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DEVELOPMENTS IN THE FINANCING OF RESIDENTIAL REAL ESTATE

By

James Thomas Mills, Jr.

Submitted in partial fulfillment of the requirements for the degree of Master of Science in Business Administration, University of Richmond, Richmond, Virginia.

July 1962

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TO MY WIFE....

who has given unselfishly and untiringly of her time and talents and whose constant encouragement, patience and understanding has enabled me to reach this point of my formal education.

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CHAPTER I

PRACTICES IN THE FINANCING OF RESIDENTIAL REAL ESTATE FROM 1920 to 1932

For more than a hundred years prior to 1925, mortgage loans had proven to be one of the most stable and dependable revenue-producing assets in portfolios of many investing institutions.[1] In 1925, however, there began a slow rise in the rate of foreclosures of mortgage loans. The stock market collapse came in 1929 and then the deluge.[2] By 1932 the rate of foreclosure had assumed alarming proportions, reaching a total of 248,700 and increasing to 252,400 in 1933.[3]

When the causes of foreclosures were reviewed at the President's White House Conference on Home Building and Home Ownership held December 2-5, 1931, it became apparent that certain mortgage practices were responsible for a large share of the distress.

This conference gave its attention to numerous questions, many of which can be classified under the headings of causes

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1. Home Mortgage Lending, p. 9.
2. Davies, Pearl Janet, Real Estate in American History, p. 172.
3. Savings and Home Financing Chart Book No. 6, p. 30.

of the situation faced by the conferees. Under the heading of causes, the following stood out: Terms of loans, cost of obtaining loans, restricted loan-value ratio, lack of amortization, interest and tax delinquencies, lack of credit analysis, lack of standards for quality of construction, inefficient and unsystematic appraisal practices, short-term funds invested in long-term mortgages, and weak mortgagors.

A brief consideration of some of these practices will serve to clarify the study of present-day mortgage lending practices.

Terms of Loans

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

and loan associations made amortized loans for shorter periods, such as from three to five years, with only partial amortization during the term.[4]

Loans by the mutual savings banks, which were found mostly in certain northeastern states, were in some cases similar to those of for one year and are customarily renewed more or less automatically. Mortgages made by banks of deposit ordinarily ran not more than five years and frequently from one to three years.[5]

Second mortgages ordinarily ran for shorter periods, one to three years being the commonest. They usually carry heavy amortization payments, often being retired in from one to three years. In some localities, second mortgages ran for five years where the first mortgage, being held by a bank, ran for from one to three years.[6] This created a handicap upon the home owner if the first mortgage was called at maturity.

Cost of Obtaining Loans

The customary rate of interest ranged ordinarily from 5 to 7 per cent, with 6 per cent as the prevailing standard, but extended in certain areas up to 8 or 9 per cent.[7] The

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4. Gries, John Matthew and Ford, James (Editors), Home Financing and Taxation, pp. 19-20.
5. Loc. cit.
6. Loc. cit.
7. Gries and Ford, op. cit., pp. 15-16.

various state laws usually controlled the maximum interest rate on first mortgages, although there were exceptions in most states in regard to building and loan societies. A typical first mortgage loan transaction involved incidental expenses of (a) commission or service charge, (b) title examination, (c) recording fees, (d) plat of survey when not furnished by the borrower. In some instances, as with banks investing their savings deposits and trust companies investing trust funds, no commission was charged but there was a nominal fee for appraising and preparing the loan papers. In some construction loans the borrower was required to furnish a bond to guarantee completion.

On a typical $3,000 residential loan, these charges would amount to $35 to $50, exclusive of interest or commission, or approximately 1.5 per cent of the loan. Where a commission charge was made, this generally ranged from 1 per cent to 3 per cent and usually included appraisal fee and all office charges. On loans running ten to fifteen years, these charges were at the rate of one-fifth to one-third of 1 per cent per year.[8]

While the practice of making amortization loans for long terms was growing, the fact remained that many lending institutions made first mortgages for terms not exceeding

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8. Ibid., p. 16.

three years. On the expiration of this term the borrower was required to repeat some if not all of these expenditures. Practice varied widely on this matter and ranged all the way from no renewal charge whatever to payments covering all the initial financing costs, including the full commission. The repetition of these charges on the renewals on one to three year mortgages added materially to the cost of home financing whereever this practice was followed, and was a factor of which borrowers should have been clearly aware. The borrower in the final analysis had to make the decision as to whether he wanted a long time amortized loan or a straight loan for three years.[9]

Far more serious, however, was the problem of junior or second mortgage financing costs. Due to the increased hazards surrounding second mortgage loans, second mortgage money was not ordinarily available to home buyers at interest rates permitted by law, and hence, second mortgage financing in ordinary times generally involved discounting second mortgages at rates ranging from 5 to 10 per cent per year. When to the discount was added the various service charges customary in making mortgage loans and a brokerage fee which generally averaged higher on second mortgage loans than on first mortgages, the total initial charges for obtaining a

9. Loc. cit.

second mortgage loan for one to three years ranged from 15 to 25 per cent, in addition to annual interest, which sometimes was paid on the full face value of an amortized loan to maturity.[10]

Restricted Loan-Value Ratio

Most lending institutions maintained rigid restrictions on the ratio of the amount of a mortgage loan to the value of the property offered as security. The most common ratio was 50% or 60% of the appraised value of the property. State laws also restricted mortgage loan-value ratios to about 60%.[11]

The instability of real estate values in this country resulted in low percentage loans in relation to values. Even normally low percentages were further reduced in periods of economic distress, so that refinancing became very much restricted when most needed.[12]

These restrictions often prevented a borrower from obtaining a bank loan in sufficient amount to meet his need, thereby requiring supplementary financing for many real estate owners. This took the form of short-term second and third mortgages.[13] Refunding of these short-term obligations was costly under the best of circumstances, because of the

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10. Ibid., pp. 16-17, 28.
11. Ibid., p. 26.
12. Wallace, E. S., Law and Contemporary Problems, "Home Financing," V, (1938), p. 481.
13. Home Mortgage Lending, op. cit., p. 10.

prevalence of heavy discounts. Under circumstances which represented less than the best, mortgagees, fearing the future, pressed for liquidation of their claims, precipitating numerous foreclosure action.[14]

Lack of Amortization

Many lenders felt that the servicing of amortized loans entailed too much clerical work, and they failed to visualize the borrower's problem of liquidating his obligation as he received his income. Therefore, most loans were written without adequate amortization, and often with no amortization at all.[15]

The Prevalence of short-term primary financing in some sections of the country resulted in demands for repayment when the mortgagor had very little chance of success in refinancing with other lenders on mortgage security. Because these short-term mortgages made no provision for amortization, the mortgagees had no steady inflow of liquid funds which would have enabled them to assist mortgagors.[16] Unsatisfied demands for repayment of matured mortgages invited many foreclosures.

Interest and Tax Delinquencies

Common practice before 1933 called for the payment of interest semi-annually. Therefore, if a borrower was

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14. Hoagland, Henry E., Real Estate Finance, p. 415.
15. Home Mortgage Lending, op. cit., p. 10.
16. Wallace, op. cit., p. 481.

in difficulty, that fact came to the attention of the lender only after interest had accrued for six months or more. The lenders failed to keep uniform records of tax payments on mortgaged properties, on many of which there were arrearages of two or more years' taxes. The average loan taken over by the Home Owners' Loan Corporation was two years in default on principal and interest and three years in default in taxes.[17]

Lack of Proper Credit Analysis

Many lending institutions paid little attention to analyzing the financial burdens undertaken by a borrower. Even though most mortgages did not provide for periodic payments of principal, interest and tax payments alone often were so excessive in relation to the borrower's income that only a slight reduction in income was sufficient to cause default. If demand were made for a reduction of the principal at the time the loan fell due, this added to the burden of the borrower, commonly when he was least able to meet such payment.[18]

The use of credit reports to check an applicant's past paying record was seldom required before 1933. That is, most lenders had their eyes focused mainly on the security. The failure of mortgage lenders to consider

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17. Home Mortgage Lending, op. cit., p. 10.
18. Ibid., p. 11.

important elements of credit analysis accounted for many foreclosures which could have been avoided.

<u>Lack of Standards for Quality of Construction</u>

There was a lack of standards for quality of building construction before 1933. Lenders did not ordinarily undertake to tell contractors and owners what type of structures to build.[20] Indeed, some of them had no yardstick by which to measure construction quality. They merely responded favorably or unfavorably to the applications for loans. Since the nature of the response to such applications was conditioned, in part at least, by their anxiety to put to work the surpluses of cash that they might have on hand, jerry-builders undoubtedly received more encouragement and support in times of surplus than in times of shortages. Jerry-built structures always complicate real estate markets and make refinancing even more difficult in times of economic stress and tight money.

<u>Inefficient and Unsystematic Appraisal Practices</u>

Inefficient and unsystematic appraisal practices, resulted in the unrealistic valuation of many real estate parcels at the time mortgages were to be placed against them.[21] Some loans were actually 40 or 50 per cent loans. Others, labeled 40 or 50 per cent loans, were actually nearer to 110 per cent loans because of excessive appraisals. Many

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20. Gries and Ford, <u>op. cit.</u>, pp. 33-34.
21. <u>Ibid.</u>, p. 5; and Wallace, <u>op. cit.</u>, p. 482.

lenders had only vague ideas on the subject of appraisal techniques. They let some of their borrowers make appraisals for them by shopping around for loans until they found the highest bidders. Frequently the amount of the loan was agreed upon, and the appraisal was adjusted to make the loan fit the announced lending policy of the mortgagee.[22]

Short-Term Funds Invested in Long-Term Mortgages

Short-term funds became frozen in long-term mortgages at times when the demand for the withdrawal of these funds was greatest.[23] In general, whether a real estate mortgage is written for a long or a short term, it is to be considered a frozen asset, especially long-term mortgages.

Weak Mortgagors

Prior to 1933 many real estate parcels were held by mortgagors who lacked the capacity to meet their obligations when their economic circumstances were disturbed, even slightly disturbed.[24] Like some of their more fortunate friends and acquaintances, they made an emotional response to the sentimental appeal for home ownership. However, lacking the financial resources with which to back up their emotions, they fell an easy prey to foreclosure action as soon as the economic road became rough. Such foreclosures commonly flooded a market already glutted with unwanted properties, intensified fluctuations in all real estate values, and raised doubts in the minds

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22. Hoagland, *op. cit.*, p. 415.
23. Wallace, *op. cit.*, p. 482.
24. *Loc. cit.*

of all property owners about the desirability of investments in real estate.[25]

Problems of Home Purchasers

Before 1933 there were two problems which stuck like thorns in the flesh of a great many families trying to finance their own homes. One was the high cost of financing a home, largely the result of reliance on second mortgages (often involving the payment of bonuses as high as 15 to 20 percent), and of high interest cost plus excessive service charges and other fees.[26] The other thorn was the uncertainty and recurring crises in the credit arrangements inherent in the then prevalent practice of buying a home with a first mortgage written for one to five years and carrying no definite plan for paying back the principal of the loan.

