favorable influence on urban problems. For example, our recent nation-wide plant expansion program has resulted in an estimated increase in employment of 50,000. In some cases these new or expanded plants were located in central areas of Detroit, Pontiac, Flint, Lansing, Kalamazoo, Dayton, Baltimore and Buffalo. In this connection, the tax proposals you advance could present a strong incentive to industry in general in carrying forward your purposes. However, they are not the sole consideration as is evidenced by our plant expansions in the areas noted which were dictated by business considerations when such incentives were not available.

Further, regarding the role of private enterprises, as an "equal opportunity" employer we are hiring large numbers of persons from minority groups, providing them with training programs and offering promotion opportunities. Our on-the-job training programs have permitted employes to obtain new or additional skills and our employe-in-training program affords a non-high school graduate the opportunity to attain journeyman status in a skilled trade. The policy of the Corporation is to extend these opportunities to qualified applicants and employes on a nondiscriminatory basis and without regard to an individual's age, race, color, sex, creed, or national origin. We are actively recruiting those willing to work and learn, and will continue to do so as long as vacancies exist. However, as you know, the greatest demand will always be for people with skills and aptitude for training.

In connection with the immediate situation in Detroit arising out of the recent riots, as I noted above, I am currently on the New Detroit Committee. Our people are actively assisting this Committee's efforts to rebuild the damaged areas, developing new housing facilities, and alleviate hard-core unemployment. The Committee will work through existing agencies and groups and where possible lend its assistance when it is deemed advisable. It is interesting to note one of the first conclusions arrived at by a task force of this Committee was that rather than various governmental agencies providing ready made plans for various localities, the local areas residents must have some participation in the planning, execution and administration of plans that affect their immediate local area.

You may also have heard about the Metropolitan Citizens Development Authority. This non-profit non-governmental organization was formed in November, 1966, for the primary purpose of substantially increasing in the six-county Detroit metropolitan area the supply and availability of low and moderate cost housing on a scale sufficient to realize the benefits of modern management and technology. I am a vice-chairman of the organization and General Motors has offered to participate and contribute toward its operating budget. We also now have under consideration a proposal designed to provide funds in the form of a five-year loan to the organization to acquire land for site development and construction.

You also asked Mr. Donner for his comments, and I am speaking for him as well as myself in this letter. I want to thank you again for giving us an opportunity to review your legislative proposals in these important areas of social concern.

With kind regards,

J. M. ROCHE.

INTERNATIONAL TELEPHONE & TELEGRAPH CORP.,
New York, N.Y., September 1, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: Thank you for your courtesy in writing about the urban improvement bills which you introduced in the Senate. I read both of them with interest.

The creation of more jobs and better housing in slums and ghettos goes to the heart of the matter in this complex question of combatting city poverty.

Your coupling of a chance for a decent job and a chance for a decent home with a meaningful participation by private enterprise is, in my judgment, a sensible approach to the problem. It is one which deserves careful consideration by that segment of the private sector which can surely make a significant contribution.

Our company, as you may be aware, has been interested for some time in implementing programs to strike poverty at its roots. One of these, the operation of the Job Corps Center at Camp Kilmer, N.J., is a worthwhile example. The commendations which it has received have been a source of great personal satisfaction to me, and an indication of how industry can help nurture our nation's human resources.

Your bills have great merit. I assure you that I will discuss them in detail with ITT company officials who are particularly concerned with poverty programs and pass on their recommendations to you. Meanwhile, I will follow with interest the ideas you have proposed.

Sincerely,

HAROLD S. GENEEN,
Chairman and President.

STAUFFER CHEMICAL CO.,
New York, N.Y., August 23, 1967.

Hon. ROBERT F. KENNEDY,
Senator from New York,
Washington, D.C.

DEAR SENATOR KENNEDY: Thank you for your August 17 letter and the copies of your remarks to the Senate about private investment in urban areas.

Both of your proposals are excellent. They go to the heart of the problem—urban unemployment. They utilize a vastly powerful economic force—the free enterprise system. They eliminate the "government intervention" argument by placing private capital in the lead role.

I favor the legislation which you have proposed and hope that the Senate will hold hearings on it during this session. The hearings themselves will answer in particular those questions relating to the sufficiency of the incentives.

The most important and the most difficult question you ask is whether a given company might be induced to invest in a poverty area under the conditions proposed. I am certain you understand that many considerations bear on the selection of a site for a new capital investment—availability of skilled labor, raw material supply, transportation, to mention a few. The incentives contemplated by your bills would simply add one more factor to the overall package to be considered by a management group. I can conceive of circumstances, however, in which the incentives might well tip the scales in favor of locating in a poverty area.

I will continue to follow your proposals with great interest and want you to know that I stand ready to help.

Sincerely yours,

A. E. ALBRIGHT,
Executive Vice President.

THE DREYFUS CORP.,
MANAGERS & UNDERWRITERS OF THE DREYFUS FUND, INC.,
New York, August 28, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: Thank you for your interesting letter of August 11th.

Your legislative proposals seem well conceived. You have made this seemingly un-understandable problem of the afflicted areas understandable. Our research

group feels the incentives offered are of sufficient proportion to stimulate the necessary business activity.

If we can be of any practical assistance to you please do not hesitate to call upon us.

With best wishes,

Sincerely,

HOWARD STEIN.

THE BOEING CO.,
Seattle, Wash., September 7, 1967.

Hon. ROBERT F. KENNEDY,
Senate Office Building,
Washington, D.C.

DEAR SENATOR KENNEDY: I am pleased to respond to your letter of August 10, 1967 concerning S. 2100 and S. 2088.

We share your concern for the problems of hard core unemployment and the decay of our urban centers. Certainly, private enterprise has a deep interest in the solution of these problems. Responding directly to the questions contained in your letter, we would offer the following comments.

The incentives provided in both S. 2088 and S. 2100 should make investment in poverty areas attractive. Our experience with existing federal programs for the hard core unemployed suggests to us that the approval procedure contained in both of these proposals would be unwieldy and possibly unworkable. The requirement to coordinate with and secure approval from three separate departments of the Federal Government and a number of local or regional agencies would be frustrating and discouraging to participants in the program. We recognize the need for governmental control and coordination, but we believe this approval procedure should be streamlined.

We are also somewhat concerned that local building codes across the country would be a deterrent to implementing S. 2100. Many of these building codes preclude the application of modern construction, materials and methods which are needed to achieve low-cost housing.

Our only possible area of interest under S. 2088 would be in those locations where we have expansion requirements. However, even in those areas, I doubt that we could meet the requirement for two-thirds of the employees of our facility to be from the urban poverty area. Our industry has an unusually high skill level requirement, and I cannot conceive of one of our operations in which two-thirds of the employees could be newly hired and trained people.

We have an obvious interest in the development of good housing in the communities where we have plant operations. However, the actual construction of housing is outside our field of experience. We do work closely with the construction industry and would continue to do so to meet the purposes of the Urban Housing Development Act of 1967.

It is obvious that all sectors of our nation must take aggressive steps to remedy the problems that cause urban poverty areas. The attainment of higher educational levels, the development of skills and a much higher degree of attachment of the people in these areas to the labor market is essential to the continued growth of our country. Working with others in our communities, we have had some success in reducing the hard core unemployment. It is obvious that much more needs to be done, and we will pursue the problem with means at our disposal. We commend your suggestion that a higher degree of cooperation between the private sector and government will help. In the few instances where we have been able to work in this environment, there have been rewarding results.

I appreciate the opportunity to comment on your proposals and sincerely hope their objectives can be met.

Respectfully,

WILLIAM M. ALLEN.

UNION CARBIDE CORP.,
New York, N.Y., September 8, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: Thank you for your letter of August 16 and for the copies of your two bills covering private investment in urban poverty areas. I have studied these bills with much interest and am in thorough accord with the

objectives and intent of the proposed legislation. Rehabilitation and revitalization of urban areas is essential to our society, and this cannot be accomplished if left entirely to public administration and management. Your proposed legislation recognizes this by offering realistic economic incentives to private industry.

These incentives offered in your proposed bills are very attractive and would constitute important considerations in making private investment decisions. However, as you know, there are many other factors involved in the selection of sites for new capital facilities. In some cases, such as in the case of petrochemical plants, proximity to raw materials can be an overriding consideration. In others, such as a tonnage oxygen plant designed primarily to supply the steel industry, proximity to the customer may be the primary determinant. Many other factors may also be involved in the selection of plant or commercial sites, such as, to mention only a few, availability of skilled labor, availability of water, cost of transportation, cost of electric power, local taxes, and local political climate. Each new facility must be examined in the light of its individual needs. Therefore, in the event your proposed legislation should be adopted, it would be an important but not necessarily decisive consideration to be taken into account with regard to the location of the particular facility to be installed. Unless all factors pertinent to the selection of a facility site are given due weight, there is danger that, in some cases, capital investments might be made in urban poverty areas which, even with the incentives offered in your bills, would not be competitive. In such event, the facility, of course, would in time be a financial failure and rather than being an asset in improving the urban poverty area would be a distinct liability.

May I point out that, while I am in favor of the general objectives and intent of your proposed bills, we have not as yet studied them in detail. There may be various items which we think should be changed or various omissions from the bills which we think should be included. After we have made a detailed study, if we have further suggestions, I shall be pleased to forward them to you.

Sincerely yours,

KENNETH RUSH.

CITY OF ALEXANDRIA, VA.,
September 11, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

MY DEAR SENATOR KENNEDY: We have noted with considerable interest two bills, S2088 and S2100, co-sponsored by you and Senators Pearson and Smathers, in the Senate and presented in the House by Representative Boggs concerning housing and industrial investment in urban poverty areas. We heartily support the intent of these bills and trust that they will become law as soon as possible.

Two questions raised by these bills, however, do cause us concern. These involve the designation and definition of urban poverty areas provided by the Census Bureau for the Office of Economic Opportunity and to which these bills are related, subject to some modification by the Secretary of Housing and Urban Development.

First, the poverty areas to be assisted are limited to metropolitan areas with more than 250,000 people in 1960. This initially eliminates entire states such as Alaska, Mississippi, Montana and Wyoming; limits many states to only one metropolitan area; and excludes major cities which probably have poverty areas. Examples of the latter are Elmira, Niagara Falls, Schenectady and Yonkers, New York; Hutchinson, Salina and Topeka, Kansas; Pensacola and Tallahassee, Florida; Baton Rouge, Lake Charles and Monroe, Louisiana; Charleston, South Carolina; and Savannah, Georgia. It would also eliminate the "typical" area of 230,000 people used in your introductory speech for S2088.

Second, by using the Urban Poverty Area definition, the number of qualified census tracts in the Nation is limited to 193 of 20,911 or less than 1% of the total. Alexandria has three census tracts which were eliminated from qualification by application of the Urban Poverty Area definition and which contain substantial evidence of poverty. We are sure that many other poverty areas throughout the United States were also eliminated simply because they did not meet the questionable artificial criteria used in the Urban Poverty Area definition.

Adherence to the recommended procedure will abort the real intent of the legislation, will promote unnecessary competition among localities for designa-

tion by the Secretary of Housing and Urban Development, may cause detrimental redirection of funds from areas now included on the poverty maps to other deserving areas designated by the Secretary and will cause delay in program execution due to compounding administrative review and investigation.

We strongly urge that these bills be amended to require identification by the Census Bureau through the Office of Economic Opportunity of all census tracts falling in the poverty category without arbitrary elimination because of number, population, contiguity, or other reasons such as those in the Poverty Area Definition. Only in this way can the legislation be applied equally throughout the country and Congress be fully aware of the extent of urban poverty needs and the success of its anti-poverty programs.

I have taken the liberty of forwarding copies of this letter to Senators Pearson and Smathers, Representative Boggs and the Senate Finance Committee for their information. I have also called this matter to the attention of Secretary Weaver.

Sincerely,

ALBERT M. HAIR, Jr.,
City Manager.

NEW YORK UNIVERSITY SCHOOL OF LAW,
New York, N.Y., September 15, 1967.

Senator GEORGE S. SMATHERS,
Senate Finance Committee,
Washington, D.C.

DEAR SENATOR SMATHERS: According to this morning's edition of the New York Times, Under Secretary of the Treasury Joseph W. Barr, on behalf of the Administration, has objected to the provisions of S2100 mainly on the grounds that the Treasury has long opposed use of tax incentives for "narrow and specialized purposes."

In view of the Treasury initiative over the last three years in proposing amendment of the Internal Revenue Code, I find this position astonishing.

In particular, it was not a year ago that the Administration vigorously supported the enactment of the Foreign Investors Tax Act, which added to the Code a conglomeration of provisions dealing with the income, estate and gift tax treatment of foreign investment and business in the United States.

As stated by the House Ways and Means Committee in H.R. Report No. 1450, 89th Congress—Second Session (April 26, 1966), the purpose of that Act was "to provide more equitable tax treatment for foreign investment in the United States." Although the Committee Report does state the Act is part of the President's program to improve the U.S. balance of payments, the report continues, "the bill . . . sought, as its primary objective, the equitable tax treatment by the United States of non-resident aliens and foreign corporations." To remove any doubts about the Committee's intent, with which the Administration fully concurred, the Committee summarized the purpose and background of the bill as follows:

"The legislation is designed to increase the equity of the tax treatment accorded foreign investment in the United States."

In addition, since 1964 numerous Code provisions have been added or amended on the initiative of the Treasury or without its objection benefitting, among others, (a) stockholders of collapsible corporations (Sec. 341(f)); (b) dealers in property who are contingently liable on debt obligations (Sec. 166(g)); (c) shareholders who redeem their shares in corporations with substantial accumulated earnings and profits (Sec. 318); and (d) shareholders in corporations combining with other corporations (Sec. 368(a)(1)(B)).

In light of this recent history, it is the height of hypocrisy to find the Treasury now saying it has *long been opposed to provisions* "with narrow or specialized purposes." The number of individuals or businesses affected by the Foreign Investors Tax Act and the other provisions cited above is infinitesimal compared to the number of U.S. citizens and businesses who would assuredly benefit from the enactment of S2100 and its companion S2088. The social and economic benefits to be derived from providing more equitable treatment for nonresident alien investors or shareholders of collapsible corporations can hardly be anything but a small fraction of the long overdue social and economic improvement S2100 would help bring to the many needy citizens of the United States living in our urban areas.

