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1-26-84

Mallach's letter re. use of Consumer  
price Index

Ass. 5

P: #3337

AMC00118E

Alan Mallach 15 Pine Drive Roosevelt New Jersey 08555

January 26, 1984

*file*

Kenneth E. Meiser, Esq.  
Deputy Director, Division of Public  
Interest Advocacy  
NJ Department of the Public Advocate  
CN 850  
Trenton, New Jersey 08625

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JAN 30 1984

Henry A. Hill, Jr., Esq.  
Brener, Wallack & Hill  
2-4 Chambers Street  
Princeton, New Jersey 08540

JUDGE SERPENTELLI'S CHAMBERS

Gentlemen:

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You have conveyed to me the concern of the court, in resolving the remaining issues in the Bedminster settlement, over the use of the Consumer Price Index rather than an income measurement for determining the resale price of lower income units in The Hills, and that I further evaluate this issue in order to make a recommendation as to an equitable formula to be applied. Having reviewed the matter further, I have concluded that it is feasible to apply a ~~\_\_\_\_\_~~ to the determination of resale price, and will make a specific recommendation in that regard below.

I would like to note that doing so involves balancing benefits, as it were, to the owner/seller and to the buyer of the unit. By using CPI, one assures the owner that the value of the unit will not fall below its initial relationship to the marketplace. One can do so, however, only at the risk that the affordability of the unit is impaired, perhaps severely, if income growth does not keep pace with the CPI. By adopting an income standard, we have implicitly placed greater stress on ensuring affordability to the prospective lower income buyer, than on ensuring a return to the owner/seller. At least in the Bedminster context, I believe that this is a sound choice.

This is supported by a review of the relationship between household income growth and CPI during the past decade. I have attached a chart showing this relationship. During the entire period, CPI increased by 134%, while income increased by 118%, notably less. More significantly, during shorter periods the two indices were widely at variance. From 1978 to 1981, for example, CPI increased by 35% while incomes only rose by 25%. Thus, the concern that affordability problems could result from

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using the CPI index is a significant one.

The most appropriate income index available, which has been applied consistently on an annual basis over an extended period, is the Median Household Income determined by the Bureau of the Census Current Population Reports as of March of each year. This is a national index derived by an annual sample survey of the American population. As is true of any index, there is a significant lag between the effective date of the information and the date at which it becomes available. The most recent available information is for 1982. The 1982 figure is for a year ending on March 1982.

For calculation purposes, a common starting point of the unit prices and the income index must be established. This can be simply done. The initial selling price of each unit is considered to be 1.00, as is the national median household income for 1982. The percentage increase in the median household income from 1982 to 1983 is the basis for the allowable resale price appreciation in the first year from initial purchase, from 1983 to 1984 for the second year, etc. Since the 1982-1983 percentage income growth will be known in late 1984, the information will be available in timely fashion for any prospective seller.

The lag is inevitable with any body of data, including the CPI, since whenever one uses real data, it takes a great deal of time to compile, analyze, and publish it. It is important, however, to use real data. For that reason, I do not consider the HUD figures ~~appropriate~~ for an index. First, the geographic area for which they are calculated is likely to change over time (as is now happening), thus ruining any consistency. Second, they are based on an extrapolation formula rather than on hard data, as a result of which substantial discrepancies develop between decennial Census period, requiring substantial revisions and adjustments every ten years. Third, they cannot be relied upon to be issued on a consistent annual basis.

The fact that the national median household income is not the same as the area median household income is immaterial. The purpose of the index is to determine a sound starting point, and to measure the increase/decrease from that starting point over time. Thus, as long as the data base is sound, and the measurement is internally consistent, no problem arises. Although small areas, such as individual municipalities or counties will show divergent patterns with regard to income growth, a large area such as Northeastern New Jersey will have an income growth pattern that is unlikely to diverge dramatically from the national pattern over time. Although it might be preferable to have data for a smaller area, such as for New Jersey, the data does not exist except from the decennial Census reports.

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Finally, I consider it appropriate to use a household income index rather than a per capita income index; the prospective purchasers of the units are households, with an aggregated income of the various household members. Because of changes in labor force patterns, household size, etc., there are substantial divergences over time between trends in household and in per capita income, and the former is clearly more germane to this purpose.