What usually happened was that the average family went along, budgeting for the interest payments on the mortgage, subconsciously regarding the mortgage itself as written for an indefinite period, as if the lender was never going to want his money back but would just be content to keep it out at interest forever. This impression, which the homeowner built up when things were going fine, was strengthened by the fact that lenders most frequently did renew the mortgage over and over again

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25. Loc. cit.
26. Gries and Ford, op. cit., p. 28

whenever money was plentiful. They usually charged a fee for this renewal which added to the high cost of financing, but even this did not give the homeowners of that day a clear notion of the real dangers to their own financial stability presented by this procedure which became magnified in times of stress.

Such a time of stress came in 1929-30: Many short-term mortgages came to maturity during a situation of tight credit and, in many cases, of no credit: The borrowers had to be informed that they would have to pay a high fee to get the mortgages renewed or, in innumerable instances, pay in full. Such a situation, of course, added to the seriousness of the homeowner's cost as well as to the uncertainty shadowing the entire family.

Still more serious was the homeowner's problem as the business cycle moved into the great depths of the 1930's. Very often the lender, the holder of the mortgage, needed his money in cash. He did not want to renew the loan to the homeowner no matter how high the premium or rate of interest. The family which owed the money had to look around for a new lender: This, however, was often a fruitless search because few then had money which they wanted to lend. The family which couldn't find anyone to take it over had no alternative to losing its

home. Multiplying this situation by many thousands of families resulted in the 248,700 foreclosures in 1932.

TABLE 1.
NUMBER OF NONFARM REAL ESTATE FORECLOSURES

Year	Foreclosures
1930	150,000
1931	193,800
1932	248,700
1933	252,400
1934	230,350
1935	228,713
1936	185,439
1937	151,366
1938	118,357
1939	100,410
1940	75,556
1941	58,559
1942	41,997
1943	25,281
1944	17,153
1945	12,706
1946	10,453
1947	10,559
1948	13,052
1949	17,635
1950	21,537
1951	18,141
1952	18,135
1953	21,473
1954	26,211
1955	28,529
1956	30,963
1957	34,204
1958	42,367
1959	44,075
1960	51,353

Source: Savings and Home Financing Chart Book, 1961, No. 6.

CHAPTER II

DEVELOPMENTS IN THE FINANCING OF RESIDENTIAL REAL ESTATE 1930-1934

Herbert Hoover was the first President of the United States to give serious attention to the importance of housing conditions to the general welfare and responsibility of the government and to take an active part in promoting good housing.[1] With the real estate business in the doldrums and getting worse day by day; with increasingly large numbers of home owners facing the threat of foreclosure by mortgagees who were hard pressed to find the means of liquidating the claims of those whose funds they held for investment; and with the whole structure of home mortgage financing about to collapse: President Hoover called a conference on home finance and home ownership to meet in Washington, D. C., on December 2-5, 1931. This conference, which was attended by more than 3,700 experts in various aspects of housing and representatives of the construction industry, was the federal Government's major point of entry into housing.[2]

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1. The F.H.A. Story in Summary, compiled by the Office of Public Information, Federal Housing Administration, (Washington: Government Printing Office, 1959), p. 1.
2. Loc. cit.

President Hoover's opening address at the opening meeting of this conference on home building and home ownership expresses so many principles which have served as the basis of such subsequent legislation in the areas of housing and finance that it is reproduced in full in Appendix A.

The keynote of the conference, as expressed by President Hoover, is that it should be possible in our country for anybody of sound character and industrious habits to provide himself with adequate housing and preferably to buy his own home.[3] It will be noted also that much emphasis was placed upon individual responsibility for home ownership. Homes rather than housing dominated the thinking of those who planned this conference.

While the conference was called at the insistence of representatives of the real estate business and those interested in real estate finance, it included other groups as well. Distressed home owners were not represented as such because there appeared to be no way to select competent representatives of the group. The conference was arranged by a planning committee under the joint chairmanship of the Secretary of Commerce and the Secretary of the Interior. As early as August, 1930, this committee started planning the scope and objectives of the conference.

Among the diverse interest represented were real estate, real estate finance, city planning, building,

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3. Address of President Hoover at opening meeting of the President's Conference on Home Building and Home Ownership, Washington, D. C., Wednesday, December 2, 1931.

construction, education, social work, and government. The members of the conference were divided into thirty-one committees covering practically all subjects concerned with home ownership.[4]

Home Loan Bank Act

Recommendation for Legislation: As one result of the Hoover conference, the President made formal recommendations to Congress in December of 1931 and again in January, 1932, along the lines of setting up a system of banks in the home-financing field comparable to the Federal Reserve System, which serves the needs of the commercial financial institutions of the country. The proposed legislation was intended to serve both as a recovery measure and as a reform program for the future.[5]

Prolonged hearings developed three divergent points of view about the proposed legislation.[6] The real estate groups, which had been primarily responsible for the original Hoover conference, contended for a mortgage discount system which would enable mortgage holders to acquire liquidity when needed by selling mortgages to proposed national mortgage banks. The commercial banks were not convinced of the need for any new legislation and opposed the passage of any new bills, looking toward a new credit system in the home-financing field. The savings and loan

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4. Hoagland, Henry E., Real Estate Finance, p. 414.
5. The Federal Home Loan Bank System, published by the Federal Home Loan Banks, p. 23.
6. Loc. cit.

lenders worked for a credit reserve system instead of a mortgage discount program. With some support from insurance companies and others, the credit reserve principle finally prevailed, resulting in the passage of the Home Loan Bank Act of July 22, 1932.[7]

Home Loan Bank Act of July 22, 1932

Home Loan Bank Board: The administration of the Home Loan Bank Act was entrusted to a bipartisan five-man board appointed by the President with the consent of the Senate. The overlapping terms of the board members were for six years.

The five-man board was abolished during World War II under the war powers of the President. It was superseded by a single commissioner in the person of the former chairman. In 1946 a board of three members with four-year terms succeeded the commissionership by executive order of the President.[8] Since this action had the tacit approval of the Senate, it thereby acquired the effect of law.

The agency received no appropriated funds from the Government. Although there are no tax dollars involved, the Board's budget is reviewed and approved by the Bureau of the Budget.[9] In addition, the Board's expenses are

7. Public No. 304, 72d Congress (Federal Home Loan Bank Act) approved July 22, 1932: The following discussion is based primarily on this Act, therefore, only references to complimentary material will be footnoted hereafter.
8. Hoagland, op. cit., p. 414.
9. Fifth Annual Report of the Federal Home Loan Bank Board, July 1, 1936-June 30, 1937, p. 20.

subject to an annual limitation set by Congress. These expenses are paid from funds derived from assessments made on the Federal Home Loan Banks, the Federal Savings and Loan Insurance Corporation[10] and the Board's Division of Examination.[11]

Functions of the Federal Home Loan Bank Board

The work of the Federal Home Loan Bank Board embraces four separate activities, the main purpose of which is to give greater security to people of small or moderate means in the ownership of their homes, and in the investment of their savings. It touches directly or indirectly every urban home owner and every individual whose savings are invested directly or indirectly in home mortgage loans or in home-financing institutions.

The original purpose of the Board was to supervise the operation of the Federal Home Loan Bank System which was created July 22, 1932, to serve as a central credit agency for private home-financing institutions.[12]

On June 13, 1933, the responsibilities of the Federal Home Loan Bank Board were increased by the Home Owners' Loan Act of 1933. This act created the Home Owners' Loan Corporation and appointed the members of the Federal Home Loan Bank Board as its directors.[13]

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10. Public No. 479, 73d Congress, National Housing Act, approved June 27, 1934, Title IV, Sec. 404a.
11. Fifth Annual Report, op. cit., pp. 20, 28.
12. Third Annual Report of the Federal Home Loan Bank Board, January 1 through June 30, 1935, p. 5.
13. Public No. 43, 73d Congress, Home Owners' Loan Act, Sec. 4(a).

The major purpose of the Home Owners' Loan Corporation was to finance the mortgages of urban home owners in actual danger of losing their homes through foreclosure, and thus enable them to save their home properties by assuming more liberal loans.[14]

The Home Owners' Loan Act of 1933 also authorized the Board "to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as Federal savings and loan associations, and to issue charters therefor, giving primary consideration to the best practices of local mutual thrift and home financing institutions in the United States."[15]

In order to extend the benefits contemplated by the act to existing State-chartered institutions, the act further provides that "any member of a Federal home-loan bank may convert itself into a Federal saving and loan association.....subject to such rules and regulations as the Board may prescribe."[16]

On June 27, 1934 under Title IV of the National Housing Act the Congress created the Federal Savings and Loan Insurance Corporation, to be governed by a board of trustees identical in membership with the

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14. _Third Annual Report_, op. cit., p. 5.
15. _Home Owners' Loan Act_, Sec. 5(a).
16. _Ibid._, Sec. 5(i).

Federal Home Loan Bank Board.[17] The Insurance Corporation was created by Congress to restore and strengthen the confidence of the public institutions of the savings and loan type throughout the Nation through insurance of their accounts.[18]

Generally the basic functions of the Board, at present, are to establish policies, issue regulations and supervise the operations of Home Loan Banks System, the Federal Savings and Loan System, the Federal Savings and Loan Insurance Corporation. More specifically, the board has the job of issuing consolidated obligations from time to time which become the joint and several obligations of the eleven Federal Home Loan Banks. The decision as to the amount of an issue of consolidated obligations and the rate of interest to be paid thereon is made by the Board after due consultation with the Department of Treasury and the open market committee of the Federal Reserve System.

The charters of Federal Savings and Loan Associations and the licenses for such associations to establish branch facilities are issued by the Board. The Board reviews applications for conversion from state to Federal charter and passes on applications for membership in the Federal Home Loan Bank System and the Federal Savings

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17. Ibid., Sec. 5(a).
18. Fifth Annual Report, p. 45.

and Loan Insurance Corporation.[19] Responsibility rests with the Board for the examination and supervision of all Federal Associations, as well as Examinations either independently or jointly with state authorities, of state-chartered associations which are insured by the Federal Savings and Loan Insurance Corporation.[20]

Federal Home Loan Bank System

Prior to 1932 numerous private financial institutions were developed in the United States to meet the demand for facilities in which the public could safely accumulate its savings and from which it could obtain loans for building or purchasing homes. These institutions had to rely almost entirely on their own resources to match local demands for mortgage funds with local supplies of savings. They had no access to a dependable source of credit when supplementary funds were needed to meet unanticipated withdrawals of savings or seasonal and other fluctuations in demand for home mortgage loans.