S2100 and S2088 are the most meaningful provisions yet introduced to encourage private industry to do its share in eliminating the human suffering and degradation so many of our citizens are forced to endure because of inadequate job opportunities and housing.

The sponsors of these bills correctly gauge the present temper of prudent businessmen. Incentives, particularly tax incentives, are indispensable to the meaningful participation in these programs by business enterprises with adequate capital and experience. If we are ever to convert rat-filled slums into decent housing accommodations, jobless men into dignified taxpayers, now is the time to act. The bill under consideration by your Committee should be favorably acted upon promptly.

Although times does not now permit an extended discussion of the technical provisions of the bill, I find it exceptionally well drafted, more comprehensible than most existing provisions of the Code and structured to provide taxpayers qualifying thereunder with the intended benefits without opening up glaring loopholes.

In summary, the Treasury's objections to the far reaching and imaginative proposals embodied in S2100 are without substance. Unfortunately, the suspicion persists that the Administration's objections would be muted, if not nonexistent, if the names of the sponsors of this bill were different.

I wish to thank the Committee in advance for permitting me to express my views on this matter.

Yours very truly,

NORMAN SINRICH,
Professor of Law.

METROPOLITAN DEVELOPMENT ASSOCIATION
OF SYRACUSE & ONONDAGA COUNTY, INC.,
September 13, 1967.

Senator ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: Many thanks for your letter of August 22nd. I have been on my vacation and therefore am apologetic about being late in answering you.

We had known about the two bills which you introduced in the Senate and have been most impressed with both. I have been in the housing and urban renewal field for quite a number of years and have found that private enterprise incentives have generally been so circumscribed that, after the initial attraction has worn off, few investors remain interested, unless there is a hidden bonus. Examples of this are Sections 220 and 608 of the Housing Act. The current section 221d3 program current appears close to being regulated to a state of relative ineffectiveness.

The interest rate and income tax incentives in your proposals should, I believe, provide a considerable attraction to private investment in an open and above board way which has not hitherto been possible.

Mr. Bruno mentioned to my assistant and myself that we might visit your office in Washington to discuss the proposed legislation further with either Mr. Curzan or Mr. Walinsky. I trust that we may do this sometime in the near future at their convenience.

If by any chance Syracuse is fortunate enough to be designated as a Model City under the new program, we would have an opportunity to demonstrate the effectiveness of your two proposals in our run-down central area.

With best wishes,

Sincerely,

JOHN R. SEARLES, Jr.,
Executive Vice President.

CITY OF SAN JOSE, CALIF.,
August 21, 1967.

ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: Mayor Ronald R. James has referred your letter of August 4, to me for reply. We appreciated receiving the two Senate Bills you recently introduced in the Senate covering "Industrial Investment in Urban

Poverty Areas," and "Investment in Housing in Urban Poverty Areas." We think that both of these bills are excellent, and will be happy to contact you should we require further information relative to them.

Thank you kindly for sending them to us.

Sincerely,

A. P. HAMANN, *City Manager.*

ABEX CORP.,
New York, N.Y., September 12, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: Thank you for your letter of August 14, 1967 enclosing copies of the Congressional Record containing speeches and bills introduced by you and Senator Pearson of Kansas on investment in industrial development and housing in urban poverty areas.

I have read your enclosures with interest and compliment you on what appears on first reading to be a reasonable and practical approach to a problem which has seemed to almost defy practical solution.

I have passed this information on to other officers of Abex, and if we can develop any constructive criticism or suggestions, we shall pass them along to your staff in Washington.

Sincerely,

KEMPTON DUNN, *Chairman.*

THE FLORIDA SAVINGS AND LOAN LEAGUE,
Orlando, Fla., September 12, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: Thank you very much for your letter of August 31, regarding the two very significant bills you have introduced to encourage private investment in our older neighborhoods and urban poverty areas. We are very flattered that you would ask for the views of the Florida Savings and Loan League.

We are in the process of studying the details of your legislation but are already in a position to endorse the objectives as you have outlined them. Although our business is only an indirect force in combating joblessness, we certainly share your belief that a very high level of employment is essential to our urban and national well-being. In spite of tight money, our associations have done their level best to maximize the level of home building and since home building is one of the largest industries in the country, this has a definitely favorable effect on employment.

We also share your belief that the present government programs are not adequate to the task and that no wholly governmental effort can be the complete answer. In fact, we have always had strong reservations about the present amount of emphasis on government programs. It is also apparent that the existing system of private enterprise is not going to carry us to the goal of a decent American home for every American family in the near future. We don't know all the answers, but we do feel that some combination of government and private enterprise offers the best hope.

Our two national trade associations, the United States Savings and Loan League and the National League of Insured Savings Associations have submitted papers to the Senate Housing Subcommittee (May 1—Study of Mortgage Credit) suggesting important ways in which savings and loan associations could play a stepped-up role in financing home ownership and making a larger contribution to the solution of the problems you cite.

In this connection, the U.S. Savings and Loan League recently held a special clinic attended by many Floridians devoted entirely to the special types of financing outside of the typical single family home. There is national recognition in our business that savings and loan associations must reshape their thinking and policies with respect to the very special and urgent needs of our urban areas.

I realize that this does not present detailed and concrete suggestions, but I did want you to know that your letter and your programs to rejuvenate our urban areas strikes a very responsive note with the savings and loan people of Florida.

Sincerely,

WILLIAM D. HUSSEY,
Executive Vice President.

THE STANDARD OIL CO.,
Cleveland, Ohio, September 11, 1967.

Hon. ROBERT F. KENNEDY,
Senate Office Building,
Washington, D.C.

DEAR SENATOR KENNEDY: Adding to my letter of August 21, I am happy to report my favorable interest in both S-2088 and S-2100.

To answer the specific questions raised in your letter of August 16, the incentives certainly make investment in poverty areas more attractive and would be considered in investment decisions.

As to my company making investments in an urban poverty area under the conditions specified, many opportunities are eliminated by the elimination of retail outlets from qualification. However, we will continue to study the implications of the bills you have proposed.

Sincerely yours,

CHARLES E. SPAHR, *President.*

CIVIC CENTER REDEVELOPMENT CORP.,
St. Louis, Mo., September 14, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: Thank you for sending me copies of the two bills you introduced for stimulating private investment in urban poverty areas.

I certainly agree that joblessness together with inadequate housing are root causes of our present urban crisis—and that private enterprise must take a major participating role in the ultimate solution to these problems.

Our corporation is not chartered to engage in housing construction. However, it is not beyond the realm of possibility that this corporation might, at some future time, come under the provisions of your bill for stimulating industrial investment in urban poverty areas.

Whether or not the tax incentives are sufficient I think no one can tell, but certainly it is a step in the right direction. The answer to this would be the arithmetic on individual projects on a case by case basis. In this connection it would seem important that some assurance be given that the tax incentives would prevail for the life of the project and not be subject to changes as was the case in the recent suspension of the investment tax credit provision.

Sincerely yours,

O. O. McCRACKEN,
Executive Vice President.

THE AMERICAN ASSOCIATION OF
FUND-RAISING COUNSEL, INC.,
New York, N.Y., September 15, 1967.

Senator ROBERT F. KENNEDY,
U.S. Senate, Washington, D.C.

DEAR SENATOR KENNEDY: In reference to your letter of August 30th, I appreciate receiving copies of the two Bills you have introduced in the Senate to stimulate private investment in urban poverty areas. While it is not within the range of this office's competence to be able to analyze the structure of such legislation the member firms of this Association work so closely with the resources made available by private enterprise to institutions involved in the betterment of society, that we would like to commit our wholehearted endorsement to the nature and spirit of these Bills.

It is obvious to most concerned citizens that present government programs for housing and employment in urban poverty areas are making bearly measurable progress.

In the field of philanthropy, we have seen again and again the remarkable results of the stimulus of private enterprise toward solving problems of social improvement. Therefore, we hope that the approach contained in your Bills will meet with the full endorsement of your colleagues.

Sincerely,

JOHN J. SCHWARTZ.

CHEMICAL BANK NEW YORK TRUST CO.,
New York, N.Y., September 15, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate, Washington, D.C.

DEAR SENATOR KENNEDY: We have reviewed with a great deal of interest your two bills, S. 2088 and S. 2100 for private investment in slum areas—one providing for incentives to attract new business and the other providing incentives for housing construction. We strongly encourage a private enterprise approach for housing and private industry in the poverty areas.

Attracting industry to these areas may be limited to those businesses using unskilled labor. Then, too, other factors affect decisions in selecting plant locations, e.g., local taxes, transportation, etc. Relative to your housing bill we believe encouragement of ownership on a condominium or cooperative basis would be preferable to the rental approach because people with a pride of ownership will respect and take care of property more than those who occupy on a rental basis. Government guaranteed loans may even be necessary to assist purchasers in making the down payment. Home owners should be given the opportunity to profit on the resale of their homes and, where possible, emphasis should be placed on individual and group effort at the community and neighborhood level.

Chemical, as a commercial bank, cannot make equity investments contemplated by your two bills; however, we are actively working with other banks as well as several large corporations and real estate developers to assist in financing of housing developments in slum areas.

Sincerely,

WILLIAM S. RENCHARD, *Chairman.*

SPERRY RAND CORP.,
New York, N.Y., September 15, 1967.

Hon. ROBERT F. KENNEDY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR KENNEDY: Thank you for your letter of August 17, 1967. I am glad to give you my comments on the bill for promoting private investment in urban poverty areas to which you refer.

I agree with the objectives of the proposed law. Sperry Rand Corporation was one of the first large corporations to participate in Puerto Rico's "Operation Bootstrap" which you referred to in your speech of July 12, 1967, before the United States Senate. "Operation Bootstrap" offered substantial tax incentives which evidently induced many other corporations to establish manufacturing plants in Puerto Rico with the resulting great improvement in economic conditions there.

Insofar as our policies as to investment in plant and equipment are concerned, the location of a new facility is normally determined by considering many factors, such as proximity to markets and to suppliers, availability of transportation, labor supply, real property taxes, other taxes and other local conditions. We believe that similar factors govern decisions by other companies. The proposed legislation would introduce another factor that would have an important bearing on the consideration of locations that would qualify for the benefits of the proposed legislation.

As you request, I submit the following comments on the proposed legislations:

(a) I suggest that those cities and states that would benefit from the program be required to extend their co-operation. Among other methods, such co-operation would include provision for stabilizing, for a stated number of

years, taxes levied on real and personal property subject to the program. Obviously, lack of such co-operation could offset the incentives offered in the proposed legislation.

(b) I suggest that the bill set forth the additional investment tax credit in terms of a ratio of the present investment tax credit, rather than a flat rate. Then, as the amount of the present credit is changed, the additional credit would be changed.

(c) I suggest that greater flexibility in the number of poverty area employees required to be hired might result in an increase in the number of companies that would participate in the program. A business that requires an unusual proportion of highly skilled employees might feel that its efficiency would suffer too much from the proposed requirement of a large percentage of presumably unskilled employees.

I hope my comments will be of assistance to you and that Congress will give the proposed legislation the careful consideration that it deserves. I share your interest, as I believe responsible citizens do, in finding a constructive solution to the serious problems of our urban areas.

Sincerely,

J. FRANK FORSTER.

ARMONK, N.Y., *September 12, 1967.*

Hon. ROBERT F. KENNEDY,
New York, N.Y.

DEAR SENATOR: Thank you for sending me copies of S. 2088 and S. 2100, which you have introduced to encourage investment by private business and the construction of low-cost housing in urban poverty areas.

I regret that a long-scheduled business trip makes it impossible for me to attend the hearings on these bills to be held later this week before the Committee on Finance. However, I am delighted to give you my comments on the proposals.

Both bills, of course, start from the premise that it is essential to bring the resources of private industry to bear upon conditions in these urban areas. I have no doubt that this approach is correct. Whatever the short-run utility of government-financed projects in urban areas, there is none that I have seen proposed that could be expected to provide as a permanent matter the significant job opportunities and decent housing that are needed. The whole history of this country's development, from the railroads to the space effort, shows that it will be necessary to give the private sector a compelling motive to engage itself in the redevelopment of poverty areas.

While I am confident that your basic approach is sound in the case of both bills, I feel better qualified to speak to the thrust of S. 2088, which is designed to stimulate business investments in these urban areas.

It seems to me that there can be no quarrel with the end you have in mind. Everyone will agree that new business ventures in the poverty areas are necessary and desirable. The question is whether such ventures will follow simply from public exhortations to businessmen to become involved in urban problems, or whether more is needed.

I think virtually all businessmen would agree with me that more is needed. This is not to say that American business does not have a vital interest in the redevelopment of urban poverty areas. They do, not only as responsible citizens, but also because we are poised as a nation on the brink of such a disastrous and prolonged crisis if conditions are not improved that our national development is at stake, economic as well as social.

American business realizes this increasingly. The problem, however, is that each business manager individually has a primary, immediate responsibility to his stockholders and employees, and that the usual profit-motivated considerations relating to the location of investment sites—an available trained labor force; acceptable tax rates; predictable, prosperous and peaceful living conditions; good law enforcement; good schools and recreation; and so forth—are all deeply affected in an adverse way by the very conditions that we must correct. Accordingly, if anything other than sporadic and relatively insignificant investment decisions are to be turned toward the inner cities, we must devise incentives that are realistic and lasting, and that will motivate not only the top business leaders, but many thousands of business managers in small businesses as well as large, who are inevitably going to make decisions based ultimately on cost and profit factors.

I believe that S. 2088 takes a realistic and workable step in this direction, and that it merits most careful and thoughtful consideration by the Committee and the Congress. The basic incentives used in the bill—the increased and extended investment tax credit, rapid depreciation, special deductions—are entirely appropriate and would undoubtedly affect many business decisions.

As you know, I am acquainted with the efforts to attract business investment to the Bedford-Stuyvesant area of Brooklyn; I am sure they would be measurably helped by the passage of such legislation as S. 2088. In a business I know something about, for instance, which is very attractive to new small business ventures, I can conceive of new computer card printing plants being located in urban areas where they would otherwise be placed in outlying regions.

