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## A Thought on Slum Clearance

## A THOUGHT ON SLUM CLEARANCE

TERRY J. O'NEILL\*

*of the Denver Bar*

The slum problem is one of the greatest faced by any municipal government. This is so because the slum appears as an ulcer to mar the physical beauty of the community and creates an environment which breeds crime and a wide variety of social problems and leaves scars upon our youth which can rarely be eradicated completely. The cost of these slums to the community is incalculable as it is in this area that most of our welfare services, our social services and our police services operate. Our very costly jails and juvenile detention halls are largely populated with the product of the slum.

The usual method of slum clearance at the present time is through condemnation which not only is extremely costly but which often leads to another evil, government owned and operated housing projects. The author submits that any city can permanently free itself of slums in a period of several decades without cost to itself, without invoking powers of eminent domain and without violating any constitutional guarantees of due process.

Although the usual slum is a costly burden to all taxpayers of a community, it still produces income for its owners. The slum can be made self-liquidating without any government subsidy by a plan which will make it economically desirable for the owner of substandard property to replace his improvements. Before showing how this might be brought about let me outline the economic conditions responsible for most slums.

The investor who erects a housing unit, a warehouse, hotel or office calculates an estimated life for the improvement and sets up a depreciation schedule based upon this estimated life. He may estimate the life of his duplex at forty years, for example, and take a depreciation of  $2\frac{1}{2}\%$  of the total cost as an ordinary operating expense each year before computing the profit on his investment. He certainly will claim such a deduction for federal tax purposes. If the building is destroyed by fire or other casualty the remaining cost is usually restored to the investor through insurance proceeds. If the building is not destroyed by some casualty, it is still standing and probably is still producing income at the end of its estimated life. If the building is not producing income, the landowner still will not go to the expense of demolishing it unless to make room for another improvement or to avoid taxes and other liability on account of the structure. A slum has been created.

Another investor may acquire the structure and he in turn will again calculate a schedule of depreciation, estimating maybe

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\* The author writes as an individual and a property owner and not in any representative capacity.

a ten year remaining life, and will rent the property to whatever use will produce the highest income to meet his 10% per year depreciation schedule. He again claims a tax deduction for this expense and the building may still be standing when the second estimated life expires. It still has some value which each subsequent owner will try to bleed from it or which will have to be paid by any condemning authority attempting to remove the offending structure. The tax value of the land is reduced. Tax revenue is lost because each subsequent owner claims larger deductions for depreciation and quite frequently extra burdens are imposed upon city services as pointed out earlier because of the uses to which the now sub-standard structure is being put.

This is the condition which exists in all of our slums. The economic flaw is that a building is constructed with but one life expectancy for the purpose of amortizing its cost and should not acquire a new life expectancy each time a new owner acquires the premises. Some income produced by a building after its anticipated life has expired should be held by any prudent investor as a fund to replace the structure. Instead, with each sale, the vendor takes the fruit and relinquishes all responsibility for the tree that produced it and a new owner begins his exploitation of a property that has already repaid its cost and normal profit.

Analyzing the slum problem economically in this fashion leads to one obvious solution. The owner of a structure should not be allowed to entirely sever the fruit from the tree that produces it and the following method of accomplishing this end is suggested.

Each municipality seriously considering its slum problem and willing to lay long range plans which can not vacillate with changing administrations can create a municipal housing authority to fix the estimated remaining life of every building now used for the production of income or for each building when converted to such use. Each building owner should be allowed an election between the estimated life fixed by the engineer for the municipal housing authority or that adopted by himself in computing his depreciation deduction for federal tax purposes. But, once fixed the estimated life should not be altered regardless of any sale of the property except on account of capital improvements which clearly prolong the life of the building and comply with definitions of capital improvements as set forth in existing Federal revenue laws.

When any building producing income completes its fixed life expectancy, a quarterly payment equal to the amount previously deducted for depreciation should be paid into an escrow fund either in a local bank approved by the housing authority or to the housing authority itself. In many cases this will create a hardship as a building forty years old may not produce income equal to  $2\frac{1}{2}\%$  of its original cost each year. Therefore an alternative payment of 10% of the gross income produced by the property might be allowed for the owner claiming hardship.

Title to the funds thus held in escrow must remain in the owner of the land and run with the land, being bought by and passed on to any subsequent purchaser acquiring the property. Withdrawals from the fund could only be allowed for justified capital improvements which will clearly improve or prolong the life of the structure and which receive the approval of the municipal housing authority. The entire amount in the escrow fund could not be paid out to the owner until it is showed that the land has been leveled and returned to a virgin state or that the funds are to be used to replace the former structure with a new structure in all respects complying with existing city building codes and zoning ordinances.

The plan should provide an effective penalty to be imposed upon anyone who receives income from any property without having its remaining life expectancy fixed and recorded with the housing authority even if this income be merely the rental of a sleeping room in a private residence. Thus the plan would reach virtually every property which might be involved in a slum problem for rare indeed would be the house, hotel or the like that will not at some time be used to produce income.

It is to be noted that the plan also provides relief for the owner of his own home who wishes to stay in his residence however decrepit it might become. Quarterly payments into the escrow fund are only paid out of income produced by the property either on the basis of the depreciation schedule previously adopted by the property owner or on the basis of 10% of the gross income received from the property itself or a business operated on the property. This owner would have no payments to make for he has no income from the property even though the life expectancy of his home may have been recorded at an earlier date. However, few indeed are the present slum residents who own their own homes and these usually maintain their property with some degree of pride. Business properties would always be covered by the plan.

It is true that some old buildings produce a negligible amount of income and it would be a long time before the escrow funds attaching to these properties would be substantial enough to induce the owner to demolish or replace his improvements in order to obtain a release of the fund. However the funds would grow, however slowly, and the time would eventually arrive. Even here the situation could be no worse than under the present method where we wait until the owner decides that it is cheaper to level the building than to continue to pay taxes on it or until some authority exercises powers of eminent domain.

Giving further thought to the application of such a plan as this will reveal that many situations must be provided for if no hardships are to result, if constitutional guarantees are not to be abridged and if the plan is to reach all types of offending properties. While I have considered a large number of these problems

and feel that solutions to all of them can be easily developed, I have not attempted to confuse this outline with a discussion of them.

It is my belief that we can plan the economy of our communities to make it more economical for a landowner to build new buildings than to maintain sub-standard structures. The plan here suggested is far less drastic than slum clearance through exercise of the power of eminent domain and will effectively and permanently meet the problem even though more slowly at first—and it will not put municipal governments in the housing business under the guise of slum clearance.

Some structures in our slums are fine old buildings of which we were once proud and which returned nice profits for their various owners. They are not to blame and some of the income they produce during their declining years should be used to provide for them a dignified burial.

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## PERSONALS

Norris C. Bakke, formerly Justice of the Supreme Court of Colorado and more recently in charge of the Legal Division of the Federal Deposit Insurance Corporation in Washington, D. C., has returned to the private practice of law in association with Renah F. Camalier and H. Stewart McDonald under the firm name of Camalier, McDonald & Bakke, 1025 Connecticut Avenue, N. W., Washington 6, D. C.