With the enactment of the Home Loan Act, which established the Federal Home Loan Bank system, savings and loan institutions were given an opportunity for the first time to become members of a nationwide financial system capable of pooling their resources and drawing

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19. National Housing Act, Title IV, Sec. 406(a).
20. Ibid., Title IV, Sec. 403(b).

funds from the general capital market.[21] By so strengthening the structure of the home-financing industry, the Federal Home Loan Bank system was to reach into every area and locality in which its members operate and its benefits were to extend to millions of savers and home owners served by member institutions. Thus was born the Home Loan Bank System which consists of three parts: (1) The Federal Home Loan Bank Board (2) The eleven Home Loan Banks and (3) the member institutions. The Home Loan Bank system has as its major objective the provision of liquidity for its member institutions.[22]

The creation of the Federal Home Loan Bank System was the first major action of the Federal Government to improve and strengthen the home-financing facilities that were provided by savings institutions, and to modernize the methods of mortgage lending for the building and purchase of homes.[23]

Created in the depths of the depression and in an era of sweeping financial changes, the Federal Home Loan Bank System has assumed a permanent place in the credit structure of the nation. Described

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21. Williams, Joseph J., The Federal Home Loan Bank Board, Its Organization and Operations, (A speech given at the 55th National Convention of the American Title Assn., Minneapolis, Minnesota, October 19, 1961, 10:00 A.M.)

22. Third Annual Report, p. 5.

23. Savings and Loan Fact Book 1961, compiled by Dr. Don M. Dailey, p. 103.

very briefly, the System consists of the Home Loan Bank Board, eleven Federal Home Loan Banks, and as of 1960 4,716 affiliated institutions for which the banks provide reserve banking facilities. These member institutions are chiefly savings and loan associations but include also a number of savings banks and insurance companies. Although the Federal Home Loan Banks were established in 1932 the member institutions have a history dating back to the early 1800's.

Membership

The Home Loan Bank System has both compulsory and voluntary membership. All federal savings and loan associations are required to be members. As for state-chartered savings and loan associations (the term includes building associations, cooperative banks, building and loan associations and homestead associations, life insurance companies, and savings banks), these are eligible for membership on a voluntary basis if their applications are approved by the Home Loan Bank Board. There has been a steady and substantial gain in the number of associations in the Federal Home Loan Bank System. Of all state chartered institutions, for which membership is optional, 64% are members of the system as of 1960. The wide base of membership is revealed in the fact that of all associations, federal and state together, 75% are members.[24]

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24. Ibid., p. 105.

TABLE 2 SAVINGS AND LOAN ASSOCIATION MEMBERS OF THE FEDERAL HOME LOAN BANK SYSTEM

Year (Dec. 31)	Insured by FSLIC		Other State-Chartered	Total
	Federally Chartered	State-Chartered		
1935	987	125	2,343	3,455
1940	1,437	836	1,551	3,824
1945	1,467	1,004	1,187	3,658
1946	1,471	1,021	1,169	3,661
1947	1,478	1,054	1,138	3,670
1948	1,485	1,127	1,121	3,733
1949	1,508	1,244	1,070	3,822
1950	1,526	1,332	1,036	3,894
1951	1,549	1,470	931	3,950
1952	1,581	1,591	856	4,028
1953	1,604	1,700	804	4,108
1954	1,640	1,793	776	4,209
1955	1,683	1,861	763	4,307
1956	1,739	1,927	732	4,398
1957	1,772	2,000	703	4,475
1958	1,804	2,077	662	4,543
1959	1,841	2,138	620	4,599
1960	1,873	2,225	596	4,694

Source: Federal Home Loan Bank Board.

To be eligible for membership an institution must be duly organized under the laws of a state or of the United States. It must also make long-term loans. In addition the institution must be found by the Federal Home Loan Bank Board to be in sound financial condition and the character of its management and its home-financing policy must be consistent with sound and economical financing.

Members of the Bank system have accounted for a large and increasing share of the public's savings in financial institutions. The members of the system have also supplied a large and growing share of the funds made available for home financing by all types of lenders. Savings held by the system's members at the end of 1960 exceeded sixty billion dollars, or 26% of the savings held by all savings and loan associations, commercial and savings banks, life insurance companies, credit unions, and the Postal Savings System.[25]

Mortgage loans held by member institutions at the close of 1960 totaled more than fifty-eight billion dollars, or nearly two-fifths of the aggregate amount of home mortgages outstanding. At the close of 1960 there were a total of 4,716 member institutions with assets of approximately $69,945,000,000 (4,694 savings and loan associations with assets of $69,525,000,000, 22 mutual

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25. The Federal Home Loan Bank System, p. 3.

savings banks with assets of 420 million, and no insurance companies).[26] Thus the membership represents a highly significant segment of the nation's financial system and the member institutions serve the public directly in local communities throughout the country.

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26. Ibid., p. 4.

TABLE 3. THE FEDERAL HOME LOAN BANK SYSTEM

Number and Assets ($ Millions)

	1940	1945	1950	1955	1960
All Member Institutions	3,864	3,697	3,930	4,336	4,716
Assets	$5,035	$8,755	$16,245	$36,725	$69,945
Savings and Loan Associations	3,824	3,658	3,894	4,307	4,694
	$4,417	$7,706	$15,516	$36,147	$69,525
Federally chartered	1,437	1,467	1,526	1,683	1,873
	$1,871	$3,923	$ 8,457	$20,035	$38,511
State chartered: Insured by FSLIC	840	1,004	1,332	1,861	2,225
	$1,056	$2,218	$ 5,224	$14,163	$28,919
Not insured by FSLIC	1,547	1,187	1,036	763	596
	$1,490	$1,565	$ 1,835	$ 1,949	$ 2,095
Savings Banks	11	25	29	26	22
	$ 212	$ 594	$ 640	$ 550	$ 420
Insurance Companies	29	14	7	3	0
	$ 406	$ 455	$ 89	$ 28	--

Source: The Federal Home Loan Bank System

Federal Home Loan Banks

The law provides that the Home Loan Bank Board should establish not less than eight nor more than twelve regional banks. At present there are eleven Federal Home Loan Banks which are financial institutions created under the Federal Home Loan Bank Act, each operating in a geographical district designated by the Board and together covering all the United States, Puerto Rico, the Virgin Islands and Guam.

The areas served by each of the 11 banks are shown below:

Federal Home Loan Bank of Boston
New Hampshire, Connecticut, Maine, Massachusetts, Rhode Island, Vermont

Federal Home Loan Bank of New York
New Jersey, New York, Puerto Rico, Virgin Islands

Federal Home Loan Bank of Pittsburgh
Delaware, Pennsylvania, West Virginia

Federal Home Loan Bank of Greensboro
Alabama, District of Columbia, Florida, Georgia, Maryland, North Carolina, South Carolina, Virginia

Federal Home Loan Bank of Cincinnati
Kentucky, Ohio, Tennessee

Federal Home Loan Bank of Indianapolis
Indiana, Michigan

Federal Home Loan Bank of Chicago
Illinois, Wisconsin

Federal Home Loan Bank of Des Moines
Iowa, Minnesota, Missouri, North Dakota, South Dakota

Federal Home Loan Bank of Little Rock
Arkansas, Louisiana, Mississippi, New Mexico, Texas

Federal Home Loan Bank of Topeka
Colorado, Kansas, Nebraska, Oklahoma

Federal Home Loan Bank of San Francisco
Alaska, Arizona, California, Hawaii, Idado, Montana, Nevada, Oregon, Utah, Washington, Wyoming, Guam[27]

The Banks are corporations established by the Federal Government, but their capital stock is owned entirely by their members. The affairs of each bank are conducted by a Board of Directors, the members of which are drawn from the district in which the Banks operate, subject to the general rules, policies and supervision of the Federal Home Loan Bank Board. (These areas of the bank's operations are discussed more fully under the separate headings.)

Capital of Home Loan Banks

The law provides that each member of a Home Loan Bank must purchase stock equivalent to 1 per cent of the unpaid principal of the home loans held in its portfolio, or $1,500, whichever was greater.[28] Each bank was required to have a total capital of not less than $5 million. Any amounts needed by a bank over and above the amounts contributed by the members could be invested by the United States Treasury at the call of the Home Loan Bank Board. The maximum investment of the Treasury in all Home Loan Banks was limited to $125 million. At the outset most

27. Ibid., p. 7.
28. Public Law No. 576, 81st Congress, approved June 27, 1950, sec. 2, changed this to 2 per cent and not less than $500.

of the capital was owned by the Treasury.[29] In order to make sure of getting the entire amount due from the Treasury, the Home Loan Bank Board built the capital of the regional banks rapidly from this source until it was practically exhausted, regardless of the amounts invested by the members.

Later it appeared advantageous for the members to own the stock of these banks. The 1 per cent of home loans stated above as the basis for stock purchase by the members was interpreted to be a minimum, and members were encouraged to purchase additional amounts. Also, some members purchased additional amounts of stock to increase their borrowing capacity at these banks, since this was limited to twelve times the amount of stock owned by them. A part of the contributions made by members was used to redeem the stock owned by the Treasury.

In June, 1950, the second session of the Eighty-first Congress amended the Home Loan Bank Act by requiring that, within one year after the enactment of the amendment, each member of a Home Loan Bank should acquire and maintain a stockholding of not less than 2 per cent of its home mortgage loans.[30] At the end of the year each bank was to retire at par an amount of stock held by the Treasury of the United States equal to the amount of its stock held

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29. The Federal Home Loan Bank System, op. cit., p. 30.
30. Public Law No. 576, op. cit., sec. 2.

by its members in excess of 1 per cent of their home mortgage loans. Annually thereafter it was to retire Treasury-owned stock equal to one half of the net increase in member-owned stock since the last previous retirement. Such retirement of Treasury-owned stock was subject to the limitation that it should not operate to reduce the aggregate capital stock, reserves, surplus, and undivided profits of the Home Loan Banks below $200 million. All stock of all Home Loan Banks has been owned by their members since July 2, 1951. As of the end of 1960, member-owned stock amounted to $989,315,000 or 31 per cent of the aggregate funds of the banks.[31]

Other Sources of Funds

In addition to the capital of the Home Loan Banks, other sources of funds consist of consolidated debentures and deposits of members.

Consolidated debentures which are sold in the open market by the Home Loan Bank Board as they are needed, with the proceeds distributed among the various regional banks on the basis of their probable loan demands. These debentures carry such maturity as best seems to meet the needs of the system. Interest rates reflect the cost of money for that type of paper at the time the debentures are

31. The Federal Home Loan Bank System, p. 30.

issued. By the sale of these debentures, the member institutions have access to the capital markets of the country. This represents an abrupt change from the prevailing dependence upon local funds that were obtained before this bank system was started. At the end of 1960 debentures outstanding amounted to $1,266,265,000 which comprised 40 percent of the total of the three main sources of FHLB funds. This amount was equal to 38.2% of the system's $3,315,700,188 total assets.[32]

To facilitate the distribution of these debentures the Home Loan Bank Board maintains a New York office headed by a fiscal agent. His function is to keep in touch with dealers who serve as wholesale purchasers of these debentures throughout the country. In addition to their open-market distribution, these debentures can be sold on short notice---ten days if necessary---through a private offering to selected dealers. These are usually for shorter terms than those offered in the open market.

Deposits of members who have excess funds sometimes add to the funds available to other members. Demand deposits pay no return to their owners. Interest rates on time deposits vary with the length of time and with the needs of the banks. Recently a new pattern using a definite maturity certificate of deposit has been introduced into the system. Under the theory of system operations, it is expected that excess deposits in one bank can

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32. Ibid., p. 34.

be borrowed by another bank in the system. Until 1945 member deposits were not very significant in amount. At the end of 1952 they totaled $419 million and at the year end 1960 deposits were $939,010,000 or 29 per cent of the total of the three main sources of Federal Home Loan Bank funds.