In short, I agree that it is vital to take steps to attract business to the redevelopment of our cities, and to do so immediately. If a cost is involved over the short run, it is a necessary one, and certainly far short of the massive expenditures that will be required if conditions are not visibly and shortly improved. It is also obviously far short of the costs we are paying now for our past neglect of our cities and our racial minorities in them. Even in the short run, however, I am not sure but what the costs would be more than balanced by the revenue benefits from increased employment and business capital investment that is contemplated.

Sincerely yours,

THOMAS J. WATSON, Jr.

GENERAL ELECTRIC CO.,
New York, N.Y., August 30, 1967.

Hon. JAMES B. PEARSON,
U.S. Senate,
Washington, D.C.

DEAR SENATOR PEARSON: It was most thoughtful of you to invite me to testify before the Senate Finance Committee on the urban housing and employment legislation which you and Senator Kennedy of New York are sponsoring, and I deeply wish I could accept.

However, as you have no doubt already learned from your staff assistant who telephoned me, I find to my great regret that it is impossible to do so.

I do want you to know, however, that I share fully with you and Senator Kennedy your concern for the plight of the people in our urban slums and your determination that this be alleviated as quickly and thoroughly as may be possible. I believe, too, that private corporations like General Electric have a very substantial role to play in both the human and physical renewal of our cities, and I am gratified that the legislation you propose well recognizes that the entire task cannot be reasonably left exclusively to the government.

Thanking you for your invitation, may I wish you all success in your efforts to cope with these aspects of our national urban problems.

Sincerely yours,

FRED J. BORCH.

STATEMENT BY AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS, SUBMITTED BY ANDREW J. BIEMILLER, DIRECTOR, DEPARTMENT OF LEGISLATION

The AFL-CIO welcomes this opportunity to comment on S. 2100. We would like to begin by making clear our general position with respect to this bill.

We agree with the stated objectives of the bill; we have been, over the years, perhaps the most vigorous advocate of stronger and more effective programs to meet the steadily-increasing housing needs of the nation.

Moreover, we have heartily endorsed the idea that a coordinated housing effort should enlist, to the fullest feasible extent, the resources of private capital from appropriate sources.

It is just here that we part company with S. 2100—the point at which its ends give way to its means. For we do not believe that the ways in which S. 2100 proposes to involve private capital meet the tests of feasibility or appropriateness.

In essence, S. 2100 seeks to stimulate investment in housing by private corporations established solely for the purpose of making the highest possible profit. It would strive toward this end by various tax incentives—extraordinary credits, depreciation allowances, loan subsidies and the like—which according to the

estimates of at least one sponsor of the bill, would insure a return of 13% to 15% with virtually no risk.

Now if it were true that only through such risk inducements could a desperate nation find funds to house its people—if it were a choice between S. 2100 on the one hand and the perpetuation of the housing crisis on the other—we would find the choice a difficult one. But fortunately no such choice is necessary.

In the first place, real estate already can hold its own as an investment, for it already offers tax advantages and federal guarantees against loss.

In the second place, the structure of present housing law could provide better results, from every viewpoint, if the costly incentives of S. 2100 were translated into direct appropriations. What ails the present housing legislation is not so much its form but the miserliness of its appropriations. The same cost to the Treasury contemplated by S. 2100 could, in our opinion, yield greater returns if applied through existing statutes.

In addition, we find something basically objectionable in offering a reward—almost a bribe—to the kind of private enterprise which too often was responsible for the slums which we, along with the sponsors of S. 2100 and all clear-thinking Americans, realize must be eliminated. We doubt that corporations whose sole interest in housing is a 15% return at no risk would be deeply concerned with the relative social value of their investment, yet this should surely be a factor. While it is true that America needs all kinds of housing, over a wide range of sale and rental levels, the most desperate need is for low and low-middle income housing. We do not believe that tax gimmicks for the enrichment of private capital will build that housing; nor do we believe such an approach should be used.

This point was made with great cogency by an editorial in the New York Times on September 25. Here is what the Times said:

"To Rebuild the Slums

"In the task of rebuilding the urban slums neither Congress nor the nation itself has looked squarely at the housing problem.

"The underlying truth remains what it was twenty years ago when the late Senator Robert A. Taft became a convert to public housing and set out to persuade the real estate industry to relax its doctrinaire opposition. There is no way, Mr. Taft often said, that private enterprise can build housing for the very poor at a profit. But Congress has never been willing to appropriate sufficient money for a large-scale public housing program.

"Federal housing officials and city mayors have complicated the problem by pursuing unrelated objectives. They have pushed for so-called "middle-income housing" to persuade a remnant of the middle class not to flee to the suburbs. They have promoted urban renewal programs to revitalize the rotting downtown commercial areas and lure shoppers back into the centers of cities. These are both worthwhile purposes, but they do nothing to rehouse slum-dwellers and may actually reduce the supply of housing available to them.

* * * * * * *

"The political impasse which has long existed in the housing field, now made more visible by the budget stringency of the Vietnam war, has stimulated enterprising politicians in both parties to devise ways of luring private business into this unpromising activity. President Johnson has a committee at work studying the possibility of a mixed public-and-private Comsat-type corporation. Senator Percy, Republican of Illinois, and Senator Robert Kennedy have introduced ambitious, complex bills to encourage the entry of private capital into the field.

"None of these plans will directly help the people in the slums who are worst-off—the 32 million Americans, or one person in every six, who live in families where the bread-winner is unemployed, on welfare or whose income hovers at or slightly above minimum wage levels.

"Senator Kennedy concedes that under his bill apartments would rent for $70 to $100 a month, which is more than the really poor can afford to pay. The same is true of Senator Percy's bill, which is nominally intended to convert slum residents into homeowners. As with most existing Government housing programs, except public housing, these proposals would most help white-collar and blue-collar workers in the $4,000 to $7,000 bracket.

"Private capital's involvement, however, is not a substitute for public housing, much less a panacea. The subsidized interest rates, tax concessions, and other

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inducements of the Percy and Kennedy plans are a roundabout way of doing what the Government could do straightforwardly if the public understood that decent housing for the poor cannot be a goldmine for private profit."

We agree. And to the extent that private capital can be effectively used, we believe it should be from other sources than S. 2100 proposes.

Any number of private, non-profit organizations—including trade union organizations—are already engaged in housing operations, and there would be more of them if existing programs were expanded. To them, the tax incentives of S. 2100 would be meaningless; yet their primary interest in housing is based upon social purpose rather than greed for profit. Is it really a service to the nation to subordinate their role to that of the money-changers?

To be sure, it is argued that S. 2100 represents a "new approach" designed to tap new sources of private funds for the public good. As we have indicated, we feel strongly that the same amount of money would be vastly more useful if applied to the only slightly older approaches which have never had this kind of backing.

Moreover, S. 2100 hardly represents a plan for the involvement of undiluted private enterprise; depending upon the nature of the project, from 3% to 22% of the total costs of a project would be borne by the federal government, and thus by the taxpayers as a whole, in order to assure the safe, 13% to 15% return described earlier.

We have not attempted in this statement to analyze S. 2100 in detail. It is not necessary to go that far to demonstrate that his bill, so well intended, can only divide the available resources of the nation when their greatest unity is needed.

In essence, we stand on the position on housing needs restated only two weeks ago by the AFL–CIO Executive Council at its meeting in New York. That statement urged:

"Two and a half million new housing units each year including:

"A. Public housing through new and rehabilitated low-rent homes for the 20% of city families whose incomes are below requirements for a minimum decent standard of living. New public housing construction, now at a 30,000-to-40,000 annual level, should be immediately increased to 200,000 to 300,000 for each of the next two years and 500,000 a year thereafter. Adequate appropriations for the rent supplement program are a necessity.

"B. Housing for lower middle-income families, not eligible for public housing and unable to afford decent dwellings in the standard, privately financed housing market. Federally subsidized interest rate loans and a federal subsidy for the partial abatement of local taxes on such properties are needed to increase construction of such housing by cooperatives, non-profit and limited dividend corporations. In addition, federal legislation should make it possible for such groups to acquire existing properties, with government insurance of long-term and low-interest loans.

"C. Moderate-income housing, already operating with government-insured mortgages, stepped up through measures to increase involvement of pension funds, college endowment funds and private trusts.

"D. Open housing, in suburbs as well as in cities, an essential part of a meaning effort to rebuild our metropolitan areas.

"E. Urban renewal no longer is confined to commercial and expensive high-rise construction. The focus instead must be on homes in balanced neighborhoods, with families displaced by slum clearance given assistance in finding decent dwellings at rents they can afford.

"F. Model Cities program, with adequate appropriations."

This quotation is from a longer statement entitled "America's Urban Crisis." In order that our housing position can be understood in the context of the total problem, I am appending a copy of the full statement as well.

In short, we must oppose S. 2100 in its present form and urge instead the alternative spelled out in the statement above.

TREASURY COMMENTS ON A COMPARISON OF THE ANALYSIS SUBMITTED BY SENATOR ROBERT KENNEDY WITH THE ANALYSIS SUBMITTED BY THE DEPARTMENT OF THE TREASURY

The Comparison submited by Senator Kennedy apparently misunderstands several points in the Treasury analysis so that a brief comment is appropriate.

1. We have serious doubt about the thrust of Section B of the Comparison which seems to argue that under S. 2100 rents are lower, rates of return better, and in general costs to the Federal Government lower than other programs. This result seems to rest upon a number of special assumptions underlying the table in Section B, which assumptions, however, amount to different treatment of the situations under S. 2100 as compared with Sec. 221(d)(3) cases. Apparently the Sec. 221(d)(3) projects assumed in the table are based on a shorter loan repayment schedule than S. 2100. (This requires a larger rent supplement to cover the cost of higher debt amortization, but the faster government receipt from this loan amortization is apparently not counted.) Apparently the table also leaves out of account the cost of the property tax subsidy which is shifted to State and local government under S. 2100. Also the table apparently does not count the revenue loss from making the project-income tax free. (We comment on this below, number 6.)

The Treasury analysis of the tax provisions under S. 2100 argued that the rent reducing aspects of S. 2100 could be added to *any* housing program, and thus the efficient way of analyzing the *tax* provisions is to assume that they are added to housing programs that are similar in the nonfederal-tax features. (In any event, measures that reduce rent without reducing the rate of return on the investment would seem to have a cost proportional to the degree of rent reduction achieved. The real cost is higher if the technique of guaranteed private loans (as under Sec. 221(d)(3) rent supplement) is used rather than direct loans (as in S. 2100); but the decision to use guaranteed loans or direct loans presumably would be dictated not by housing considerations but by the general financial and budgetary situation, especially the debt limit.)

2. The Comparison in Section I–C misses our point when it characterizes as conflicting our contentions that (1) rates of return on equity are not much different under Sec. 221(d)(3) type programs and under S. 2100; and (2) the aggregate cost under S. 2100 is higher. The point is simply that equity capital costs more than debt capital, and thus the stress in S. 2100 toward inducing higher equities (and lower debt) requires more Federal cost. If a project is financed with 10 percent equity (earning, after tax, 15 percent) and 90 percent debt (carrying 5 percent before-tax interest), the cost is increased when the financing is changed to 50 percent equity and 50 percent debt. If we specify that the rent paid is the same in the two projects, the government in one way or another must finance the increased return on the 40 percent of the cost shifted to equity financing. (It is still a separate question whether higher equities would produce better housing. Our analysis simply contended that higher equities are expensive and there should be more evidence as to their value before one can evaluate the S. 2100 approach.)

3. The Comparison in Section II contends that S. 2100 provides a better *rate* of return than the hypothetical Sec. 221(d)(3) model used in our analysis. The difference depends largely on forecasting the resale price. The reader can choose his own price forecast. The difference is not, however, fundamental. If one believes the *rate* of return under Sec. 221(d)(3) is too low, this can be corrected without introducing a structure of tax benefits designed to increase the amount of return proportionately for higher equity ratios.

4. The argument in Section III D of the Comparison overlooks our point that, while a borrower who has personal liability on a conventional mortgage has made some commitment over and above his investment, his commitment is still not as much of a commitment as if he had not borrowed but used instead his own funds. There is, therefore, some significance in looking at the return on his real equity.

5. Section III E of the Comparison completely misunderstands us. A tax-exempt bond produces the *same after-tax* rate of return for a 70 percent investor as for a 30 percent investor, but this is equivalent to a *larger* before-tax rate of return for the 70 percent investor than for the 30 percent investor as the Comparison contends. But what we added was that in a plan involving excess deductions—as distinct from a plan that provides a certain amount of tax-

exempt income—the *after*-tax rate of return is much *higher* for the high bracket taxpayer. The discrepancy in equivalent before-tax yields will be even *more* favorable for high bracket taxpayers where excess deductions are allowed. Thus, the particular device of excess deductions to provide tax benefits generates windfalls; and we could expect this to be inefficient in the sense that much of the benefit would be wasted (as it is in the tax-exempt interest) because, to achieve a given housing result, the benefit must be expanded to attract marginal investors, i.e., those who get less benefit than the very top rate investors who get most from the provision.

6. The statement under Section V (A) that revenue losses from excess depreciation should be counted only when it reduces non-project income but not when it reduces project income (on the ground that the project would not exist without the excess depreciation) is incorrect. If the resources did not go into housing, the resources would go elsewhere in the economy and pay some income tax. If the resources are induced into new activity which generates tax-free income, we lose the revenue that we would have gotten from those resources used elsewhere.

7. The most important misunderstanding in the Comparison arises in Section VI. Our proposition that loan capital is cheaper than equity capital does not mean that we want public housing rather than an encouragement to private investors. We make the point simply to raise the issue of how much equity is desirable to be invested in *low-income* housing. Increasing the equity share with a given high rate of return on equity is expensive—the question remains of what benefits are expected to be obtained from such an increase in the equity share.

8. Some other differences we have with particular points in the Comparison can be passed as not particularly important to the basic issues raised by the tax provisions of S. 2100.

9. The basic issues might be summarized as follows:

(1) Arranging tax benefits which increase with the equity proportion in the housing project (including equity financed by conventional loans) is expensive. Does this yield an adequate payoff in terms of more or better housing than could be achieved by alternatively less expensive programs which work through high loan ratios?

(2) Tax benefits structured as excess deductions to be used against other incomes are a relatively inefficient device.

