



THE PROVIDENT
PROVIDENT NATIONAL BANK

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July 8, 1982

Mr. James F. Bodine
Managing Partner
Greater Philadelphia Partnership
900 Western Savings Building
Broad and Chestnut Streets
Philadelphia, PA 19107

Dear Mr. Bodine:

The state of the home building industry and residential mortgage market is a source of major concern for all of us involved with and affected by the nation's underlying economic problems. As you well know, the availability of funds for home purchases has largely been drawn away by more attractive investment alternatives, particularly the money market certificates and other short-term, high yielding investments. Not readily made known is the direct relationship between lender cost of funds and (what I have termed) the "affordability equation".

Control over interest rates must be recognized as a problem international in scope, the solution therefore dependent upon an increased worldwide political and economic stability sufficient to reduce the rational expectation by investors of renewed inflationary pressures. Interest rates, however, represent only one factor in the equation; the second factor is price. Unfortunately, the inflation-prone nature of housing prices which dominated the 1970s continues to place housing acquisitions beyond the reach of many family incomes. There also appears in the market a prolonged reluctance on the part of homeowners attempting to sell existing properties to accept losses on sales attributable to speculatively high original purchase prices. Quite simply, many individuals paid a premium for well-located housing in anticipation of future capital gains, and they have been less than willing to absorb losses similar to those experienced by investors who speculated in the gold, silver and other commodities markets.

The interesting thing about housing prices is the potential for pricing differentials as a result of local economic conditions. This is a fact most often overlooked by those who lobbied heavily in the U.S. Congress for interest rate subsidies. A somewhat detailed explanation follows of what I see as the primary elements contained in the price of housing; and, there are three: (i) the cost of land acquisition; (ii) materials acquisition and labor; and (iii) construction loan interest.

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Out of the three primary elements listed above, only one is priced in accordance with phenomena particular to local economic conditions -- that is, the acquisition price of the construction site. Available statistics reveal the price of well-located urban building sites has during the last twenty years escalated at a rate far in excess of most other commodities (and, more than occasionally, greater than the percentage increase in crude oil prices). Even this prolonged recession has only brought a reduction in the rate of growth in the price of construction sites, and nothing close to the drop in gold and silver prices.

Economists explain the process quite simply as a result of the very special quality of land as a production factor. Desirable urban and suburban locations are relatively scarce (ie., inelastic) in supply. Consequently, as population in large metropolitan areas has grown (requiring more and more land for housing, industry and capital improvements made by government) there occurred tremendous competition among developers for both current and future project sites. Such "land banking" activity has become a necessity for developers to assure reasonable future land costs. Unfortunately, however, land banking also takes land off the market for current use, resulting in even higher prices for those sites which remain available. The impact upon overall construction costs and ultimate selling prices of housing is tremendous.

An additional (and even more serious) problem for the developer and home buyer is the speculative activity of investors who have historically viewed raw land as a prime source of future capital gains. Many developable tracts are purchased by such investors with absolutely no development plan in mind. Such speculative holdings contribute markedly to a significantly overpriced market for raw land and further motivate real estate developers to invest in land banking as a "defense" measure against future rises in land prices. For the most part, everyone connected with the real estate sector has simply accepted this process -- and its ramifications for orderly and sustained development -- as a cost of the market system. My own view differs substantially, and I believe there is great potential for very positive change with a minimum of market interruption (or government intervention).

What has been needed for many years is a market mechanism for discouraging both land banking and investor speculation in undeveloped land. Continued analysis of this problem eventually led to research conducted by two well-respected economists, Professors Mason Gaffney (now at the University of California, Riverside) and C. Lowell Harris (recently retired from Columbia University), who have strongly recommended a restructuring of the local property tax system as a key ingredient to a solution to escalating land speculation.

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Both Mason Gaffney and Lowell Harriss have concluded that the property tax, as presently structured in most municipalities, penalizes new construction or rehabilitation in all but the most profitable areas of the city (which explains Philadelphia's extensive use of tax abatements) and, at the same time, encourages (as a result of low, fractional assessments and low tax rates) acquisition of undeveloped and underdeveloped sites for speculative purposes. Mason Gaffney directed me to our sister city, Pittsburgh, for an example of a system which more appropriately treats land and improvements in a manner which encourages growth and development and discourages underutilization and speculation.

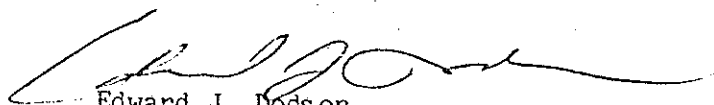
The City of Pittsburgh has adopted what is called a "graded tax" system, under which the assessed value of land and buildings are taxed at separate rates. The current ratio of the rate applied to land is approximately 4.5 to 1 over buildings. Although there are certainly other factors involved, I have been extremely impressed by the degree of construction activity which has occurred during the past several years in Pittsburgh as compared with other major northern cities.

Some time ago I met with representatives of a public interest group known as the "Incentive Tax League", organized in Pennsylvania to promote tax reform. This organization has been promoting a change in Philadelphia similar to that which now exists in Pittsburgh (and also several other smaller Pennsylvania cities, including Harrisburg). A bill has recently been introduced into City Council by Councilman Tayoun (No. 1226, a copy of which is enclosed) which is designed to permit Philadelphia to apply different millage rates to land and improvements in any ratio deemed appropriate. On June 22nd, I appeared before the Finance Committee of City Council (not as an officer of Provident National Bank, but as a member of the real estate community) and testified in support of Bill 1226.

Among those who also appeared before the Finance Committee was the Director of the New York based "Center for Local Tax Research". A copy of his testimony has been provided me, and I enclose this for review. Mr. Finkelstein raises several points associated with this proposal which I have not addressed.

I understand a second hearing will be held in City Council early this Fall. In the interim, I strongly recommend examination of this measure by the Greater Philadelphia Partnership inasmuch as the economic health of our community is at issue. To that end, I certainly offer my services in whatever capacity will prove beneficial.

Sincerely,



Edward J. Dodson

Senior Mortgage Officer

Manager - Mortgage Administration

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Enclosure