TABLE 4. CAPITAL STOCK, MEMBER DEPOSITS AND OBLIGATIONS, FEDERAL HOME LOAN BANKS (In Thousands of Dollars)

Year (Dec. 31)	FHLB Stock Owned by Government	FHLB Stock (Fully Paid) Owned by Members	Deposits of Members	FHLB Obligations Outstanding
1935	$ 94,196	$ 24,471	$ 4,063	$ None
1936	117,869	28,316	10,746	None
1937	124,741	34,834	12,566	77,700
1938	124,741	37,971	21,900	90,000
1939	124,741	40,978	29,617	48,500
1940	124,741	44,541	26,921	90,500
1941	124,741	48,815	29,826	90,500
1942	124,741	51,703	25,436	69,500
1943	124,741	57,577	29,534	64,300
1944	124,741	63,805	28,744	66,500
1945	124,510	75,658	45,697	68,500
1946	123,651	85,828	70,248	169,000
1947	122,672	103,078	87,835	261,700
1948	119,791	121,237	133,355	416,500
1949	95,819	130,239	267,112	206,500
1950	56,022	182,547	224,097	561,000
1951	None	270,652	261,236	529,500
1952	None	315,483	419,661	448,550
1953	None	368,524	558,446	413,500
1954	None	437,904	802,039	273,000
1955	None	515,517	698,493	975,000
1956	None	607,120	683,665	962,500
1957	None	685,383	653,230	825,000
1958	None	768,627	818,847	714,235
1959	None	865,509	589,807	1,773,660
1960	None	989,315	939,010	1,266,265

Source: Federal Home Loan Bank Board

Backstop Needed

As stated in the preceding section, the sale of Home Loan Bank debentures gives the members of these banks access to the capital markets of the country. This is predicated upon the assumption that the market will absorb whatever debentures are offered to it. To date the debentures which have been offered have been readily purchased.[33] But the real test of strength of a debenture market will occur in a period of uncertainty and tight money. This will also be a period in which the largest volume of debentures will be offered to the market, because the demand for advances by the members of the Home Loan Bank System will be greatest at that time. Will the open market absorb the required amount of debentures at reasonable cost to the issuers? Nobody knows.

Congress has granted to commercial banks ample protection by authorizing various government agencies concerned with commercial bank operation to take whatever steps may be necessary to provide liquidity as needed. Those best acquainted with the problems involved and sympathetic to the types of institutions which are members of the Home Loan Bank System had for years urged Congress to provide a comparable backstop for the debentures issued by this system.

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33. *Ibid.*, p. 33.

The opposition to such a law was strong. Until the second session of the Eighty-first Congress, this opposition was successful in preventing the passage of the necessary legislation. In June, 1950, Congress finally provided that the Secretary of the Treasury at his discretion may purchase from time to time up to $1 billion of obligations of the Home Loan Bank System.[34] Each purchase "shall be upon such terms and conditions as to yield a return at a rate determined by the Secretary of the Treasury, taking into consideration the current average rate on outstanding marketable obligations of the United States as of the last day of the month preceding the making of such purchase."[35] The Secretary is also authorized to sell such obligations of this nature as he may purchase, at such prices as he shall determine.

The term "backstop" is intended to describe the discretion now resting with the Secretary of the Treasury in the purchase of obligations of the Home Loan Bank System. It is not expected that he will exercise this discretion so long as there is available an open market for such obligations. It is only in times of emergency, when the market is no longer open, that the Treasury will be called upon to purchase such obligations. Such a backstop is

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34. Public Law No. 576, _op. cit._, sec. 4(i).
35. _Loc. cit._

needed not alone in the interests of the members of the Home Loan Bank System but in the interests of our whole economy as well.

Liquidity Requirements

As a part of the strategy in securing the enactment of legislation providing for the backstop just described, the same law included a provision that has not been quite so palatable to operators of savings and loan associations. It is recognized that the backstop of Treasury purchases of Home Loan Bank obligations would be needed to provide liquidity for bank members in a time of crisis. In order to force such members to provide some of their own liquidity, the Congress gave the Home Loan Bank Board the responsibility for requiring members of the system to maintain--in cash and government bonds--not less than 4 nor more than 8 per cent of each member's obligations on withdrawable accounts.[36]

In making the above requirement operative, the Home Loan Bank Board is authorized to pass regulations prescribing different amounts, within the above limits, for different classes of member institutions. Such classification of members may be according to "type of institution, size, location, rate of withdrawals, or such

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36. Ibid., sec. 5(a).

other basis or bases of differentiation as the Board may deem to be reasonably necessary or appropriate."[37]

Whenever a member fails to measure up to the liquidity demanded for its class of institution, it may not make or purchase any loan. Failure to comply with this liquidity requirement shall constitute grounds for removal of the member from the Home Loan Bank System. This provision of the law became effective six months after its enactment.

Bank Management

Each Home Loan Bank is separately incorporated, with its own stock outstanding. It is managed by a board of directors of twelve members.[38] Four are appointed by the Home Loan Bank Board as public interest directors. As a general rule these members are not directly connected with the home-financing business. The other eight directors are elected by the members of the bank, two in each of three size classifications of members and two at large. In determining eligibility for membership, the Home Loan Bank Board has given attention to geographical distribution. For example, where a regional bank serves several states, each state is given representation on the board

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37. Loc. cit.

38. Federal Home Loan Bank System, op. cit., p. 76.; the one exception to this rule is the Federal Home Loan Bank of San Francisco which has nineteen directors, six public interest directors appointed and thirteen directors elected.

of directors, even though a preponderance of members and assets is concentrated in one of the states. The chairman and vice-chairman are appointed by the Home Loan Bank Board. The former is usually a public interest director, and the latter is usually an elected member.

The appointment of bank officers and the determination of their salaries are first passed upon by the board of directors. This action is then subject to review by the Home Loan Bank Board, whose decision is final.

Each bank is expected to earn its own expenses, add to its reserves, and pay a return on its stock subject to the amount of services it renders its members. Included in such expenses is each bank's pro rata share of the part of the Home Loan Bank Board's operating expenses that are properly chargeable against the regional banks. Assessments for this purpose are usually made semiannually in advance, but may be made at other times if necessary.

Within broad limits set by the Home Loan Bank Board the directors of each bank operate it according to their own best judgment. For example, the board may decree that the rate of interest on long-term advances to members shall not be less than x per cent nor more than y per cent. The exact rate within these limits is then fixed by the board of each bank. The Home Loan Bank Board

establishes the broad pattern of lending operations. The bank management passes upon each application for an advance to a member to make sure that it conforms to this pattern.

Advances to Members

As already emphasized, the major purpose in establishing the Home Loan Bank System was to give its members access to capital markets broader than the localities in which they operated. Any member may secure advances from his Home Loan Bank for any legitimate purpose. If a member needs funds to meet the requirements of withdrawal demands from its members, it may call upon its Home Loan Bank for an advance. If its opportunities to make mortgage loans exceed its available cash, it may obtain similar advances. Even if a member merely wishes to make a better showing of liquidity for window-dressing purposes, it may look to the same source for the cash it needs.

Advances to any member are limited to twelve times the amount of the bank's stock owned by such member and to 50 per cent of the unpaid principal balance of the home loans held in its portfolio or 50 per cent of a member's liability for shares and deposits. None of the banks in the system encourage any of their members to exhaust their maximum capacity to obtain advances. To do so might place the member in an embarrassing position should it be unable

to obtain advances in case of emergency. Advances may be granted for a short period of time without security. Long-term advances are usually collateralized and are also amortized. Interest rates vary with the length of the loan period and with the state of the capital market.

Types and Terms of Advances

Because Federal Home Loan Bank advances may serve a member of different purposes, and in order to tailor this type of credit to the varying needs and preferences of member institutions, several types of advances are authorized. Advances may be:[39]

1. Short term (maximum maturity of 12 months) or long term (maximum maturity of 10 years).

2. Secured by specific collateral or unsecured, except that the Federal Home Loan Bank in any event holds a lien against the Bank stock owned by the borrowing member.

3. Amortized or unamortized. Those to members for thirty days or less need not be collateralized or amortized. Advances up to one year need not be amortized. If made to members whose creditor obligations do not exceed 5 per cent of their net assets, they need not be

39. Federal Home Loan Bank System, pp. 50-51.

collateralized. All advances of more than one year but not in excess of ten years must be both collateralized and amortized. Usually the larger portion of Federal Home Loan Bank advances is secured by specific collateral. At the end of 1960 (for example) 66 per cent of the amount of outstanding advances was collateralized. The security backing the $1,306 million in secured advances had a face value in excess of $3.2 billion, consisting for the most part of home mortgages with an unpaid balance of nearly $3. billion. The collateral value which the banks assigned to this security totaled more than $2 billion.[40]

40. Ibid., pp. 53-54.

TABLE 5. FHLB LENDING OPERATIONS, 1933-1960
(In Millions of Dollars)

Year	Total Advances	Total Repayments	Balance Outstanding at Year End	Number of Borrowers At Year End
1933	$ 90.0	$ 5.5	$ 85.5	----
1934	38.7	37.5	86.6	1,769
1935	59.1	43.0	102.7	2,192
1936	93.2	50.7	145.2	2,483
1937	123.2	68.4	200.0	2,707
1938	81.9	83.1	198.8	2,607
1939	94.7	112.3	181.3	2,339
1940	134.2	114.0	201.5	2,262
1941	157.6	139.6	219.4	2,057
1942	99.5	189.7	129.2	1,388
1943	156.8	176.0	110.0	919
1944	239.2	218.7	130.6	821
1945	277.7	213.4	194.9	916
1946	329.2	230.6	293.5	1,420
1947	351.0	208.9	435.6	1,804
1948	359.6	280.1	515.0	1,993
1949	255.6	337.2	433.4	1,800
1950	674.8	292.2	816.0	2,279
1951	423.0	433.0	806.0	2,221
1952	585.8	527.6	864.2	2,056
1953	727.5	640.1	951.6	2,146
1954	734.2	818.3	867.5	1,922
1955	1,251.7	702.4	1,416.8	2,408
1956	744.9	933.5	1,228.2	2,241
1957	1,116.3	1,079.1	1,265.2	2,018
1958	1,363.7	1,330.6	1,298.3	2,040
1959	2,066.8	1,230.8	2,134.3	2,443
1960	1,943.2	2,096.7	1,980.8	2,371

Source: Federal Home Loan Bank Board

Line of Credit

Each member may be given a line of credit with the Home Loan Bank. Under the Federal Home Loan Act the aggregate outstanding advances made by any Bank to any member may not exceed 12 times the amount of the member's holdings of Federal Home Loan Bank stock or 50 percent of the member's net assets or 50 per cent of the member's savings capital (share and deposit liability).

Lines of credit may be extended, at the discretion of the Board of Directors or the executive committee, to nonmembers which are chartered institutions having succession and subject to the inspection and supervision of some governmental agency. Rates of interest on advances to nonmembers are 1/2 per cent higher than rates on similar advances to members.