Finally the fact that there is so much difficulty in specifying just what the tax benefits are suggests that investors might have similar difficulties. This would argue in favor of more explicit measures to improve investor's returns.

Office of the Secretary of the Treasury
Office of Tax Analysis

(S. 2100, amended to reflect changes suggested by Senator Robert F. Kennedy, follows:)

90TH CONGRESS
1ST SESSION

S. 2100

IN THE SENATE OF THE UNITED STATES

SEPTEMBER 14, 1967

Referred to the Committee on Finance and ordered to be printed

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AMENDMENT

(IN THE NATURE OF A SUBSTITUTE)

Intended to be proposed by Mr. KENNEDY of New York to S. 2100, a bill to encourage and assist private enterprise to provide adequate housing in urban poverty areas for low-income and lower middle income persons, viz: Strike out all after the enacting clause and insert the following:

1 That this Act may be cited as the "Urban Housing Develop-
2 ment Act of 1967".
3 DECLARATION OF PURPOSE
4 SEC. 2. It is the purpose of this Act to assist private
5 enterprise in providing new and substantially rehabilitated
6 housing in urban poverty areas in order to enhance the living
7 conditions of such areas, and to meet an immediate and
8 pressing need for decent, safe, and sanitary housing for low-

1 income and lower middle income persons at rentals which
2 they can afford.

3 DEFINITIONS

4 SEC. 3. As used in this Act—
5 (1) The term "Secretary" (for purposes of title I and
6 title II) means the Secretary of Housing and Urban Devel-
7 opment.
8 (2) The term "urban poverty area" means an area,
9 within a standard metropolitan statistical area containing a
10 population of at least two hundred and fifty thousand, which
11 the Bureau of the Census has determined, at the request of,
12 and under procedures approved by, the Office of Economic
13 Opportunity, to be a poverty area, subject to such modifica-
14 tions, exceptions, or additions as the Secretary, in consulta-
15 tion with the Director of the Office of Economic Opportunity,
16 may determine to be appropriate for the purposes of this Act.
17 (3) The term "city" means any municipality, county,
18 parish, or other political subdivision of a State having general
19 governmental powers.
20 (4) The term "certified project" means a housing proj-
21 ect, which may consist of one or more buildings, with respect
22 to which an unrevoked certificate of eligibility has been issued
23 by the Secretary under section 101 of this Act.
24 (5) The term "certified operation period" means with
25 regard to a certified project—

1 (A) in the case of a project financed in part by a
2 mortgage insured under section 235 (d) of the National
3 Housing Act, the term of such mortgage, or
4 (B) in the case of a project not financed in part by
5 a mortgage insured under section 235 (d) of the National
6 Housing Act, fifty years from the date of completion of
7 construction or rehabilitation of the project which is
8 certified under section 101 of this Act.
9 (6) The term "net return" means with respect to any
10 fiscal year, the net operating income of a certified project,
11 before any deductions for depreciation, interest, United States
12 income tax, and State or local income or franchise taxes com-
13 puted with reference to net income, but less the amount of the
14 amortization payment (including both the amount thereof
15 attributable to interest and the amount thereof attributable to
16 retirement of principal) payable on a mortgage on the project
17 insured under section 235 (d) of the National Housing Act.
18 (7) The term "home management corporation" means
19 a public or private nonprofit corporation or association which
20 is organized under State or local law by the residents of one
21 or more certified projects in an urban poverty area, and of
22 which such residents are the sole members for the purpose
23 of managing and performing maintenance tasks on each
24 project, for developing and carrying out programs for
25 improving the physical, economic, and social conditions pre-

1 vailing in the urban poverty area where such project is con-
2 structed, and ultimately for purchasing such project to take
3 ownership either in the name of the corporation or in the
4 name of each resident of such project.
5 (8) The term "holder" means any individual, firm, or
6 corporation possessing an unrevoked certificate of eligibility
7 issued by the Secretary under section 101 of this Act.
8 (9) The term "initial equity" means, with respect to
9 the holder of a certified project, the difference between the
10 total cost of the project to the holder as determined under
11 section 235(d)(3) of the National Housing Act and the
12 principal amount of any mortgage on the project, insured
13 under section 235(d) of the National Housing Act, at the
14 particular time in question.
15 (10) The term "occupancy charge" means the rental
16 or other payment made by the occupants of dwelling units
17 in a certified project to any holder of such project including
18 a home management corporation composed of such occupants.
19 TITLE I—ELIGIBILITY FOR ASSISTANCE
20 CERTIFICATES OF ELIGIBILITY
21 SEC. 101. (a) The Secretary shall issue a certificate of
22 eligibility to any applicant desiring to provide housing in an
23 urban poverty area for low-income and lower middle income
24 persons, if—
25 (1) the governing body of the city in which the

1 project is to be primarily located and which, under local
2 law, has the primary authority to act in regard to the
3 construction or substantial rehabilitation of such project,
4 has given written notice to the Secretary that it wishes
5 to participate in the program authorized by this Act;
6 (2) the city and, when necessary, the State in
7 which the project is to be located, have—
8 (A) given written assurances, deemed satis-
9 factory to the Secretary, that the aggregate of State
10 and city real estate taxes and assessments levied
11 against any project, during any year in the certified
12 operation period (less any direct subsidies given
13 by the State and city to the project, including but
14 not limited to any reductions in land cost) will not
15 exceed 5 per centum of the occupancy charges of
16 the project during such period; or
17 (B) submitted a written opinion of the highest
18 legal officer of the State that the furnishing of such
19 assurances is barred, or barred to the extent not
20 furnished, by a provision in the constitution of such
21 State in force on Juy 13, 1967;
22 (3) the Secretary, after consultation with such
23 governing body or an agency or instrumentality of such
24 city designated by such body, and after consultation
25 with the residents of such urban poverty area deter-

1 mines that such project will contribute to the overall
2 economic and social welfare of the area and will be
3 coordinated with all other governmental programs for
4 community development;
5 (4) the Secretary determines that the applicant
6 meets such requirements with respect to business and
7 financial responsibility as he may prescribe; and
8 (5) the applicant agrees, in such form and manner
9 as the Secretary may prescribe—
10 (A) to provide at least one hundred dwelling
11 units of housing (through new construction or the
12 substantial rehabilitation of existing structures) in
13 conformity with standards prescribed by the Secre-
14 tary under subsection (d) within such period of
15 time, and at such site within an urban poverty area,
16 as may be specified or agreed to by the approving
17 agency under paragraph (2);
18 (B) to provide at least as many dwelling units
19 of housing (through new construction or the sub-
20 stantial rehabilitation of existing structures) as are
21 eliminated in the course of such construction or sub-
22 stantial rehabilitation;
23 (C) to hold and manage the certified project
24 in accordance with the provisions of this Act, and
25 any regulations issued pursuant thereto;

1 (D) to establish, during the certified operation
2 period, occupancy charges for dwelling units in the
3 project which are not in excess of the levels pre-
4 scribed by the Secretary pursuant to section 102;
5 (E) to lease, during the certified operation
6 period, dwelling units in the project to eligible indi-
7 viduals and families in accordance with regulations
8 prescribed by the Secretary under section 103;
9 (F) to utilize, during the certified operation
10 period, the services of a home management corpora-
11 tion whenever such services are available; and
12 (G) to sell, transfer, or otherwise dispose of the
13 certified project only to the holder of a certificate of
14 eligibility issued pursuant to subsection (b), during
15 the certified operation period: *Provided*, That any
16 home management corporation established for the
17 certified project shall have an option to purchase
18 such project from the applicant at any time after the
19 expiration of two years of the applicant's minimum
20 holding period. Such option shall be exercised only
21 upon the affirmative vote of two-thirds of the mem-
22 bers of the home management corporation and,
23 during the first seven years of such corporation's
24 existence shall require the approval of the Sec-
25 retary. The Secretary shall, in cases where his

1 approval for an exercise of such option is required,
2 grant such approval only if the home manage-
3 ment corporation demonstrates to his satisfaction
4 that it is capable of managing the building on an
5 efficient and financially sound basis. Such option
6 shall be a right to purchase the project for a price
7 equal to the excess of:
8 (i) the aggregate qualified expenditures
9 (as defined in section 1391 (9) of the Internal
10 Revenue Code) of the first holder thereof (as
11 defined in section 1391 (10) of the Internal
12 Revenue Code) over
13 (ii) the aggregate amount of depreciation
14 deductions that would have been allowable to
15 such holder under section 167 of the Internal
16 Revenue Code if he had held the project
17 through the date of exercise of the option and
18 depreciation deductions were computed under
19 the straight line method of depreciation over a
20 useful life of fifty years. A purchase pursuant
21 to any such option shall be subject to such other
22 terms and conditions as may be specified by
23 the Secretary;
24 (6) the Secretary determines that the cost of the
25 project, estimated operating costs of the project, and

1 other factors relating thereto, will permit the establish-
2 ment of occupancy charges, under the standards set
3 forth in section 102, which will not be in excess of those
4 suitable for low-income or lower middle income individ-
5 uals and families. The Secretary shall issue, from time to
6 time, bulletins setting forth maximum occupancy charge
7 levels suitable for low-income or lower middle income
8 individuals and families in various urban poverty areas
9 throughout the country; and
10 (7) the Secretary determines that the approving
11 agency under paragraph (2), or such other agency or
12 instrumentality as the governing body of the city may
13 designate, will carry out an adequate relocation program,
14 in accordance with section 105, for any persons displaced
15 from their homes or business establishments by the
16 project.
17 (b) The Secretary shall issue a certificate of eligibility
18 for benefits under this Act to any applicant who is or will
19 be the successor in interest to the ownership of any project
20 with respect to which a certificate was issued under subsection
21 (a), if—
22 (1) the Secretary determines that the applicant
23 meets such requirements with respect to business and
24 financial responsibility as he may prescribe; and

1 (2) the applicant agrees to conform to the require-
2 ments of subsection (a) (5).
3 (c) The Secretary shall terminate a certificate of eligi-
4 bility issued to any holder under this section whenever he
5 determines after a hearing that such holder has failed, after
6 due notice and a reasonable opportunity to correct the failure
7 has been given, to carry out its agreement under subsection
8 (a) (5) or (b) (2).
9 (d) Any certified project with respect to which a cer-
10 tificate of eligibility is issued under this section shall conform
11 to such standards of design, construction, and operation as
12 the Secretary shall by regulation require. Such regulations
13 shall—
14 (1) giving due effect to any action taken by the
15 locality in which such project is located, insure that the
16 project is so designed, constructed, and operated as to
17 provide decent, safe, and sanitary dwellings in estheti-
18 cally pleasing structures, and
19 (2) establish maximum cost limitations for the
20 project and for dwelling units in the project having
21 regard for—
22 (A) the provisions of subsection (a) (5),
23 (B) the size and nature of the unit,
24 (C) whether the unit is provided by new con-
25 struction or substantial rehabilitation, and

1 (D) building costs in the particular locality.
2 (e) The Secretary shall keep interested and participat-
3 ing Federal, State, and local agencies fully apprised of any
4 action taken by him under this section.
5 (f) The Secretary may by regulation require the holder
6 of a certificate of eligibility issued under this section to file
7 such reports from time to time as he may deem necessary in
8 order to carry out his functions under this title.
9 (g) No certificate of eligibility shall be issued under
10 this section, unless application therefor is received by the
11 Secretary prior to the expiration of fifteen years after the
12 date of enactment of this Act.
13 OCCUPANCY CHARGES FOR DWELLING UNITS IN CERTIFIED
14 PROJECTS
15 SEC. 102. (a) The maximum occupancy charges for
16 dwelling units in any certified project shall be fixed in
17 accordance with schedules to be submitted by the holder
18 to the Secretary, from time to time, and approved by the
19 Secretary. In approving any such schedule for any such
20 project, the Secretary shall be guided by the following
21 criteria:
22 (1) The gross occupancy charges for a certified
23 project shall be established at a level which (assuming
24 a vacancy factor of not more than 7 per centum of
25 the available dwelling units in the project) would be

1 sufficient to produce, for a holder having the minimum
2 initial equity in the project, a net return equal to 3 per
3 centum of such equity in each fiscal year of the holder
4 commencing or ending during the certified operation
5 period. The fact that a holder has a greater equity in
6 a certified project than the minimum required equity
7 shall not affect the gross occupancy charge of the
8 project.
9 (2) The gross occupancy charges for a certified
10 project held by a home management corporation may
11 include any additional amount needed to cover the pay-
12 ments on any mortgage placed on such project by the
13 home management corporation to finance the purchase
14 of such project: *Provided,* That such charges will not
15 be increased to a level in excess of 105 per centum of
16 that otherwise permissible under paragraph (1).
17 (3) The occupancy charge for each dwelling unit
18 shall bear its reasonable and proportionate share (having
19 regard to the type and size of the accommodations
20 provided) of the gross occupancy charge for the project.
21 (b) The Secretary may, at the request of the owner of
22 a certified project or upon his own initiative, authorize or
23 require such changes or modifications in any occupancy
24 charge schedule, approved for such project under subsection
25 (a), as he determines to be necessary (1) to allow for

1 maintenance costs or a vacancy factor above or below those
2 upon which such schedule was previously predicated and
3 approved, or (2) to insure compliance with the require-
4 ments set forth in subsection (a) of section 101 (a) (5).
5 (c) The Secretary is authorized, upon such terms and
6 conditions as he shall by regulation prescribe, to make com-
7 mitments to insure, and to insure, the owner of a certified
8 project against a negative annual net return from such
9 project in a particular fiscal year. For the purposes of this
10 subsection there is hereby created an Equity Insurance Fund
11 which shall be used by the Secretary as a revolving fund
12 with respect to insurance provided hereunder, and there is
13 authorized to be appropriated (1) the sum of $10,000,000
14 to provide initial capital for such fund, and (2) such addi-
15 tional sums as may from time to time be required, in the
16 event the balance in such fund becomes less than $5,000,000,
17 to restore such balance to an amount equal to $10,000,000.
18 For insurance granted under this subsection the Secretary
19 shall fix and collect a premium charge in such amount as
20 he determines to be necessary to maintain the fund on a
21 sound basis: *Provided*, That any charges so established shall
22 be reduced during any period in which the balance in such
23 fund exceeds $11,000,000: *Provided further*, That no sums
24 shall be paid from such fund to the owner of a certified

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1 project who willfully causes his annual net return from his
2 investment to fall below 0 per centum.