I have attached a second table illustrating hypothetical income growth rates and resulting house price appreciation, along with a division between the seller and the nonprofit corporation based on a proposed sliding scale. The table shows two schedules, one based on compounded annual increases, and the second based on a simple increase. In view of the fact that indices are compounded as a rule; that is, each year's increase is calculated as a percentage of the preceding year total, rather than as a percentage increase of a initial base, I suggest that a compounded approach be used.

I believe that this is a straightforward and reasonable approach to this problem. Please let me know if you have any questions, or would like to suggest other approaches.

Sincerely,



Alan Mallach

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enc. (2)

cc: Hon. Eugene D. Serpentelli, J.S.C.

M.Masanoff, Esq.

G.Raymond

J.Kerwin

R.Coppola

COIMPARISON OF INCOME GROWTH AND CPI 1970-1981

YEAR	MEDIAN HOUSEHOLD INCOME	PERCENTAGE INCOME GROWTH	PERCENTAGE CPI CHANGE	REAL INCOME INCREASE (DECREASE)*
1970	\$ 8734			
1971	9028	3.4%	4.3%	(-0.9%)
1972	9697	7.4	3.3	+4.0
1973	10512	8.4	6.2	+2.1
1974	11197	6.5	11.0	(-4.0)
1975	11800	5.4	9.1	(-3.4)
1976	12686	7.6	5.8	+1.6
1977	13572	7.0	6.5	+0.5
1978	15064	11.0	7.7	+3.1
1979	16533	9.8	11.3	(-1.4)
1980	17710	7.1	13.5	(-5.2)
1981	19074	7.7	10.4	(-2.4)

\*Change in constant (1981) dollars

SOURCE: Statistical Abstract of the United States 1982-1983

DIVISION OF PROCEEDS FROM APPRECIATION OF UNIT SELLING FOR \$33,500 - HYPOTHETICAL CASE STUDY.

YEAR	INCOME GROWTH	RESALE PRICE	ANNUAL INCREASE	CORPORATION			SELLER		
				SHARE	ANNUAL AMOUNT	CUMUL. AMOUNT	SHARE	ANNUAL AMOUNT	CUMUL. AMOUNT
<u>I. APPRECIATION BASED ON COMPOUNDED INCOME GROWTH*</u>									
1	6%	\$35510	\$2010	75%	\$1508	\$1508	25%	\$ 502	\$ 502
2	8	38350	2840	65	1846	3354	35	994	1496
3	10	42185	3835	55	2109	5463	45	1726	3222
4	7	45140	2955	45	1330	6793	55	1625	4847
5	6	47850	2710	35	949	7742	65	1761	6608
6	9	52155	4305	25	1076	8818	75	3229	9837
7	5	54760	2605	25	651	9469	75	1954	11791
8	3	56405	1645	25	411	9880	75	1234	13025
9	8	60915	3510	25	878	10758	75	2632	15657
10	7	65180	4265	25	1066	11824	75	3199	18856

II. APPRECIATION BASED ON SIMPLE INCOME GROWTH\*

1	6%	\$35510	\$2010	75%	\$1508	\$1508	25%	\$ 502	\$ 502
2	6	38190	2680	65	1742	3250	35	938	1440
3	10	41540	3350	55	1843	5093	45	1507	2947
4	7	43885	2345	45	1055	6148	55	1290	4237
5	6	45895	2010	35	704	6752	65	1306	5543
6	9	48910	3015	25	754	7506	75	2261	7804
7	5	50585	1675	25	419	7925	75	1256	9060
8	3	51590	1005	25	251	8176	75	754	9814
9	8	54270	2680	25	670	8846	75	2010	11824
10	7	56615	2345	25	586	9432	75	1759	13583

\*Compounded income growth means that the percentage increase has been calculated as an increase from the previous year's base, which is the product of the initial sales price to which all prior increases have been added. Simple income growth means that each year's percentage increase is calculated as a percentage of the initial base price of \$33,500. After 10 years, the effect of the two different approaches, as can be seen, is quite substantial.