The actual amount of Federal Home Loan Bank advances outstanding has always been far below the maximum borrowing capacity of the combined membership as established by these general rules and lines of credit. The total advances outstanding at year-ends, between 1946 to 1960, has varied between approximately 3 and 5 per cent of the combined assets of the member institutions.

Federal Home Loan Bank System: Summary

The basic purpose of the Federal Home Loan Bank System is to strengthen the capacity of its member institutions to serve the public as a savings medium and as mortgage lenders in their respective communities.[41] The system meets this purpose in several ways. The Federal Home Loan Banks give the member access to a pool of resources when they require supplemental funds. By providing them with secondary liquidity, the Banks make the investment of savings in member institutions more attractive and more readily available when needed. By supplying funds to meet seasonal demands on their members for construction or mortgage loans, the Federal Home Loan Banks help smooth the flow of credit into home building and home purchase. Because the fluctuations in the demand for loans often do not coincide with the seasonal swing in the flow of savings, the home-buying public as well as builders and the construction trades are served by this device. By supplementing available local savings in rapidly growing areas, the Bank's advances to members assist in meeting more fully the home-financing needs in many communities which would otherwise face serious obstacles to their development.

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41. Williams, Joseph J., Speech, op. cit.

An important function of the Federal Home Loan Bank System is to facilitate the flow of funds for home mortgage investment from capital-surplus areas to capital-deficit areas. For many reasons the demand for mortgage loans is not matched geographically with the amount of savings available for mortgage investment. Consequently, an efficient home-financing system requires one or more "transmission belts" for the movement of funds. The Home Loan Bank System provides several means of transferring funds from one area to another.

When the Home Loan Banks issue consolidated obligations in the national security markets, the bulk of the obligations is likely to be sold in the East where these markets are concentrated; but a substantial portion of the proceeds is apt to be used by member institutions in the West or South where local savings are insufficient for meeting the demand for capital. Likewise, interbank deposits may be utilized for transferring from one Federal Home Loan Bank to another. Similar reallocations of resources are arranged within each Home Loan Bank's district when deposits of member institutions having excess funds are channeled, in the form of Bank advances, to other member institutions in need of funds. Still another means of facilitating the inter-regional and inter-local flow of funds is the loan participation program initiated in 1957, in which the Federal Home Loan Banks frequently act as intermediaries between

member institutions. Under this program any savings and loan association which is insured by the Federal Savings and Loan Insurance Corporation may, within certain limits set by Board regulation, acquire participating interest in mortgage loans which were originated outside its regular lending area and held by another insured association. An insured association may also sell participating interests to pension and trust funds and thus bring additional savings into the home-financing field.

Finally, the Federal Home Loan Banks can augment the flow of funds into home-financing by tapping savings which are not normally invested in mortgage loans. They can do so by offering consolidated obligations of the 11 banks to investors who prefer the purchase of large blocks of high-grade marketable securities to the direct investment of their funds in many individual mortgages or in savings and similar accounts, or who wish to maintain a mixed investment portfolio. Thus, the Bank System may serve, among other things, to channel capital accumulating in the rapidly growing pension and trust funds indirectly into the home mortgage market. This kind of transmission is performed wholly within the competitive structure of the capital market.

In summary, the Federal Home Loan Bank System operates, and was indeed established, on the principle

that savings by the public are the basic source of funds for the building and purchase of homes.

It helps promote, cultivate, and protect the habit of thrift and offers facilities far more efficient and more evenly distributed for the utilization of savings available for home mortgage lending.

CHAPTER III

HOME OWNERS' LOAN ACT

The Hoover Administration sought to avoid direct intervention in home financing. However, when the Roosevelt Administration took over in 1933 the general situation had become so acute that emergency action was called for. In that year non-farm real estate foreclosures reached an all-time high of 252,400[1] and housing starts were less than one tenth of the 1925 record figure of 937,000.[2]

In April 13, 1933, President Roosevelt sent each house of Congress a short message urging the passage of legislation that would (1) protect the small home owner from foreclosure; (2) relieve him of part "of the burden of excessive interest and principal payments incurred during the period of high values and higher earning power"; and declare that it was a national policy to protect home ownership.[3] He advocated a plan that would

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1. Savings and Home Financing Chart Book 1961, No. 6, p. 30.
2. Federal Home Loan Bank Board Source Book 1961, p. 40.
3. New York Times, April 14, 1933, 2: 3,4; and Harriss, Clement Lowell, History and Policies of the Home Owners' Loan Corporation, p. 9.

put the least possible charge on the federal Treasury and that would avoid injustice to the investor.

In recommending the necessary legislation to Congress the President said:

> Implicit in the legislation which I am suggesting to you is a declaration of a national policy.....that the broad interest of the nation require that special safe-guards should be thrown around home ownership as a guarantee of social and economic stability, and that to protect home owners from inequitable, enforced liquidation in time of general distress is a proper concern of the Government.[4]

The resulting legislation took the form of the Home Owners' Loan Act which was passed on June 13, 1933.[5] This act directed the Federal Home Loan Bank Board to create a new agency--the Home Owners' Loan Corporation--with a maximum capital of $200 million, to be provided by the Treasury, which in turn was to secure funds from the Reconstruction Finance Corporation.[6] The members of the Federal Home Loan Bank Board were to be the directors of the Home Owners' Loan Corporation.[7]

The Home Owners' Loan Corporation was authorized to issue not more than $2 billion[8] (later increased to 4.75 billion)[9] of its own bonds, in denominations prescribed

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4. 77th Congressional Record (1933) 1618.
5. First Annual Report of the Federal Home Loan Bank Board, July 1, 1938 through June 30, 1939, p. 47.
6. Public Law No. 43, 73d Congress, Home Owners' Loan Act, approved June 13, 1933, sec. 4(b).
7. Ibid., sec. 4(a).
8. Ibid., sec. 4(c).
9. Raised to $3,000,000,000 by Public Law. No. 479, 73d Cong., approved June 27, 1934, sec. 506(b) and to $4,000,000,000 by Public Law No. 76, 74th Congress, approved May 28, 1935, sec. 16. Increased to $4.75 billion by Public Law No. 76, 74th Cong., approved My 28, 1935, sec. 10(c).

by the Board, for cash sale or for exchange for home mortgages. The maximum interest rate on its bonds was set at 4 percent, the maximum maturity at eighteen years.[10] At first only the interest was guaranteed by the government. Later, the government guaranteed the repayment of principal as well.[11]

The bonds were exempt from all taxes (national, state, or local) except surtaxes, estate, inheritance and gift taxes.[12]

The major function of the Home Owners' Loan Corporation was to make real estate loans to distressed home owners. The most widely used plan followed by the corporation was to exchange its bonds for the outstanding mortgage which was about to be foreclosed.[13]

At the outset institutions were not too enthusiastic about this exchange. With only the interest on the bonds guaranteed by the government and with the uncertainties which surrounded the new program, bonds sold as low as 82¼.[14] With the addition of the guarantee of principal repayment by the government in April, 1934, the board of

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10. Home Owners' Loan Act, sec. 4(c).
11. Public Law No. 178, 73d Congress, approved April 27, 1934, sec. 1(a).
12. Home Owners' Loan Act, sec. 4(c).
13. Harriss, op. cit., p. 9.
14. Wallace, E. S., "Home Financing," Law and Contemporary Problems, V Autumn 1938, No. 4, p. 491.

directors of the Home Owners' Loan Corporation were finally able to get their bonds up to par in the open market.[15] From then on price never dropped below par. Mortgagees then were seen to change their attitude toward these securities. In many instances mortgagees encouraged their borrowers to apply for Home Owners' Loan Corporation loans, thus enabling them to exchange their frozen assets for a liquid asset worth more than its face value in the open market.

Home Owners' Loan Corporation loans[16]

No loan on any one property could exceed $14,000 nor more than 80 percent of the appraised value as established by the corporation. Loans were limited to properties having an appraised value not in excess of $20,000. The loan had to be secured by a first lien on predominantly residential property, containing not more than four-family units and occupied in whole or in part by the applicant for the loan or held by him as a homestead. The original interest rate on these loans was 5 percent. This was later reduced to 4½ percent. The term of the loan was originally fifteen years. Later extensions were granted up to twenty-five years.[17]

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15. Public Law No. 178, 73d Congress, approved April 27, 1934, sec. 1(a).

16. The following discussion is based on the Home Owners' Loan Act of 1933, therefore, only references to complimentary sources will be footnoted.

17. Public Law No. 381, 76th Congress, approved August 11, 1939, sec. 4(b).

In connection with the loans described above the Home Owners' Loan Corporation was authorized to advance whatever cash was needed to liquidate delinquent taxes and assessments, and to pay the cost of necessary repairs, maintenance cost, insurance, and expenses of the transaction. All of these advances were added to the loan and had to be kept within the limitations imposed by the law. The corporation pursued a policy of encouraging fairly liberal repairs to put the property in good condition at the time the loan was made. Properties eligible for Home Owners' Loan Corporation loans frequently required considerable repairs and had large tax delinquencies as well.

Total advances by the corporation for taxes, repairs, etc. exceeded $400 million.[18]

Where the holder of a mortgage which was eligible for refinancing by the Home Owners' Loan Corporation was unwilling to accept the bonds of the corporation in return for his mortgage, and if the distressed home owner was unable to secure financial assistance elsewhere, the Home Owners' Loan Corporation was authorized to use cach to pay off the existing mortgage, making a loan to the borrower for that purpose. In suchcase the interest rate could not exceed 6 percent nor the amount of the loan 40 percent of the Home Owners' Loan Corporation appraisal. Each loan

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18. Sixth Annual Report of the Home Loan Bank Board, p. 70.

was to be secured by a duly recorded home mortgage and bear interest at a rate uniform throughout the United States not to exceed 6 percentum per annum.

Where the property was not encumbered by a mortgage, the corporation was authorized to lend up to 50 percent of its appraisal value at a rate of interest not in excess of 5 percent for the purpose of liquidating delinquent taxes and assessments and paying the cost of necessary repairs and maintenance.

Extent of Operations of Home Owners' Loan Corporation

The period of time within which the Home Owners' Loan Corporation was permitted to make loans to distressed home owners was limited by Congress to three years, expiring June 13, 1936. Thereafter some loans were refinanced by the corporation, but no new loans were granted.

Home Owners' Loan Corporation Appraisals

A key factor in the success of Home Owners' Loan Corporation was its appraisal work, the reappraisal of the single biggest group of real estate holdings in the country. This was the pioneer operation in a vast re-appraisal of real estate values which took place in the United States between 1931 and 1940, some of it reflected in refinancing, some of it reflected only in men's minds.

Standards and procedures worked out by the corporation were largely accepted by other government agencies, and by the country's lending institution. They had a profound effect, not only on appraisal practice but also on mortgage practice.[19]

Appraising properties for loans presented a critical and difficult problem. In an effort to assure a high quality of appraisals the Home Owners' Loan Corporation trained and supervised appraisers, most of whom it employed on a part-time fee basis. Home Owners' Loan Corporation training of personnel in, and systematizing of, appraisal methods are credited with having helped raise the general level of American real estate appraisal methods. The Home Owners' Loan Corporation standard was based on three factors of equal weight: (1) the estimated current market price, (2) the cost of a similar lot at the time of appraisal plus the cost of reproducing the building, less depreciation, and (3) the capitalization of the monthly reasonable rental value of the property for the previous ten years.