3 ELIGIBILITY REQUIREMENTS FOR OBTAINING OCCUPANCY
4 IN CERTIFIED PROJECTS

5 SEC. 103. The Secretary shall prescribe regulations with
6 respect to the eligibility of individuals and families for occu-
7 pancy in a certified project. In prescribing such regulations,
8 the Secretary shall be guided by the following criteria:
9 (1) No person shall be ineligible for occupancy in
10 the project because of race, creed, color, or national
11 origin.
12 (2) A first priority shall be granted to individuals
13 and families who were displaced from their homes as a
14 result of property acquisitions made in connection with
15 the establishment of such project or an industrial or
16 commercial facility under the provisions of the Urban
17 Employment Opportunities Development Act of 1967.
18 (3) Except as provided in paragraph (2), no indi-
19 vidual or family shall be eligible to obtain occupany in
20 a dwelling unit of the project if the annual occupancy
21 charge established and approved for such unit is less
22 than 18 per centum of the average annual adjusted
23 gross annual income (as defined in section 62 of the
24 Internal Revenue Code) of such individual or the adults
25 in such family taken in the aggregate, over a period to

1 be specified by the Secretary: *Provided*, That the Secre-
2 tary may waive the foregoing requirement whenever he
3 determines that there are no prospective tenants avail-
4 able for such dwelling unit, at the established occupancy
5 charge rate, who are eligible individuals and families.

6 ELIGIBILITY REQUIREMENTS FOR MAINTAINING OCCU-
7 PANCY IN CERTIFIED PROJECTS

8 SEC. 104. (a) No individual or family shall be required
9 to move from a certified project as a result of an increase in
10 his or its income: *Provided*, That if the annual occupancy
11 charge for the dwelling unit occupied by the individual or
12 family is less than 15 per centum of such individual's aver-
13 age annual adjusted gross income, or the aggregate average
14 adjusted gross income of the adults in such family, in such
15 period as may be specified by the Secretary, such individual
16 or family shall prospectively be required to pay to the
17 holder of the project an annual occupancy charge equal
18 to 18 per centum of the average adjusted gross income of
19 such individual, or the aggregate average adjusted gross in-
20 come of the adults of such family, in such period as the
21 Secretary specified. Any such additional amounts received
22 by the owner of the project shall be used to make payments
23 to the Secretary for deposit in the Tax Abatement Fund,
24 established under section 106, to reduce the costs to the
25 Federal Government of making grants under such section.

1 (b) The Secretary may by regulation require each in-
2 dividual or family occupying a unit in a certified project to
3 file such copies of income tax returns or other income state-
4 ments from time to time as he may deem necessary in order
5 to carry out his functions under this section.

6 RELOCATION ASSISTANCE

7 SEC. 105. (a) In determining whether, for the purposes
8 of section 101 (a) (6), an adequate relocation program exists
9 in any city to assist in the relocation of persons, businesses,
10 and nonprofit organizations displaced as the result of property
11 acquisitions made in connection with a certified project, the
12 Secretary shall be guided by the following criteria:

13 (1) Any persons so displaced shall be assured under
14 the program obtaining decent, safe, and sanitary hous-
15 ing at rentals which they can afford and at locations
16 which are reasonably accessible to their places of em-
17 ployment.

18 (2) As part of the program, a local group of resi-
19 dents of the area in which the project will be situated
20 may receive training and compensation, in accordance
21 with regulations prescribed by the Secretary, in pro-
22 viding moving and resettlement assistance to persons so
23 displaced.

24 (3) (A) There will be paid to any person or family
25 so displaced—

1 (i) a moving expense allowance, determined
2 according to a schedule approved by the Secretary,
3 not to exceed $200;
4 (ii) a dislocation allowance equal to the amount
5 under (i) or $100, whichever is the lesser;
6 (iii) an additional payment of $300, if such
7 person or family purchases a dwelling for the pur-
8 pose of residence within one year from the date of
9 actual displacement, and the dwelling so purchased
10 is situated upon real estate in which such person or
11 family acquires a fee title or a life estate, or which is
12 held under a ninety-nine-year lease or other type of
13 long-term lease equivalent to fee ownership.
14 (B) In addition to the amounts payable under sub-
15 paragraph (A), there will be paid to any family, any
16 individual (not a member of a family) who is sixty-two
17 years of age or over, or any individual (not a member
18 of a family) who is handicapped within the meaning of
19 section 202 of the Housing Act of 1959, monthly pay-
20 ments over a period not to exceed twenty-four months
21 in an amount not to exceed $500 in the first twelve
22 months and $500 in the second twelve months to
23 assist such family or individual to secure a decent,
24 safe, and sanitary dwelling. Subject to the limitation

1 imposed by the preceding sentence, the additional pay-
2 ments shall be an amount which, when added to 20
3 per centum of the average adjusted gross income of such
4 individual or the average aggregate adjusted gross in-
5 come of the adults in such family, over a period to be
6 specified by the Secretary, equals the average annual
7 rental required for such a decent, safe, and sanitary
8 dwelling of modest standards adequate in size to accom-
9 modate such family or individual in areas not generally
10 less desirable in regard to public utilities and public and
11 commercial facilities: *Provided*, That such payments
12 shall be made only to a family or individual who is un-
13 able to secure a dwelling unit in a low-rent housing
14 project assisted under the United States Housing Act of
15 1937, or under a State or local program having the same
16 general purposes as the Federal program under such
17 Act, or a dwelling unit assisted under section 101 of the
18 Housing and Urban Development Act of 1965.
19 (4) There will be paid to any business concern or
20 nonprofit organization so displaced—
21 (A) its reasonable and necessary moving ex-
22 penses and any actual direct losses of property
23 (except goodwill or profit) for which reimburse-
24 ment or compensation is not otherwise made; and
25 (B) an additional $2,500 in the case of a pri-

1 vate business concern with average annual taxable
2 income, over a period to be specified by the Secre-
3 tary, of less than $10,000 per year, if such concern
4 is not part of a larger enterprise (as defined under
5 regulations to be prescribed by the Secretary) hav-
6 ing establishments other than the one with respect
7 to which the displacement occurred.
8 (b) The Secretary is authorized to enter into contracts
9 to make, and to make grants to any city carrying out an
10 approved relocation program under this section, or to any
11 agency or instrumentality of such city designated by the gov-
12 erning body thereof, to defray that part of the cost of carry-
13 ing out such program which is required under paragraphs
14 (2), (3), and (4) of subsection (a).
15 (c) There are authorized to be appropriated such sums
16 as may be necessary to carry out the purposes of this section.
17 Any sums so appropriated shall remain available until
18 expended.
19 GRANTS TO CITIES PROVIDING TAX BENEFITS WITH RESPECT
20 TO CERTIFIED PROJECTS
21 SEC. 106. (a) The Secretary is authorized to enter into
22 contracts to make, and to make, annual grants to States and
23 cities participating in the program authorized by this Act.
24 The amount of any such grant shall not exceed a sum equal
25 to—

1 (1) to a State or city, 50 per centum of the amount
2 by which the real estate tax revenues and assessments
3 received or receivable by such State or city in any tax-
4 able year were reduced by reason of assurances granted
5 under section 101 (a) (2), plus
6 (2) to a city, an amount equal to any contribution
7 paid or payable to such city by a State to defray any
8 part of the reduction of tax revenues incurred or in-
9 currable by such city during such year as the result
10 of such assurances: *Provided,* That in no case shall the
11 amount payable under this paragraph exceed 25 per
12 centum of the amount by which the tax revenues receiv-
13 able by any such city during any year were reduced by
14 reason of such assurances.
15 (b) In any case in which assurances under section 101
16 (a) (2) were not furnished, or were furnished only in part,
17 the Secretary is authorized to enter into contracts to make,
18 and to make, annual grants to the holder of a certified proj-
19 ect in such city equal to 50 per centum of the excess of—
20 (1) the amount of State and city real estate taxes
21 and assessments paid or payable by such holder for each
22 year, after subtracting any reductions in such taxes
23 as a result of any assurances, over
24 (2) 5 per centum of the occupancy charges for such
25 year.
26 (c) For purposes of subsections (a) and (b), a reduc-

1 tion in tax revenues shall include any subsidies given by
2 a State or city to, or for, a certified project for the purpose
3 of reducing the local real estate tax assessments pursuant to
4 assurances granted under section 101 (a) (2).

5 (d) No payments shall be made under subsections (a)
6 or (b) with respect to State or city real estate taxes and
7 assessments which constitute a higher percentage of the
8 occupancy charges of a certified project than the percentage
9 which such taxes and assessment bear to the gross rental
10 income of conventional apartment houses in the same city.

11 (e) For the purpose of this section, there is hereby
12 created a Tax Abatement Fund which shall be used by the
13 Secretary for grants hereunder. Such funds shall consist of
14 (1) the sum of $30,000,000 to be appropriated by the Con-
15 gress to provide initial capital to such fund, (2) such addi-
16 tional sums as may be appropriated thereto by the Congress
17 in the event the balance in such fund becomes less than $20,-
18 000,000 to restore such balance to an amount equal to $30.-
19 000,000, and (3) such sums as may be deposited therein by
20 the Secretary from receipts under section 104 (a).

21 ASSISTANCE FOR HOME MANAGEMENT CORPORATIONS

22 SEC. 107. (a) The Secretary, in consultation with the
23 Director of the Office of Economic Opportunity, is authorized
24 to undertake such activities as he determines to be appro-
25 priate to assist the residents of urban poverty areas to orga-
26 nize and make use of home management corporations. Such

1 activities may include grants to defray reasonable and neces-
2 sary expenses incident to the organization of such corpora-
3 tions. Such activities may also include the issuance of model
4 forms of constitutions for home management corporations and
5 of model forms of management agreements which may be
6 entered into between holders and such corporations.
7 (b) For the purposes of this section, there is hereby
8 created a Home Management Assistance Fund, and there is
9 authorized to be appropriated (1) the sum of $5,000,000 to
10 provide initial capital for such fund, and (2) such addi-
11 tional sums as may from time to time be required to make all
12 necessary grants to home management corporations. Any
13 sum so appropriated shall remain available until expended.
14 (c) After its organization, a home management corpora-
15 tion shall receive funds from the Home Management Fund
16 and from any other Federal agency only if the Secretary, in
17 consultation with the Director of the Office of Economic
18 Opportunity, determines that the members of such corpora-
19 tion are contributing sufficient time and funds to insure that
20 the corporation is operating efficiently and effectively.

21 OWNERSHIP SUBSIDY FOR HOME MANAGEMENT
22 CORPORATIONS

23 SEC. 108. (a) A home management corporation which,
24 pursuant to section 101 (a) (5) (G) has exercised its option
25 to purchase a certified project shall be entitled to receive as

1 a subsidy, for each of its fiscal years ending after the exer-
2 cise of such option, but within the certified operation period,
3 the amount needed to meet the payments on any mortgage
4 placed on such project by such corporation to finance the
5 purchase of such project, but only to the extent such amount
6 cannot be obtained by such corporation through gross occu-
7 pancy charges because of the limitation on such charges
8 provided in section 102 (a) (2).
9 (b) For purposes of this section, there is hereby created
10 a Home Management Purchase Fund, and there is author-
11 ized to be appropriated (1) the sum of $5,000,000 to pro-
12 vide initial capital for such fund, and (2) such additional
13 sums as may from time to time be required to make all
14 necessary subsidy payments to home management corpora-
15 tions pursuant to subsection (a). Any sum so appropriated
16 shall remain available until expended.
17 ADMINISTRATION
18 SEC. 109. The provisions of this title shall be admin-
19 istered by the Secretary through a Low-Income Housing
20 Administration to be established by the Secretary in the
21 Department of Housing and Urban Development.
22 PENALTIES
23 SEC. 110. Whoever, in any report or income statement
24 required to be filed under this title, or any regulation issued
25 pursuant thereto, knowingly makes a false statement of a

1 material fact, shall be fined not more than $ or
2 imprisoned not more than , or both.

3 TITLE II—HOUSING ACTS AMENDMENTS

4 MORTGAGE INSURANCE

5 SEC. 201. Title II of the National Housing Act is
6 amended by adding at the end thereof a new section as
7 follows:

8 "MORTGAGE INSURANCE FOR URBAN HOUSING

9 "SEC. 235. (a) This section is designed to assist private
10 industry to provide housing in urban poverty areas for low-
11 income and lower middle income persons, and to assist home
12 management corporations to purchase housing, in further-
13 ance of the purposes of, and under a program authorized by,
14 the Urban Housing and Development Act of 1967.

15 "(b) The Secretary is authorized, upon application by
16 the mortgagee (1) to insure in accordance with the pro-
17 visions of this section any mortgage (including advances dur-
18 ing construction) which meets the requirements of subsection
19 (d) or (e) of this section, and which is otherwise eligible
20 for insurance as herein provided; and (2) upon such terms
21 and conditions as the Secretary may prescribe, to make
22 commitments for the insurance of such mortgages prior to
23 their execution or disbursement thereon.