Appraisal Methods

In developing its appraisal procedures the Home Owners' Loan Corporation attempted to devise and apply methods

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19. Davies, Janet Pearl, Real Estate in American History, p. 178.

that would both guide individual appraisers and facilitate supervision and review. An informal appraisal--typically just a look at the property--would qualify for a loan. If the report was favorable a detailed appraisal was ordered. For this purpose uniform appraisal regulations and a standard form and instructions had been developed by January 1934, early enough to cover about 95 percent of the cases on which the Corporation was to pass.

The form contained ninety-eight items (several with more than one query) to be filled in by the local appraiser, and eleven more items for reviewers. The requirement of specific answers, which was at that time something of an innovation in appraising dwellings, compelled the appraiser to investigate certain factors which presumably affected his final valuation. Moreover, the forms standardized procedures and facilitated supervision.

The instructions to appraisers began with a warning against wilful overvaluation, a paragraph emphasizing that the appraiser's first obligation was to protect the United States Government, to report fully and promptly on all matters bearing on the Home Owners' Loan Corporation's interest, to keep full notes on each case and on real estate and building conditions generally, to make the appraisal independently of the amount of the loan requested, to be tactful and considerate, and to

return the assignment if he had any interest in, or connection with, the applicant.

Each appraisal report was to contain a photograph of the building, a location map, and dimensions of the lot, such information about neighborhood and property as would enable the "reviewing authority" very clearly to visualize the territory surrounding the subject property, and such facts bearing on the property's marketability as sidewalk and street surfacing, connected utilities, possible violations of building restrictions, the current bid prices for similar vacant land in the immediate vicinity, and the normal fair value of the land, as suggested by reasonable future use.

Instructions reminded the appraisers that, in general, cities had stopped growing, indicating the need for caution in estimating "higher potential use and value". Where this higher value was indicated, the appraiser was directed to take account of the time that would be required for this improvement to eventuate (allowing for carrying charges in that period) and to estimate the cost of removing existing buildings. The possibility of a downward trend of values was also to be investigated and reported on.

In valuing buildings the appraiser was directed to give the building code classification (if any), the material used (brick, frame, stucco, and the like), the

quality of the structure (cheap, fair, good, or expensive), the number and kinds of rooms, repairs necessary to protect the structure as security for a long-term mortgage loan (with a rough estimate of cost), and an estimate of reproduction cost less depreciation. As an alternative to reproduction cost less depreciation, and where it was lower, the appraiser might give an estimate of the economic value of the improvements, which was to be a normal rather than a current market value, taking into account and explaining all unfavorable factors such as poor location, excess size and capacity, and special, related structures with poor marketability such as swimming pools and greenhouses.

The final element in the appraisal formula--the capitalized value of rentals--called for the actual current rental value (unfurnished), the appraiser's estimate of a fair monthly rental, and the actual average monthly rental for the last ten years (the subject or a similar house in the neighborhood). A capital value was then computed on the basis of the ten-year average normal rental, the appraiser being told to use "the basis generally accepted or prevailing in the particular locality," an instruction which obviously left an important point to his judgment and that of his supervisors.

The Home Owners' Loan Corporation formula appraisal--the arithmetic average of (1) the present market price obtainable (from a buyer with a substantial cash payment but not in a distress sale), (2) the reproduction cost minus depreciation, and (3) the capitalized rental value--was then computed.

The appraisal form also called for values assessed for tax purposes, taxes, unpaid assessments, and accrued interest charges. The owner's appraisal, the preliminary appraisal, and the fee appraisal were noted together with the recommendations of the district appraiser and the chief state appraiser. The state manager indicated a final decision on the appraisal to be allowed and on the repairs to be made.

A credit report was obtained on each applicant from a commercial reporting agency giving information paralleling that provided by the applicant on the size of his family, his occupation and income, his age, color, and length of residence at the property. In addition the credit report indicated the interest the applicant showed in the home, the experience of others in the community who had extended him credit, the applicant's standing as a moral risk, and his possible possession of other resources.

Extent of Operations

More than a third of the existing urban home mortgage debt was at one time or another the subject of an application to the HOLC. Total loans applied for numbered 1,886,491 and amounted to $6,173,355,652 which is more than half of the estimated debt on owner-occupied urban homes in the United States. When the Corporation's lending life expired by limitation of the original law on June 13, 1936, it had acquired 1,018,390 mortgages totaling $3,093,459,271, accepting more than half of the applications filed. More than 99% of these loans were made in the form of bond exchanges. The Corporation is now entirely a liquidating organization engaged in the service and collection of its loans and the management of acquired property.[20]

Approximately one-sixth of the urban home mortgage debt of the United States was taken over by the HOLC. It originally held a mortgage on one out of every ten owner-occupied urban homes and at one time or another acquired title to many of these homes.

Effects of the Home Owners' Loan Corporation

Through the exchange of its readily marketable, interest-bearing bonds for the frozen mortgages held by financial institutions, the Home Owners' Loan Corporation helped materially to combat the financial crisis

20. Sixth Annual Report Home Owners' Loan Act, p. 70-72.

by 1936. Nearly $400 million of its bonds went to closed financial institutions, permitting the release of funds to depositors and relieving the pressure for payment upon debtors of such institutions.

In many instances the mortgage debts originally owed by Home Owners' Loan Corporation borrowers were scaled down in the process of refinancing. In all it is estimated that this reduction was in the neighborhood of $200 million or about 7 percent of the original debt.

Those borrowers whose loans were refinanced prior to April 1934 were given the option of a temporary moratorium on principal repayments, but under the amended Act of April 27, 1934, this optional moratorium was withdrawn.

The direct achievements of the Home Owners' Loan Corporation were the relief given to over one million home owners, the placing of thousands of financial institutions on a more liquid basis, and a marked contribution to the stabilization of real-estate values. Its operations were thus an important factor in the general and comparatively sharp economic recovery of 1933 to 1937.

However, the lasting effects of the Home Owners' Loan Corporation will long outlive its immediate accomplishments. Through the acquisition of the bulk of dubious mortgages, the Home Owners' Loan Corporation to a considerable extent cleared the field for home mortgage

credit. In connection with its refinancing operations, it reduced interest rates and improved loan terms to the borrowers' advantage. Practically all of the Corporation's loans, even though below the average as risks, now bear 5 percent interest per year as against 6, 7, or 8 percent which many borrowers were paying before their loans were refinanced by the Corporation. Many of the original mortgages taken over by the Corporation were of the short-term variety, repayable in one lump sum at maturity. The disadvantages of this type of mortgage from the borrower's standpoint are obvious. The Home Owners' Loan Corporation loans, on the other hand, were based on the "direct-reduction" plan providing for the gradual and orderly retirement of the principal indebtedness through regular monthly payments over a long-term, 15-year period. The Federal Government, by underwriting more than $3 billion of these loans in one enormous operation, thus made available to one million distressed home owners the most advantageous low-cost loan amortization plan in the history of the United States.

The Corporation's standard use of the direct-reduction plan has stimulated a general acceptance of long-term amortized mortgage loans by private financial institutions throughout the country. In addition, by extending the first mortgage loan to as much as 80 percent of the

appraised value of the property, the Corporation has encouraged a similar liberality in amortized loans on the part of private lenders.

With its large reconditioning program on which more than $112 million has been expended, the Home Owners' Loan Corporation assisted in the recovery of the building industry and the reemployment of workers in the building trades. At the same time, it demonstrated to private home-financing institutions the advantages that a well-directed reconditioning program can yield both in protecting an institution's active loans and stimulating the rental and sale of acquired properties.

Finally, another highly important achievement has been the improvement of appraisal technique. The importance of the reliability of appraisals to the real estate market and to a sound mortgage credit structure can hardly be overestimated. Reliable appraisals form the basis for secure investment. Indeed, the collapse of mortgage finance during the "great depression" might well be attributed in part to the lack of uniformity and consistency in appraisals. The Home Owners' Loan Corporation played an important part in making the country "appraisal conscious". In the course of its operations the Corporation also contributed largely to the development of a scientific appraisal technique and the training

of skilled appraisal personnel. For the first time in the history of American real estate a nation-wide scientific appraisal procedure and a standardized appraisal formula were developed which could be applied to all types of residential property throughout the country.

CHAPTER IV
ATTEMPTS TO ENCOURAGE THRIFT

FEDERAL SAVINGS AND LOAN ASSOCIATIONS

When Congress, in the special session of 1933, considered measures for the relief of home owners under threat of dispossession, it was confronted with the almost equally urgent problem of devising ways and means to revive thrift and home financing. Immediate relief for distressed home owners was provided by the refinancing operations of the Home Owners' Loan Corporation. However, to minimize the possibility of a recurrence of such a crisis, and to strengthen private home financing as an effective instrument of home ownership, it was imperative to provide for assistance beyond temporary relief. Moreover, there were 1,555 counties in the United States--approximately one-half of the total number of counties--in which there were no local home-financing institutions whatever.[1]

At the time creation of the Home Loan Bank System was being considered, attention was given to the proposal for including in the law authorization for federal chartering of savings and loan associations. Some building

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1. Sixth Annual Report Federal Home Loan Bank Board for the Period July 1, 1937 through June 30, 1938, p. 45.

and loan leaders regarded the absence of such a provision as a major defect of the bill and felt that no reserve system for building and loan associations could operate successfully with a membership composed of institutions operating under such a wide variety of state laws as existed. A committee of the United States Building and Loan League repeatedly endorsed the idea of federal incorporation.[2]

It was felt also that one reason for the slow start of the bank system was the lack of retail outlets for its credit, and disappointment at the membership response brought discussion of the possibility of giving support to business men who would form new associations in certain sections of the country where existing institutions refused to become members.[3]

The solution chosen by the Congress to cope with these problems was to embody in the Home Owners' Loan Act of 1933 provisions for the creation of Federal savings and loan associations as private institutions under Federal charter.

The act states:

> In order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing

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2. Wallace, E. D., "Home Financing," Law and Contemporary Problems, V (No. 4, Autumn 1938), pp. 485-487.
3. Business Week, December 28, 1932, p. 13.

> of homes, the Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation and regulation of associations to be known as "Federal Savings and Loan Associations", and to issue charters therefor, giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States.[4]

The underlying purpose of the legislation was to meet a long existing need in many communities for adequate thrift and home-financing facilities by providing for local institutions throughout the country that would operate on a uniform plan incorporating the best practices and operating principles of savings institutions specializing in the financing of homes.[5]

The organization, incorporation, and supervision of Federal savings and loan associations were vested in the Federal Home Loan Bank Board. Federal associations were to be established either by conversion from State to Federal charter, or by the granting of charters to newly organized institutions.[6]

Under the law charters could be issued only (1) to persons of good character and responsibility; (2) if a necessity existed for such an institution in the

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4. Public Law No. 43, 73d Congress, Home Owners' Loan Act, approved June 13, 1933, sec. 5.
5. Sixth Annual Report, op. cit., p. 45.
6. Williams, Joseph J., Federal Home Loan Bank Board (a speech given at the 55th National Convention of American Title Association, Minneapolis, Minnesota, October 19, 1961, 10:00 A. M.

community; (3) if there was a reasonable probability of its usefulness and success; and (4) if it could be established without undue injury to properly conducted existing institutions of the same type.[7]

In order to supply immediate funds for home finance and to encourage private investments, the Secretary of the Treasury, and later the Home Owners' Loan Corporation, were authorized, within limits fixed by Congress, to subscribe to the shares of Federal savings and loan associations.[8]

The act states, "To enable the Board to encourage local thrift and local home financing and to promote, organize, and develop the associations organized under local laws."[9] For this purpose $850,000 has been appropriated.[10]

The original amount appropriated was $150,000.[11] The Act of April 27, 1934, increased the amount by directing the Secretary of the Treasury to turn over to the Board $500,000[12] of the funds previously made

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7. Wallace, op. cit., p. 494.
8. Sixth Annual Report, op. cit., p. 45.
9. Public Law No. 43, op. cit., sec. 6.
10. Public Law No. 178, 73d Congress, approved April 27, 1934, sec. 11.
11. Public Law No. 76, 74th Congress, approved May 28, 1935, sec. 19.
12. Public Law No. 178, op. cit., sec. 11(g).

available to him for investment in federal associations. This amount was increased to $700,000[13] by the Act of May 28, 1935. These funds were supposed to be used impartially for promotion of both state and federal associations.

A federal savings and loan association was to be a locally owned and managed mutual saving and home financing institution, chartered in perpetuity by the Federal Home Loan Bank Board with no limitation as to maximum capital. It was to be organized and directed by responsible local citizens. It would be owned by all of its investing members, whose funds are loaned principally on the security of homes owned by citizens of the community. The charter and regulations under which it would operate would embody well-defined principles with respect to investment safeguards, lending policies and other operating practices (discussed later in this paper) which had proved to be sound and practical for both investor and borrower.

All federal associations were to qualify for insurance by the Federal Savings and Loan Insurance Corporation.[14] Such associations were also to be members of the Federal Home Loan Bank System.[15] A federal association was not

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13. Public Law No. 76, op. cit., sec. 19.

14. Public Law No. 479, 73d Congress, approved June 27, 1934, sec. 403(a).

15. Public Law No. 43, op. cit., sec. 5(f).

to be permitted to accept deposits or conduct a commercial banking business. In a federal association, all accounts would participate equally in the earnings of the associations, pro rata to their withdrawal value. Their accounts were to be non-assessable, and no membership or withdrawal fee of any kind could be charge. Dividends on accounts could be paid at least twice yearly at a rate determined by the directors on the basis of earnings.[16]

For regular savings over specified periods of time, provision could be made to pay an extra return on such accounts in the form of a bonus. Funds invested in a federal savings and loan association by its members were, for the most part, to be invested by the association in first mortgages on homes located within 50 miles[17] of its home office. Only to a limited extent could the association lend on other improved real estate, or lend more than $35,000 (originally $20,000) on any one property, or lend on property beyond the fifty-mile radius.[18]

A federal association is limited by charter and regulatory provisions as to the percentages of property value that may be loaned, depending upon the type of property and the terms of repayment. Maximum limitations as to percentage of value and term of repayment apply to

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16. Ibid., sec. 5(b).
17. Ibid., sec. 5(c).
18. Ibid., sec. 6.

monthly installment loans on homes or joint home and business properties; the limitations are less liberal if the loans are payable on any other plan or are secured by any other type of property. The insured or guaranteed loans under the provisions of the National Housing Act (FHA loans) or the Servicemens' Readjustment Act of 1944 (G.I. loans) may be made in accordance with regulations of the appropriate agency. Subject to certain limitations, a federal association may make unsecured loans for property alterations, repair or improvement, and also make loans to finance the acquisition and development of land for primary residential usage.

The associations may make loans on the security of the savings accounts of their members.[19] Such associations operate under the direction of a board of directors of not less than 5 nor more than 15, as determined and elected by members.

All associations are under federal supervision, and must submit to federal examination and to a satisfactory audit at least annually.[20]

Federal associations have contributed greatly toward popularizing the monthly direct-reduction loan plan, which is used in making practically all of their mortgages.

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19. *Ibid.*, sec. 5(c).
20. *Ibid.*, sec. 5(c).

Under this plan of amortized mortgage, the borrower pays a stated sum monthly and with each payment reduces the principal of his loan. Naturally, the portion of each payment required for interest becomes smaller each succeeding month, with a correspondingly larger monthly reduction of principal. The loan commonly provides that the borrower's monthly payment include an amount equivalent to one-twelfth of the estimated taxes and insurance premiums on the property, to enable the association to pay suchcharges for the borrower when due.

The widespread public acceptance of the Federal Savings and Loan System has widened in step with its development since the inception in 1933. At the end of 1960 there were 1873 federal associations in operation with aggregate assets of thirty-eight billion, five hundred eleven million dollars. Federal charters were outstanding in each of the 50 states as well as the District of Columbia and Puerto Rico. The aggregate assets of Federal savings and loan associations at the end of 1960 represented 54 percent of the total assets of all institutions of savings and loan type in the country.[21]

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21. Savings and Loan Fact Book 1961, p. 78.

TABLE 6. NUMBER OF SAVINGS ASSOCIATIONS, BY TYPE OF CHARTER

Year (Dec. 31)	Federally Chartered	State-Chartered			Grand Total
		Total	Insured	Noninsured	
1900	--	5,356	--	5,356	5,356
1905	--	5,264	--	5,264	5,264
1910	--	5,869	--	5,869	5,869
1915	--	6,806	--	6,806	6,806
1920	--	8,633	--	8,633	8,633
1925	--	12,403	--	12,403	12,403
1930	--	11,777	--	11,777	11,777
1935	987	9,279	130	9,149	10,266
1940	1,437	6,084	840	5,244	7,521
1945	1,467	4,682	1,008	3,674	6,149
1950	1,526	4,466	1,334	3,132	5,992
1955	1,683	4,388	1,871	2,517	6,071
1956	1,739	4,397	1,927	2,470	6,136
1957	1,772	4,397	2,000	2,397	6,169
1958	1,807	4,401	2,074	2,327	6,208
1959	1,841	4,383	2,138	2,245	6,224
1960	1,873	4,403	2,225	2,178	6,276

Source: Federal Home Loan Bank Board; United States Savings and Loan League

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

For the purpose of restoring public confidence in savings and loan associations, by encouraging and accelerating the flow of savings to these institutions and thereby increasing the supply of funds available for the financing of the nation's homes, Congress under Title IV of the National Housing Act, approved June 27, 1934, created the Federal Savings and Loan Insurance Corporation.[22]

The FSLIC, a permanent government corporation under the direction of a board of trustees composed of the five members of the Federal Home Loan Bank Board[23] was to accomplish its purpose by insuring savings in all Federal Savings and Loan Associations and state chartered savings and loan, building and loan and homestead associations, and cooperative banks which applied and qualify.[24]

The corporation's insurance program protects savers in its member associations against financial loss up to a statutory limit of $10,000.[25]

This form of insurance provides only for the safety of investments, not for their liquidity. Failure to obtain

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22. Public Law No. 479, op. cit., sec. 402(a).
23. Ibid., sec. 402(b).
24. Ibid., sec. 403(a).
25. This amount was originally $5,000 but was increased to $10,000 by Public Law No. 576, 81st Congress, approved June 27, 1950, Sec. 9.

from an insured association any amounts required for withdrawal would not necessarily involve the Federal Savings and Loan Insurance Corporation.

The protection may take one of two courses--the prevention of default or the payment of insurance to savings account holders in the event of liquidation.

To help insured financial institutions which may find themselves in insolvent condition and to prevent the closing of such institution and thus diminishing confidence in other financial institutions, Congress provided that the FSLIC may (1) make the institution a loan or (2) purchase the assets of the institution or (3) make a contribution to the institution that need not be repaid. However, no contribution shall be made to any such institution in an amount in excess of that which the corporation finds to be reasonably necessary to save the expense of liquidating such institution.[26]

The corporation was authorized a capital stock of $100,000,000 the total of which was originally subscribed for by the Home Owners' Loan Corporation but was transferred to the Secretary of the Treasury in 1949.[27]

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26. Public Law No. 479, op. cit., sec. 406(f).
27. Public Law No. 860, 80th Congress, the Government Corporation Appropriation Act, approved June 30, 1948.

This stock was subsequently retired by 1958 entirely out of earnings. Nevertheless, the Corporation reported accumulated surplus and reserves amounting to nearly $381 million at the end of 1960.[28]

An additional cushion of safety is provided by the loss reserves accumulated by the insured associations themselves. Such loss reserves totaled $4.7 billion on December 31, 1960.[29] Furthermore, the Corporation is authorized to borrow up to $750 million from the United States Treasury to meet its insurance obligations should such action become necessary.[30]

The FSLIC derives its income from two major sources: one, the annual insurance premium paid by insured members and second, interest on United States Government Securities owned by the Corporation.

Each member institution is charged 1/12 of 1 percent[31] premium annually (originally 1/4 of 1%) on the total accounts of an insurable type plus all creditor obligations, as determined by its latest annual report. Such premium is paid annually until a reserve fund has been established by the Federal Savings and Loan Insurance Corporation equal to 5 per centum of all insured accounts and creditor

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28. Savings and Loan Fact Book, p. 113.
29. Loc. cit.
30. Public Law No. 576, 81st Congress, approved June 27, 1950, sec. 6(i).
31. Ibid., sec. 7(a).

obligations of all insured institutions. If at anytime such reserve fund falls below such 5 per centum, the payment of the annual premium is resumed until the reserve is brought back to 5 per centum.[32] These together with the minor item of admission fees, totaled $43.8 million for the year 1960. Interest earned on investments in U. S. government securities amounted to $10.3 million in 1960.

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32. Public Law No. 479, _op. cit._, sec. 404(a).

TABLE 7. FSLIC COMPARATIVE OPERATING STATEMENT

(In Thousands of Dollars)

Year (Dec. 31)	Income from Premiums and Admission Fees	Other Income	Total Gross Income	Operating Expenses	Net Income from Operations
1935	$ 182	$3,035	$ 3,217	$ 87	$ 3,130
1936	823	3,033	3,856	113	3,743
1937	1,412	3,146	4,559	159	4,400
1938	1,947	3,263	5,210	193	5,017
1939	2,337	3,392	5,729	223	5,506
1940	2,650	3,388	6,038	256	5,782
1941	3,087	3,481	6,569	265	6,304
1942	3,562	3,481	7,043	358	6,685
1943	4,037	3,557	7,594	332	7,262
1944	4,259	3,277	7,536	453	7,083
1945	5,087	3,550	8,637	456	8,181
1946	6,749	3,905	10,654	555	10,099
1947	8,115	4,275	12,390	562	11,827
1948	9,496	4,388	13,885	552	13,332
1949	9,149	4,683	13,832	894	12,938
1950	8,586	4,623	13,209	595	12,614
1951	10,286	4,515	14,801	645	14,157
1952	12,125	4,813	16,938	720	16,219
1953	14,514	5,104	19,618	725	18,893
1954	17,438	5,282	22,720	756	21,964
1955	20,834	5,604	26,438	825	25,613
1956	25,180	5,921	31,101	987	30,114
1957	29,043	6,615	35,658	1,065	34,593
1958	32,949	7,068	40,017	1,362	38,655
1959	37,819	7,861	45,680	1,484	44,196
1960	43,817	10,323	54,140	1,610	52,530

Source: Federal Home Loan Bank Board

The Corporation steps in only when the insured institution defaults. A default occurs only when a "conservator, receiver, or other legal custodian is appointed for an insured institution for the purpose of liquidation."[33]

When an insured association defaults, its insured members have two choices:[34]

(1) They may have their insured account transferred to a solvent insured association of their choice, where they continue their investment as if nothing had happened.