24 "(c) As used in this section (except as otherwise herein
25 provided), the terms 'mortgage', 'mortgagee', 'mortgagor',

1 and 'maturity date' shall have the same meaning as in sec-
2 tion 201 of this Act.
3 "(d) A mortgage shall be eligible for insurance under
4 this section if it shall—
5 "(1) have been executed by a mortgagor to whom
6 has been issued, under section 101 (a) of the Urban
7 Housing Development Act of 1967, an unrevoked cer-
8 tificate of elegibility;
9 "(2) have been made to and be held by a mort-
10 gagee approved by the Secretary as responsible and able
11 to service the mortgage properly;
12 "(3) not exceed in principal amount $
13 "(4) not exceed 80 per centum of the total cost of
14 the project when the proposed new construction or sub-
15 stantial rehabilitation is completed. For purposes of this
16 paragraph, the total cost of a certified project shall be
17 the sum of (A) the mortgagor's adjusted basis for the
18 project (including both the land and the buildings) for
19 Federal income tax purposes, at the time that the new
20 construction, or substantial rehabilitation, certified under
21 section 101 of the Urban Housing Development Act of
22 1967, is completed, and (B) the amount of carrying
23 charges allocable to the certified project, which were
24 incurred during such construction or rehabilitation there-

1 of and deducted by the mortgagor but which could
2 have been capitalized by the mortgagor under section
3 266 of the Internal Revenue Code. Subject to regula-
4 tions to be prescribed by the Secretary, there may be
5 included in the total cost of the project, a net profit for
6 the builder (who, for this purpose, shall include all
7 parties related to the builder under section 267 of the
8 Internal Revenue Code), of up to, but not more than,
9 10 per centum of the total cost of the project less such
10 profit;
11 "(5) bear interest (exclusive of premium charges
12 for insurance and service charge, if any) at not to
13 exceed 2 per centum per annum on the amount of the
14 principal obligation outstanding at any time; and contain
15 such terms and provisions with respect to the application
16 of the mortgagor's periodic payment to amortization of
17 the principal of the mortgage, insurance, repairs, altera-
18 tions, payment of taxes, default reserves, delinquency
19 charges, foreclosure proceedings, anticipation of matu-
20 rity, and such other matters as the Secretary may
21 prescribe; and
22 "(6) provide for complete amortization by periodic
23 payments, upon such terms as the Secretary may pre-
24 scribe, over a period of fifty years.
25 "(e) A mortgage shall be eligible for insurance under
26 this section if it shall—

1 "(1) have been executed by a home manage-
2 ment corporation which has purchased a certified proj-
3 ect;
4 "(2) have been made to, and be held by, a mort-
5 gagee approved by the Secretary as responsible and able
6 to service the mortgage properly;
7 "(3) not exceed in principal amount $:
8 "(4) not exceed in principal amount the excess,
9 if any, of:
10 "(A) the price at which the home manage-
11 ment corporation purchased the property, over
12 "(B) the sum of:
13 "(i) the amount of any mortgage insured
14 under section 235(d) of the National Housing
15 Act to which such project is subject at the
16 time of the purchase by the home manage-
17 ment corporation, plus
18 "(ii) an amount equal to the number of
19 units in such project multiplied by $100;
20 "(5) bear interest (exclusive of premium charges
21 for insurance and service charge, if any) at a rate not
22 to exceed 6 per centum per annum on the amount of the
23 principal obligation outstanding at any time; and con-
24 tain such terms and provisions with respect to the ap-
25 plication of the mortgagor's periodic payment to amorti-

1 zation of the principal of the mortgage, insurance, re-
2 pairs, alterations, payment of taxes, default reserves,
3 delinquency charges, foreclosure proceedings, anticipa-
4 tion of maturity, and such other matters as the Secretary
5 may prescribe; and
6 "(6) provide for complete amortization by periodic
7 payments, upon such terms as the Secretary may pre-
8 scribe, over a period of fifty years less the period which
9 has elapsed since the completion of construction or
10 substantial rehabilitation of such project pursuant to a
11 certificate granted under section 101 (a) of the Urban
12 Housing Development Act of 1967.
13 "(f) A project covered by a mortgage insured under
14 the provisions of this section shall comply with the require-
15 ments of the Urban Housing Development Act of 1967, and
16 regulations prescribed thereunder, and for such purpose the
17 Secretary may make such contracts with, and acquire for
18 not to exceed $100 such stock or interest in the mortgagor,
19 as he deems necessary to render effective any such require-
20 ments. Such stock or interest shall be paid for out of the
21 General Insurance Fund and shall be redeemed by the mort-
22 gagor at par upon the termination of all obligations of the
23 Secretary under the insurance.
24 "(g) Notwithstanding any provision of this Act, the
25 Secretary may, whenever he determines that such action is

1 necessary or desirable in furtherance of the purposes of this
2 section, insure a mortgage under this section with no premium
3 charge, with a reduced premium charge, or with a premium
4 charge for such period or periods during the time the insur-
5 ance is in effect, as the Secretary may determine, and there
6 is authorized to be appropriated such amounts as may be
7 necessary to reimburse the General Insurance Fund for any
8 net losses in connection with such insurance.

9 "(h) The mortgagee shall be entitled to receive the
10 benefits of insurance issued under this section as provided
11 in section 207(g) of this Act with respect to mortgage in-
12 sured under such section 207, and the provisions of subsec-
13 tions (h), (i), (j), (k), and (l) of such section 207 shall
14 be applicable to mortgages insured under this section."

15 COST CERTIFICATION

16 SEC. 202. Section 227(a) of the National Housing
17 Act is amended by striking out "or (viii) under section 234
18 (d)" and inserting in lieu thereof "(viii) under section 234
19 (d), or (ix) under section 235".

20 PURCHASES BY FEDERAL NATIONAL MORTGAGE
21 ASSOCIATION

22 SEC. 203. Section 305 of the National Housing Act is
23 amended by adding at the end thereof a new subsection as
24 follows:

25 "(j) Notwithstanding any other provision of this Act,

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1 the Association is authorized to make commitments to pur-
2 chase and to purchase, service, or sell, any mortgage insured
3 under section 235 of this Act, subject to the following limi-
4 tations:

5 "(1) The total amount of such purchases and com-
6 mitments outstanding at any one time as to mortgages
7 subject to section 235 (d) shall not exceed $500,000,-
8 000, which amount shall be increased by $500,000,000
9 on July 1 in each of the years 1968, 1969, 1970, 1971,
10 and 1972.

11 "(2) Not more than 20 per centum of the total
12 amount of such purchases and commitments outstanding
13 at any one time, after the issuance of purchases and com-
14 mitments totaling at least $, shall relate to
15 mortgages secured by properties situated in any one
16 city."

17 CERTIFIED PROJECTS IN URBAN RENEWAL AREAS

18 SEC. 204. Section 107 (a) of the Housing Act of 1949
19 is amended—

20 (1) by striking out "or (2)" and inserting "(2)";

21 (2) by adding after "Act," the following: "or (3)
22 a purchaser having an unrevoked certificate of eligibility
23 issued under section 101 of the Urban Housing Develop-
24 ment Act of 1967,"; and

25 (3) by inserting "low or" before "moderate
26 income".

1 TITLE III—INTERNAL REVENUE CODE
2 AMENDMENTS

3 TAX TREATMENT OF CERTIFIED PROJECTS

4 SEC. 301. (a) Subpart A of part IV of subchapter A of
5 chapter 1 of the Internal Revenue Code of 1954 (relating to
6 credits allowable) is amended by renumbering section 40 as
7 42, and by inserting the following new section:

8 "SEC. 41. INVESTMENT IN CERTAIN HOUSING PROJECTS
9 IN URBAN POVERTY AREAS.

10 "(a) GENERAL RULE.—There shall be allowed, as a
11 credit against the tax imposed by this chapter, the amount
12 determined under section 1392.

13 "(b) REGULATIONS.—The Secretary or his delegate
14 shall prescribe such regulations as may be necessary to carry
15 out the purposes of this section and section 1392."

16 (b) Subchapter S of chapter 1 of the Internal Revenue
17 Code of 1954 (relating to the taxable status of small business
18 corporations) is amended by inserting after section 1378 the
19 following new section:

20 "SEC. 1379. INSURED INDEBTEDNESS OF SMALL BUSINESS
21 CORPORATION.

22 "(a) INSURED LOAN.—In the case of an electing small
23 business corporation which has been granted an insured loan
24 (as defined in subsection (c)) or which has purchased a
25 section 1391 property (as defined in subsection 1391 (3))
26 subject to an insured loan (as defined in subsection (c))—

1 "(1) the insured loan shall be deemed to have been
2 made by the lender to the shareholders of such corpora-
3 tion, in proportion to their holdings of stock at the time
4 that the loan is made,
5 "(2) the proceeds of the insured loan shall be
6 deemed to have been loaned by such shareholders to the
7 electing corporation, on the same terms as those of the
8 insured loan, and
9 "(3) payments by the corporation on the insured
10 loan shall be treated as payments on the loan deemed
11 made to the corporation by its shareholders under sub-
12 section (b) hereto, which are, in turn, paid by the
13 shareholders on the insured loan.
14 "(b) SALE OF STOCK.—A sale or exchange of shares
15 of stock in an electing small business corporation, in propor-
16 tion to which an allocation of an insured loan was at any time
17 made under subsection (a) (1), shall be deemed—
18 "(1) to include a sale or exchange of the unpaid
19 portion, if any, of the loan to the corporation which was
20 deemed made by the holder of such stock under subsec-
21 tion (a) (2), and
22 "(2) to have been made subject to the portion of
23 the insured loan deemed owing by the holder of such
24 stock under subsection (a) (1).
25 "(c) DEFINITIONS.—For purposes of this section the

1 term 'insured loan' means a loan made to an electing small
2 business corporation which is insured under section 235 (d)
3 of the National Housing Act."
4 (c) Chapter 1 of the Internal Revenue Code of 1954
5 (relating to normal taxes and surtaxes) is amended by add-
6 ing at the end thereof the following new subchapter:

7 **"Subchapter U—Tax Treatment of Certain Hous-**
8 **ing Projects in Urban Poverty Areas**

"Sec. 1391. Definitions.
"Sec. 1392. Investment credit.
"Sec. 1393. Depreciation of section 1391 buildings.
"Sec. 1394. Restoration of basis.
"Sec. 1395. Dispositions before end of minimum holding period.
"Sec. 1396. Nonrecognition of gain on certain dispositions of section 1391 property.

9 **"SEC. 1391. DEFINITIONS.**
10 "For purposes of this subchapter—
11 "(1) SECTION 1391 CERTIFICATE.—The term
12 'section 1391 certificate' means a certificate of eligibility
13 issued by the Secretary of Housing and Urban De-
14 velopment—
15 "(A) under section 101 (a) of the Urban
16 Housing Development Act of 1967, authorizing the
17 grant of certain income tax and other incentives
18 to a person constructing, or substantially rehabili-
19 tating, a certified project, or
20 "(B) under section 101 (b) of such Act, au-

1 thorizing certain income tax and other incentives
2 to a person who is a successor in interest to such
3 a project.
4 "(2) SECTION 1391 BUILDING.—The term 'section
5 1391 building' means any building which has been con-
6 structed, or substantially rehabilitated, pursuant to a
7 section 1391 certificate. The term includes—
8 "(A) the structure of the building and all
9 components of such building constituting section
10 1250 property (as defined in section 1250 (c)), and
11 "(B) elevators and escalators in the building
12 but no other equipment used in the operation of
13 the building which constitutes section 1245 property
14 (as defined in section 1245 (a) (3)).
15 "(3) SECTION 1391 PROPERTY.—The term 'section
16 1391 property' means real property consisting of—
17 "(A) a section 1391 building, and
18 "(B) the land on which any such section 1391
19 building is located.
20 For purposes of this subsection, the land on which a sec-
21 tion 1391 building is located shall include reasonable
22 grounds for the building, encompassing gardens, play-
23 grounds, and other facilities. In a case in which such
24 grounds constitute less than all of a tract of land owned
25 by the taxpayer (whether or not any other building not

1 constituting a section 1391 building is located on such a
2 tract), an apportionment of the total tract as between
3 the section 1391 property and other property, shall be
4 made pursuant to regulations to be prescribed by the
5 Secretary or his delegate.

6 "(4) SECTION 1391 CORPORATION.—The term
7 'section 1391 corporation' means a corporation which is
8 holding one or more section 1391 properties.

9 "(5) EQUITY INVESTMENT.—The term 'equity
10 investment' means—

11 "(A) with respect to the first holder of a sec-
12 tion 1391 property, the amount by which (i) the
13 holder's adjusted basis for such property at the time
14 of the completion of the construction or substantial
15 rehabilitation undertaken pursuant to the section
16 1391 certificate exceeds (ii) the initial principal
17 amount of any mortgage on such property which is
18 insured under the provisions of section 235(d) of
19 the National Housing Act, and

20 "(B) with respect to a subsequent holder of a
21 section 1391 property, the amount by which (i)
22 such holder's adjusted basis for such property at the
23 time of acquisition exceeds (ii) the unpaid principal
24 amount of any mortgage insured under the provisions
25 of section 235(d) of the National Housing Act to

1 which the property is subject at the time of its
2 acquisition.
3 "(6) EQUITY INVESTMENT PERCENTAGE.—The
4 term 'equity investment percentage' means, with respect
5 to the holder of a section 1391 property, the ratio of—
6 "(A) the holder's equity investment in such
7 property, to
8 "(B) the holder's adjusted basis for such prop-
9 erty at the applicable time specified in subsection
10 (5).
11 "(7) MAXIMUM HOLDING PERIOD.—The term
12 'maximum holding period' means with respect to a sec-
13 tion 1391 property the lesser of (A) the useful life of
14 the section 1391 building, constituting part of such prop-
15 erty, as determined under section 1393 (whether or not
16 an election with respect to such building has been made
17 under such section), or (B) the useful life of such
18 building for purposes of section 167, determined without
19 regard to section 1393.
20 "(8) MINIMUM HOLDING PERIOD.—The term 'min-
21 imum holding period' means with respect to a section
22 1391 property the lesser of (A) ten years, (B) the
23 useful life of the section 1391 building, constituting part
24 of such property, as determined under section 1393
25 (whether or not an election with respect to such build-
26 ing has been made under such section), or (C) the use-

1 ful life of such section 1391 building for purposes of
2 section 167, determined without regard to section 1393.
3 "(9) QUALIFIED EXPENDITURES.—The term 'qual-
4 ified expenditures' means, with respect to any taxable
5 year—
6 "(A) as to a taxpayer who, during the taxable
7 year, completed the construction or substantial reha-
8 bilitation of a section 1391 building, pursuant to a
9 section 1391 certificate, the adjusted basis of the
10 section 1391 property of which such building con-
11 stitutes a part, at the time of the completion of such
12 construction or substantial rehabilitation, and
13 "(B) as to a taxpayer who purchases a section
14 1391 property during the taxable year, as a subse-
15 quent holder thereof, the basis of such property at
16 the time of purchase.
17 "(10) FIRST HOLDER.—The term 'first holder'
18 means with respect to any section 1391 building, or sec-
19 tion 1391 property, the person to whom a section 1391
20 certificate is issued authorizing the construction or sub-
21 stantial rehabilitation of a section 1391 building as part
22 of such property.
23 "(11) SUBSEQUENT HOLDER.—The term 'subse-
24 quent holder' means, with respect to any section 1391
25 property, a person to whom a section 1391 certificate

1 has been issued with respect to such property under sec-
2 tion 101 (b) of the Urban Housing Development Act
3 of 1967, but only if—
4 "(A) such person acquires such property by
5 purchase (as defined in section 179 (d) (2)) from
6 a person who, at the time of the purchase, was a first
7 holder or subsequent holder of the property,
8 "(B) the acquisition is made after the end of
9 the minimum holding period applicable to such prop-
10 erty in the hands of such first or subsequent holder.
11 **"SEC. 1392. INVESTMENT CREDIT.**
12 "(a) DETERMINATION OF AMOUNT.—
13 "(1) GENERAL RULE.—The amount of the credit
14 allowed by section 41 for the taxable year with respect
15 to any section 1391 property (as defined in section
16 1391 (3)) shall be the following percentage of the quali-
17 fied expenditures (as defined in section 1391 (7)) made
18 by the taxpayer with respect to such property:

"If the taxpayer's equity investment percentage (as defined in subsection 1391(6)) is—	In the case of the first holder of any section 1391 property (as defined in subsection 1391(10)), the credit shall be—	In the case of a subsequent holder of such property (as defined in subsection 1391 (11)), the credit shall be—
Less than 20 percent	None	2 percent.
20 percent or more but less than 25 percent	3 percent	2 percent.
25 percent or more but less than 30 percent	5 percent	3 percent.
30 percent or more but less than 35 percent	6.5 percent	4 percent.
35 percent or more but less than 40 percent	8 percent	5 percent.
40 percent or more but less than 45 percent	9.5 percent	6 percent.
45 percent or more but less than 50 percent	10 percent	7 percent.
50 percent or more but less than 55 percent	11 percent	8 percent.
55 percent or more but less than 60 percent	12 percent	9 percent.
60 percent or more but less than 65 percent	14 percent	10 percent.
65 percent or more but less than 70 percent	16 percent	11 percent.
70 percent or more but less than 75 percent	18 percent	12 percent.
75 percent or more but less than 80 percent	20 percent	13 percent.
80 percent or more but less than 85 percent	22 percent	15 percent.
85 percent or more but less than 90 percent	24 percent	17 percent.
90 percent or more but less than 95 percent	26 percent	19 percent.
95 percent or more but less than 100 percent	28 percent	21 percent.
100 percent	30 percent	23 percent.

1 A subsequent holder shall receive a credit under this
2 paragraph with respect to any section 1391 property
3 only if he acquires such property within 40 years after
4 the completion of construction or substantial rehabilita-
5 tion of a section 1391 building thereon.
6 "(2) LIMITATION.—Notwithstanding paragraph
7 (1), the credit allowed by section 41 for the taxable
8 year shall not exceed the taxpayer's liability for tax
9 for the taxable year.
10 "(3) LIABILITY FOR TAX.—For purposes of this
11 section, the liability for tax for the taxable year shall be
12 the tax imposed by this chapter for such year, reduced
13 by the sum of the credits allowable under—
14 "(A) section 33 (relating to foreign tax
15 credit),
16 "(B) section 35 (relating to partially tax-ex-
17 empt interest),
18 "(C) section 37 (relating to retirement in-
19 come), and
20 "(D) section 38 (relating to investment in
21 certain depreciable property).
22 For purposes of this paragraph, any tax imposed for
23 the taxable year by section 531 (relating to accumu-
24 lated earnings tax), section 541 (relating to personal
25 holding company tax), or section 1378 (relating to tax

1 on certain capital gains of subchapter S corporations),
2 and any additional tax imposed for the taxable year by
3 section 1351 (d) (1) (relating to recoveries of foreign
4 expropriation losses), shall not be considered tax im-
5 posed by this chapter for such year.

6 "(b) CARRYBACK AND CARRYOVER OF UNUSED
7 CREDITS.—

8 "(1) ALLOWANCE OF CREDIT.—If the amount of
9 the credit determined under subsection (a) (1) for any
10 taxable year exceeds the limitation provided by subsec-
11 tion (a) (2) for such taxable year (hereafter in this
12 subsection referred to as the 'unused credit year'), such
13 excess shall be—

14 "(A) a section 41 credit carryback to each of
15 the 3 taxable years preceding the unused credit
16 year, and

17 "(B) a section 41 credit carryover to each of
18 the 7 taxable years following the unused credit year,
19 and shall be added to the amount allowable as a credit
20 by section 41 for such years, except that such excess
21 may be a carryback only to a taxable year ending after
22 the date of the enactment of the Urban Housing De-
23 velopment Act of 1967. The entire amount of the
24 unused credit for an unused credit year shall be carried
25 to the earliest of the 10 taxable years to which (by

1 reason of subparagraphs (A) and (B)), such credit
2 may be carried and then to each of the other 9 taxable
3 years to the extent that, because of the limitation con-
4 tained in paragraph (2), such unused credit may not be
5 added for a prior taxable year to which such unused
6 credit may be carried.
7 "(2) LIMITATION.—The amount of the unused
8 credit which may be added under paragraph (1) for
9 any preceding or succeeding taxable year shall not ex-
10 ceed the amount by which the limitation provided by
11 subsection (a) (2) for such taxable year exceeds the
12 sum of—
13 "(A) the credit allowable under subsection
14 (a) (1) for such taxable year, and
15 "(B) the amounts which, by reason of this
16 subsection, are added to the amount allowable for
17 such taxable year and attributable to taxable years
18 preceding the unused credit year.
19 "(c) SUBCHAPTER S CORPORATIONS.—In the case of
20 an electing small business corporation (as defined in section
21 1371)—
22 "(1) the qualified expenditures for each taxable
23 year shall be apportioned pro rata among the persons
24 who are shareholders of such corporation on the last day
25 of such taxable year, and

1 "(2) any person to whom any expenditures have
2 been apportioned under paragraph (1) shall be treated
3 (for purposes of this subchapter) as the taxpayer with
4 respect to such expenditures, and such expenditures shall
5 not (by reason of such apportionment) lose their char-
6 acter as qualified expenditures.

7 "(d) ESTATES AND TRUSTS.—In the case of an estate
8 or trust—

9 "(1) the qualified expenditures for any taxable year
10 shall be apportioned between the estate or trust and the
11 beneficiaries on the basis of the income of the estate or
12 trust allocable to each, and

13 "(2) any beneficiary to whom any expenditures
14 have been apportioned under paragraph (1) shall be
15 treated (for purposes of this subchapter) as the taxpayer
16 with respect to such expenditures, and such expenditures
17 shall not (by reason of such apportionment) lose their
18 character as qualified expenditures.

19 "(e) CROSS REFERENCES.—

"(1) For the effect of a disposition of section 1391 property before the end of the minimum holding period applicable to a certified housing project, see section 1395.

"(2) For application of this subchapter to certain acquiring corporations, see section 381(c)(24).

1 "SEC. 1393. DEPRECIATION OF SECTION 1391 BUILDINGS.

2 "(a) ELECTION BY TAXPAYER.—If an election is made
3 under this subsection with respect to a section 1391 building
4 (as defined in section 1391 (2))—

5 "(1) expenditures paid or accrued in the course of
6 the construction, or substantial rehabilitation of such
7 building, pursuant to a section 1391 certificate (as de-
8 fined in section 1391 (1)), for the demolition of exist-
9 ing structures and for site improvement, which would,
10 apart from this subsection, be added to the taxpayer's
11 basis for the land, shall instead be added to the taxpay-
12 er's basis for the section 1391 building;

13 "(2) the useful life of such section 1391 building,
14 for purposes of section 167 shall be determined under
15 subsection (b); and

16 "(3) for purposes of section 167, such building shall
17 be treated as having no salvage value.

18 An election under this subsection with respect to any prop-
19 erty shall be made at such time and in such manner as the
20 Secretary or his delegate prescribes by regulations. Any such

1 election may be revoked only with the consent of the Secre-
2 tary or his delegate.
3 "(b) USEFUL LIFE.—
4 (1) For purposes of subsection (a)—

"If the taxpayer's equity investment percentage (as defined in section 1391(6)) is—	If the taxpayer is the first holder (as defined in section 1391(10)) with respect to the section 1391 building, the useful life of the building shall be the following percentage of its useful life as determined under paragraph (2)—	If the taxpayer is a subsequent holder (as defined in section 1391(11)) with respect to the section 1391 building, the useful life of the building shall be the following percentage of its useful life as determined under paragraph (2) but in no case less than 10 years—
Less than 10 percent	None	75 percent.
10 percent or more but less than 20 percent	None	55 percent.
20 percent or more but less than 25 percent	40 percent	40 percent.
25 percent or more but less than 30 percent	36 percent	39 percent.
30 percent or more but less than 35 percent	32 percent	38 percent.
35 percent or more but less than 40 percent	28 percent	37 percent.
40 percent or more but less than 45 percent	25 percent	36 percent.
45 percent or more but less than 50 percent	22 percent	35 percent.
50 percent or more but less than 55 percent	20 percent	34 percent.
55 percent or more but less than 60 percent	19 percent	33 percent.
60 percent or more but less than 65 percent	18 percent	32 percent.
65 percent or more but less than 70 percent	17.5 percent	31 percent.
70 percent or more but less than 75 percent	17 percent	30 percent.
75 percent or more but less than 80 percent	16.5 percent	29 percent.
80 percent or more but less than 85 percent	16 percent	28 percent.
85 percent or more but less than 90 percent	15.5 percent	27 percent.
90 percent or more but less than 95 percent	15 percent	26 percent.
95 percent or more but less than 100 percent	14.5 percent	25 percent.
100 percent	14 percent	24 percent.

5 "(2) For purposes of applying the percentages set
6 forth in paragraph (1), the useful life of a section 1391
7 building shall be—
8 "(A) In the case of the first holder, 50 years,
9 and
10 "(B) In the case of any subsequent holder, the
11 remaining useful life of the section 1391 building
12 at the time of its acquisition, assuming a useful life
13 of 50 years in the hands of the first holder.
14 "(3) If the useful life determined under paragraph
15 (1) includes a fraction of a year, such useful life shall
16 be computed in years and months and any fraction of
17 a month shall be rounded to the nearest month.

1 "(c) METHOD OF DEPRECIATION.—If an election is
2 made under subsection (a) with respect to any section 1391
3 building, the methods of depreciation specified in section
4 167 (c) may not be used.

5 "(d) CROSS REFERENCE.—

"For the effect of any early disposition of a section 1391 building with respect to which an election is made under subsection (a), see section 1395.

6 "SEC. 1394. RESTORATION OF BASIS.

7 "(a) ELECTION.—Under regulations prescribed by the
8 Secretary or his delegate, if a holder of a section 1391 prop-
9 erty (as defined in subsection 1391 (3)) holds such prop-
10 erty for the maximum holding period applicable thereto (as
11 defined in section 1391 (7)), and at the end of such period
12 elects to continue to hold such property in conformity with
13 the requirements of section 101 of the Urban Housing De-
14 velopment Act of 1967, such holder shall, for purposes of
15 this chapter (except as provided in subsection (b)), be
16 treated as having sold and purchased such property, on the
17 first day after the end of such maximum holding period, for
18 an amount determined under subsection (b).

19 "(b) RESTORATION PRICE.—The price at which a hold-
20 er making an election under subsection (a) shall be treated
21 as having sold and purchased the section 1391 property,
22 shall be an amount equal to:

23 "(1) in the case of the first holder of such property,

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1 the price at which a home management corporation
2 could have exercised its option to purchase such prop-
3 erty, on the date of such sale and purchase, under section
4 101 (a) (5) of the Urban Housing Development Act of
5 1967; and
6 "(2) in the case of a subsequent holder of such
7 property, the lesser of:
8 "(A) the option price for a home management
9 corporation under section 101 (a) (5) of the Urban
10 Housing Development Act of 1967, on the date of
11 such sale and purchase, or
12 "(B) the excess, if any, of—
13 "(i) the aggregate qualified expenditures
14 (as defined in section 1391 (9) of such holder,
15 over
16 "(ii) the aggregate amount of depreciation
17 deductions that would have been allowable to
18 such holder under section 167 to the date of
19 the purchase assuming depreciation deductions
20 were computed under the straight line method
21 of depreciation over the remaining useful life
22 of the section 1391 building at the time of its
23 acquisition by such holder, assuming a useful life
24 of 50 years in the hands of the first holder.
25 "(c) TREATMENT AS SUBSEQUENT HOLDER.—A tax-

1 payer who makes an election under subsection (a) hereof
2 shall be treated as of the date of the purchase under such
3 election as a subsequent holder of the section 1391 property
4 for all purposes under this chapter, except that—
5 "(1) such election shall not affect the taxpayer's
6 status as a holder or subsequent holder for purposes of
7 subsection (b),
8 "(2) such purchase shall not be a qualified reinvest-
9 ment for the purpose of applying section 1396(b) (1),
10 "(3) such taxpayer shall not be entitled to any
11 credit on such purchase under section 1392.

12 **"SEC. 1395. DISPOSITIONS BEFORE END OF MINIMUM**
13 **HOLDING PERIOD.**

14 "(a) DISPOSITIONS OF SECTION 1391 PROPERTY.—If
15 any section 1391 property (as defined in section 1391 (3))
16 is disposed of before the end of the minimum holding period
17 applicable to such property (as defined in section 1391 (8))
18 except in a disposition subject to section 1396(c)—
19 "(1) in applying section 1250 (relating to gain
20 from disposition of certain depreciable realty) to such
21 disposition—
22 "(A) the applicable percentage shall be 100
23 percent, and
24 "(B) the term 'additional depreciation' in sub-
25 section 1250(a) (1) (A) shall mean (in lieu of the

1 meaning set forth in subsection 1250(b)(1)), the
2 depreciation adjustments with respect to such prop-
3 erty, to the extent they exceed the sum of—
4 "(i) the depreciation adjustments which
5 would have resulted if such adjustments had
6 been determined for each taxable year under
7 the straight-line method of depreciation, but
8 without regard to section 1393, and
9 "(ii) any amounts eliminated from addi-
10 tional depreciation under paragraph (b)(5).
11 "(2) the tax under this chapter for the taxable year
12 in which the disposition occurs shall be increased by an
13 amount equal to the credits allowed under section 41 for
14 prior taxable years which are attributable to such prop-
15 erty, and any carrybacks and carryovers under section
16 1392(b) shall be adjusted: *Provided*, That this para-
17 graph shall not apply to any disposition upon which gain
18 otherwise subject to section 1250(a) is not recognized
19 in whole or in part by virtue of any of the provisions of
20 section 1250(c).
21 For purposes of this subsection, if the section 1391 certificate
22 (as defined in section 1391(1)), issued with respect to
23 any section 1391 property, is terminated by the Secre-
24 tary of Housing and Urban Development under section 101
25 (c) of the Urban Housing Development Act of 1967, or if

1 any property otherwise ceases to qualify as section 1391
2 property with respect to the taxpayer, such property shall
3 be treated as having been disposed of on the day on which
4 such termination becomes effective or such cessation occurs.
5 "(b) DISPOSITION OF STOCK.—
6 "(1) GENERAL RULE.—If stock in a section 1391
7 corporation (as defined in section 1391(4)) is dis-
8 posed of before the end of the minimum holding period
9 applicable to any section 1391 property held by the
10 corporation issuing such stock, gain on such disposition
11 which is not subject to the provision of section 341(a),
12 shall be considered as gain from the sale or exchange
13 of property which is not a capital asset, to the extent
14 of the amount determined under paragraph (2).
15 "(2) AMOUNT OF ORDINARY INCOME.—The
16 amount of gain subject to paragraph (1) shall be the
17 amount allocable to the stock sold (as determined by
18 the regulations to be prescribed by the Secretary or his
19 delegate) of the aggregate gain subject to section
20 1250(a) that would have been recognized by the sec-
21 tion 1391 corporation, if at the time of such disposition
22 of stock, the corporation sold, at a price determined
23 under section 1394(b); each section 1391 property (as
24 defined in subsection 1391(3)) which it had not, at
25 such time, held for its minimum holding period. In

1 applying paragraph (1) to a sale or exchange under
2 section 302, 303, or 346, any gain subject to subsection
3 (a) realized by the section 1391 corporation on such
4 sale or exchange shall not be included in the potential
5 income of the corporation subject to section 1250,
6 referred to in the preceding sentence.
7 "(3) MINORITY SHAREHOLDERS.—Paragraph (1)
8 of this subsection shall not apply if—
9 "(A) at no time during the 5 years preced-
10 ing the sale or exchange, the taxpayer owned di-
11 rectly or indirectly over 10 percent of either the
12 common stock or the voting stock of the section 1391
13 corporation, or
14 "(B) at the time of the sale or exchange, the
15 aggregate fair market value of the section 1391
16 properties held by the section 1391 corporation, less
17 the liabilities to which such properties are subject or
18 which are otherwise related thereto, represented less
19 than 10 percent of the fair market value of such cor-
20 poration's assets less the amount of all its liabilities.
21 "(4) EXCEPTED TRANSFERS.—
22 "(A) Paragraph (1) shall not apply to a dis-
23 position upon death or by gift.
24 "(B) Paragraph (1) shall not apply to a sale
25 or exchange of stock in complete liquidation of the
26 corporation under section 331.

1 "(C) If the basis of stock in a section 1391
2 corporation in the hands of a transferee is deter-
3 mined by reference to its basis in the hands of the
4 transferor thereof in a disposition otherwise subject
5 to paragraph (1), by reason of the application of
6 section 332, 351, 361, 371(a), 721, or 731, the
7 amount of gain taken into account by the transferor
8 on such disposition under paragraph (1) of this
9 subsection shall not exceed the amount of gain rec-
10 ognized on the disposition, determined without ref-
11 erence to this section.

12 "(5) ELIMINATION FROM ADDITIONAL DEPRECIA-
13 TION.—The amount of gain subject to paragraph (1)
14 on a disposition of stock in a section 1391 corporation
15 shall, as of the date of such disposition, be eliminated
16 from the additional depreciation as to the section 1391
17 properties held by such corporation under subparagraph
18 1395(a)(1)(B)(i).

19 "SEC. 1396. NONRECOGNITION OF GAINS ON CERTAIN DIS-
20 POSITIONS OF SECTION 1391 PROPERTY.

21 "(a) NONRECOGNITION OF GAIN.—Upon a disposi-
22 tion of section 1391 property (as defined in section 1391
23 (3)), gain shall not be recognized to the extent set forth in
24 subsection (b), (c), or (d).

25 "(b) QUALIFIED REINVESTMENT.—

26 "(1) GENERAL RULE.—If section 1391 property

1 is sold or exchanged at any time after the end of the
2 minimum holding period applicable to such property (as
3 defined in subsection 1391 (8)), no gain shall be recog-
4 nized if, within 1 year after the date of such sale or
5 exchange, or within such longer period of time as may
6 be authorized by the Secretary or his delegate, upon an
7 application of the taxpayer showing reasonable grounds
8 for an extension, the taxpayer makes a qualified reinvest-
9 ment (as defined in paragraph (2)) of an amount not
10 less than:
11 "(A) the amount realized on such sale or ex-
12 change, over
13 "(B) the amount of any mortgage on such
14 property insured under section 235 (d) of the
15 National Housing Act (as of the date of such sale
16 or exchange).
17 "(2) AMOUNT OF QUALIFIED REINVESTMENT.—
18 For purposes of this subsection, a qualified reinvestment
19 shall mean:
20 "(A) an expenditure paid or accrued by the
21 taxpayer which will constitute part of a qualified
22 expenditure (as defined in section 1391 (9) (A)),
23 or
24 "(B) any other expenditure paid or accrued by
25 the taxpayer for the construction or substantial re-

1 habilitation of housing, the rental levels of which
2 insure that they will be suitable for occupancy by
3 low-income or lower middle income families or indi-
4 viduals. The types of expenditures which shall con-
5 stitute qualified reinvestments under this subpara-
6 graph shall be specified in regulations to be pre-
7 scribed by the Secretary of Housing and Urban
8 Development.
9 "(c) DISPOSITION TO HOME MANAGEMENT CORPORA-
10 TION.—If section 1391 property is sold or exchanged at
11 any time after the expiration of two years of the taxpayer's
12 holding period applicable to such property, no gain shall be
13 recognized if such sale or exchange is made to a home
14 management corporation (as defined in section 3 (7) of the
15 Urban Housing Development Act of 1967).
16 "(d) DISPOSITIONS AFTER END OF MINIMUM HOLD-
17 ING PERIOD.—
18 "(1) GENERAL RULE.—If section 1391 property is
19 sold or exchanged at any time after the end of the mini-
20 mum holding period applicable to such property (as
21 defined in section 1391 (7)) and subsection (b) or
22 (c) do not apply to such sale or exchange, then the gain
23 to be recognized on such sale or exchange shall not ex-
24 ceed the amount determined under paragraph (2).
25 "(2) AMOUNT OF GAIN.—The amount of gain to

1 be recognized on a sale or exchange described in para-
2 graph (1) shall not be greater than the excess of—
3 "(A) the amount realized on such sale or ex-
4 change, over
5 "(B) the amount of the mortgage insured under
6 section 235(d) of the National Housing Act that
7 would have been on such property, as of the date of
8 such sale or exchange, on the assumption that—
9 "(i) the equity investment percentage (as
10 defined in section 1391(5)) of the first holder
11 of the property (as defined in section 1391
12 (10)) was 20 percent, and
13 "(ii) all payments on such mortgage had
14 been timely made through the date of such sale
15 or exchange.
16 "(e) CHARACTERIZATION OF GAIN.—If section 1391
17 property is sold or exchanged after the expiration of the
18 minimum holding period applicable to such property, any
19 gain or loss recognized on such sale or exchange shall be
20 treated as gain or loss on the sale or exchange of property
21 described in section 1231(b)."
22 "SEC. 1397. AUTHORITY OF PRESIDENT TO CHANGE RATES
23 AND USEFUL LIFE.
24 "(a) CHANGE BY EXECUTIVE.—The President shall
25 have the power at any time and from time to time to increase
26 or decrease by Executive order any or all of the:

1 "(1) rates of credits specified in section 1392
2 (a) (1),
3 "(2) the percentages utilized in computing useful
4 lives under section 1393 (b) (1), and
5 "(3) the useful life specified in section 1392 (b) (2)
6 as the basis for the application of the percentages
7 specified in section 1392 (b) (1).
8 "(b) MAXIMUM CHANGE.—No increase or decrease in
9 the rate, percentage, or useful life prescribed in an Executive
10 order issued under subsection (a) shall cause such rate,
11 percentage, or useful life to be higher than 115 percent or
12 lower than 85 percent of the comparable rate, percentage,
13 or useful life specified in section 1392 (a) (1), section 1393
14 (b) (1), or section 1393 (b) (2) on the date of enactment
15 of the Urban Housing Development Act of 1967.
16 "(c) DIFFERENT PROPERTY.—The power of the Presi-
17 dent under subsection (a), shall include, but not be limited
18 to, the power to prescribe different rates of credit, percent-
19 ages, and useful lives for different classes of section 1391
20 property and for different areas of the country."
21 TECHNICAL, CONFORMING, AND CLERICAL AMENDMENTS
22 SEC. 302. (a) The table of subchapters for chapter 1
23 of the Internal Revenue Code of 1954 is amended by adding
24 at the end thereof the following new item:

"SUBCHAPTER U. Tax treatment of certain housing projects in urban poverty areas."

1 (b) The table of sections for subpart A of part IV of
2 subchapter A of chapter 1 of such Code is amended by
3 inserting the following:

"Sec. 41. Investment in certain housing projects in urban poverty areas."

4 (c) Section 167 (j) of such Code is amended to read
5 as follows:

6 "(j) Cross References.—

"(1) For additional rules applicable to depreciation of improvements in the case of mines, oil and gas wells, other natural deposits, and timber, see section 611.

"(2) For additional rules applicable to depreciation of section 1391 property, see section 1393."

7 (d) Section 381 (c) of such Code is amended by adding
8 at the end thereof the following new paragraph:

9 "(24) Credit under section 41 for invest-
10 ment in certain housing projects in urban
11 poverty areas.—The acquiring corporation shall take
12 into account (to the extent proper to carry out the pur-
13 poses of this section and section 41, and under such regu-
14 lations as may be prescribed by the Secretary or his
15 delegate) the items required to be taken into account for
16 purposes of section 41 in respect to the distributor or
17 transferor corporation."

18 (e) Section 501 (c) of such Code is amended by adding
19 at the end thereof the following new paragraph:

20 "(18) A home management corporation as defined

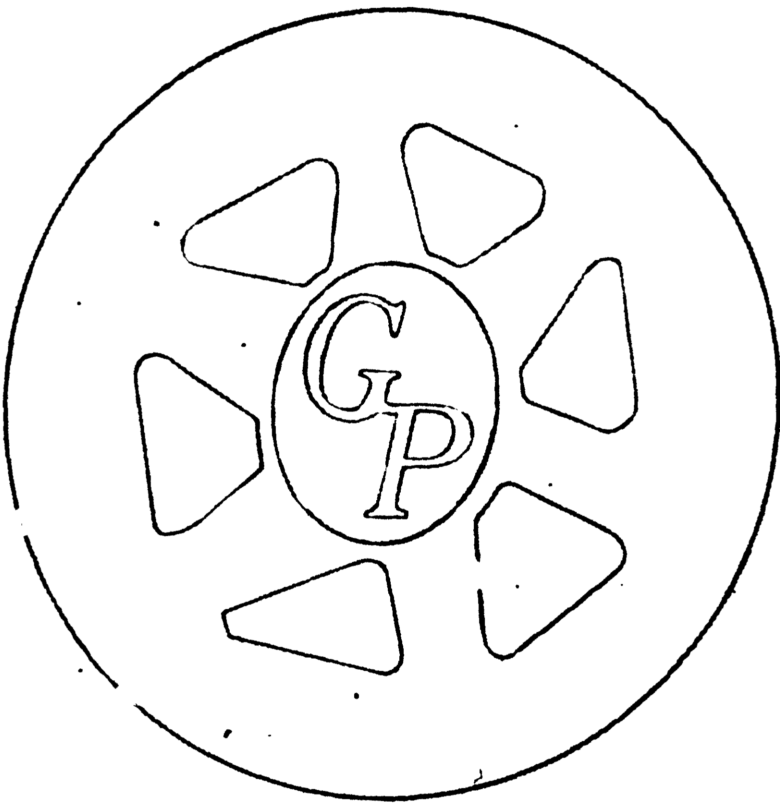
1 in section 3(7) of the Urban Housing Development
2 Act of 1967."
3 (f) Section 1250 of such Code is amended by adding
4 at the end thereof the following new subsection:
5 "(i) CERTIFIED HOUSING PROJECT.—For special rules
6 for applying this section in the case of real property com-
7 prising section 1391 property, see section 1395."
8 (g) Subsection 1250(d) is amended by adding at the
9 end thereof the following new paragraph:
10 "(9) TRANSFER TO HOME MANAGEMENT CORPO-
11 RATION.—Subsection (a) shall not apply to a disposition
12 of section 1391 property (as defined in section 1391
13 (3)) which is subject to section 1396(c)."
14 (h) Section 1371 of such Code is amended by adding
15 at the end thereof the following new subsection:
16 "(e) CORPORATE SHAREHOLDERS.—Subparagraph (a)
17 (2) of this section shall not apply to a corporation during
18 any taxable year in which over 90 percent of its gross re-
19 ceipts are realized in the operation, sale, or exchange of sec-
20 tion 1391 property."
21 (i) Section 1372(e)(5) of such Code is amended by
22 inserting after "rents" the following: "(other than rents
23 from section 1391 property)".
24 (j) The table of sections for subchapter S of chapter 1

1 of such Code is amended by adding at the end thereof the
2 following new item:

"SEC. 1379. Indebtedness to shareholders of small business corporation holding section 1391 property."

3 EFFECTIVE DATE

4 SEC. 303. The amendments made by this title shall
5 apply to taxable years ending after the date of the enactment
6 of this Act.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