(2) They may be paid in cash immediately upon the determination of the amount of their claims.

The question arises, "What happens to the uninsured portion of an account in excess of the $10,000 insurance coverage?"

By definition, it has no preferential claim against the assets of the association, since it is uninsured. For example, if Mr. Jones owns an account for $15,000 in the Henry City insured association, upon default he could elect either of the above mentioned plans with respect to $10,000 of his account. The $5,000 would continue as a claim against the institution in default, subject to any prior claims, and would depend upon how much is realized from

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33. *Ibid.*, sec. 401(d).
34. *Ibid.*, sec. 405(b).

the liquidation of the assets of the institution.[35] At present, however, 84 per cent of all investments of insured associations fall within the original $5,000 limitation, the average being $2,110.[36]

Financial assistance has been extended to an association in only two instances since 1950. Altogether, from the outset of operations, there have been 38 cases involving insurance settlements, of which 29 comprised financial contributions, seven were receiverships and two represented liquidations through purchase of assets. Net losses to the Corporation have been approximately $5,224,000 or less than 2% of cumulative gross income and less than 3% of premium incomes.[37]

By providing the much needed facility of saving account insurance of funds invested by the public in such associations, the Federal Savings and Loan Insurance Corporation has played a major role in maintaining the confidence of the public in savings institutions. Today, insurance is an accepted and normal feature of the protection of savings in our financial institutions. The growth of savings and loan associations both in volume of savings and in the volume of home mortgage lending--testifies in large part to the value of insurance of accounts.

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35. _Ibid._, sec. 406(b).
36. _Savings and Loan Fact Book 1961_, pp. 17-22.
37. _Ibid._, p. 114.

In 1936 the number of insured associations was 1,575 representing 16 per cent of the number of all savings and loan associations. These had 25 per cent of the assets and 29 per cent of the mortgage loans.

In 1952 the number of insured associations had risen to 3,172 representing 53 per cent of the number and had 87 per cent of the assets. At the end of 1960 there were 4,096 insured members representing two-thirds of the total number of savings and loan associations and had 94% of the total assets. (See Table 8.)

TABLE 8. FSLIC MEMBERSHIP AND MEMBER ASSETS
(Dollar Amounts in Millions)

Year (Dec. 31)	Total Number of Insured Institutions	Federally Chartered	State-Chartered	Total Assets	Pct. of Assets of Insured Assns. to Total
1935	1,117	987	130	$ 711	12.1%
1936	1,575	1,200	375	1,281	22.2
1937	1,884	1,318	566	1,758	30.9
1938	2,098	1,357	741	2,127	37.8
1939	2,199	1,398	801	2,509	44.8
1940	2,277	1,437	840	2,926	51.0
1941	2,343	1,460	883	3,353	55.4
1942	2,398	1,467	931	3,643	59.2
1943	2,447	1,466	981	4,173	63.2
1944	2,466	1,464	1,002	4,995	67.0
1945	2,475	1,467	1,008	6,123	70.0
1946	2,496	1,471	1,025	7,294	71.5
1947	2,536	1,478	1,058	8,528	73.0
1948	2,616	1,485	1,131	9,715	74.6
1949	2,756	1,508	1,248	11,278	77.1
1950	2,860	1,526	1,334	13,644	81.0
1951	3,020	1,549	1,471	16,146	84.3
1952	3,172	1,581	1,591	19,582	86.7
1953	3,304	1,604	1,700	23,498	88.2
1954	3,433	1,640	1,793	28,243	89.3
1955	3,554	1,683	1,871	34,075	90.6
1956	3,666	1,739	1,927	39,243	91.5
1957	3,772	1,772	2,000	44,375	92.2
1958	3,881	1,804	2,077	51,311	93.1
1959	3,979	1,841	2,138	59,547	93.8
1960	4,098	1,873	2,225	67,342	94.2

Source: Federal Home Loan Bank Board.

CHAPTER V

NATIONAL HOUSING ACT

A Sick Industry

The actions taken so far by the Government attacked special areas of the real estate crisis. Together they were not an overall cure. The housing industry was still prostrate, mortgage money was frozen, 2 million men were unemployed in the construction industry, and properties were falling apart for lack of money to pay for repairs.[1]

The lethargic state of the housing industry was the most serious problem of the depression, still defying solution.

The chief symptom was fear of action. It seemed that the Government's most effective role would be to encourage confidence. The question was how to do it.

The Administration did not intend to get into direct lending, and the growing support for Government loans intensified efforts to develop a better alternative.

In December 1933 President Roosevelt appointed a four-man committee to coordinate the Government's housing activities and to work out a proposal for federal action

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1. The F.H.A. Story in Summary, compiled by the Office of Public Information, Federal Housing Administration, p. 3.

in the housing crisis.[2] The problem involved more than immediate relief. A remedy for existing conditions had to get to the basic causes of the crisis as discussed in Chapter I.

The legislation finally enacted had four main provisions:

(1) Insurance against loss on property improvement loans.[3] This was the emergency feature. It was a simple operation and could be put into effect quickly. The institution would be insured against loss up to 20 percent of all the loans it made, which was considered ample since personal loans had a good repayment record even through the depression. The loans would be made without FHA requirement of collateral, on more reasonable terms than had previously been available. The modernization credit plan, as it was then called, was intended as a pump-priming measure for about a year and a half.

(2) Mutual mortgage insurance on homes and low-cost housing.[4] This was the heart of the program. It was intended to be permanent. Government insurance was offered to attract money into the field of home financing. The mortgages insured were to be made on realistic terms--loan-value ratios up to 80 percent, maturities up to 20

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2. *Loc. cit.*
3. Public No. 479, 73d Congress, (National Housing Act, approved June 27, 1934, Title I).
4. *Ibid.*, Title II.

years, amortization by monthly payments.

The FHA was not set up to protect lenders by insuring transactions too risky for conventional loans. On the contrary its mission was to lead the way in placing home financing on a sound basis. Only first mortgages would be insured. The insurable amount would be related to an adequate appraisal of the property but could not exceed $16,000. The loan would be amortized by periodic payments within the borrower's reasonable ability to pay. Interest could be not more than 5 percent, or up to 6 percent if the market demanded it. The transaction had to be economically sound.

The borrower's regular mortgage payment would include a mortgage insurance premium which the lender would pay annually to the FHA. In time the accumulation of premiums would make the agency self-supporting and possibly provide dividends for mortgagors. The system was similar to that used by private mutual life insurance companies.

Insurance claims were to be paid in long-term interest-bearing debentures. As a reassurance to lenders, debentures issued in exchange for mortgages insured before July 1, 1937 were to be guaranteed by the United States. (In 1938 the guarantee was made permanent.)

Mortgage insurance in amounts up to $10 million on low-cost rental housing built by limited-dividend corporations was also provided for.

(3) National Mortgage Associations.[5] The FHA was authorized to charter National Mortgage Associations with capital stock of at least $5 million. The associations would buy and sell FHA-insured mortgages. This would help to make mortgage money available more consistently in all parts of the country and to reduce interest rates in areas where scarcity made them high. Provision for National Mortgage Associations was considered essential to the successful carrying out of the mutual mortgage insurance plan.

(4) Insurance of savings and loan accounts.[6] A Federal Savings and Loan Insurance Corporation was established under the direction of the Federal Home Loan Bank Board to insure the accounts of savings and loan associations.

With the signing of the National Housing Act a new era in American housing began.

The Act provided for creation of a Federal Housing Administration, with all powers vested in an Administrator, who was appointed by the President with the advice and consent of the Senate for a term of four years.[7] The Reconstruction Finance Corporation was directed to make

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5. Ibid., Title III.
6. Ibid., Title IV.
7. Ibid., Title I, sec. 1. Reorganization Plan No. 3 of 1947 provided that the functions of the Federal Housing Administrator be transferred to the Federal Housing Commissioner.

available to the Administrator whatever funds he found necessary, and its authorized bond issue was increased by an amount sufficient to provide such funds. The President was also authorized to make allotments to the Administrator from any funds available to him for emergency purposes. Contrary to a popular impression which has been difficult to dispel, the FHA was never authorized to lend any money. Its distinctive function was and is to insure lenders against losses which they might sustain on certain types of loans. These insurance activities fall into two major divisions, usually designated as Title I and Title II loans.

<u>Title I</u>: Under Title I three types of loans were eligible for insurance:

(1) Title I was principally concerned with loans for financing alterations, repairs, and improvements on existing structures. To be eligible for insurance, such loans could not exceed $10,000.

(2) While the original intention in this part of the law was to provide increased credit for these purposes, the wording was broad enough to cover loans for new construction also. The wording was changed by the Act of April 3, 1936,[8] so as virtually to eliminate the insurance of such loans under Title I, but in the Act of February 3,

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8. Public Law 486, 74th Congress, approved April 3, 1936.

1938,[9] the original wording was restored, and it was specifically provided that loans for new construction might not exceed $2,500.

(3) The insurance of catastrophe loans was first authorized by the Act of April 17, 1936.[10] Such loans could not exceed $2,000.

The total amount of insurance granted to an institution on the first two types of loans was limited to 10% of the total amount of such loans, advances of credit, and purchases made by it. On the third type the limit was 20%. The total amount of liability which the Administrator could have outstanding at any one time plus the amount of claims paid on loans insured under Title I was limited to $100,000,000. There was no charge for insurance under Title I, and all losses were paid by the government. Except for the maximum limits, Title I was practically devoid of restrictions concerning the granting of insurance. Loans to be insured were not limited to residential structures or to urban areas. The Administrator was given complete authority to prescribe the conditions under which lending agencies would be approved for insurance and to specify the requirements concerning interest rates, maturity, security, and other conditions to which their loans must conform.

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9. Public Law 424, 75th Congress, approved February 3, 1938.

10. Public Law 525, 74th Congress, approved April 17, 1936.

Only loans in excess of $2,500 required prior approval of the Administrator. The local lending institution was to be the sole judge of the wisdom of extending credit of less than this amount and simply was to report its eligible loans for insurance within thirty-one days after they were granted. No down payment and no mortgage or other security was to be required, even on loans for new construction, but local institutions were free to require security or endorsers if they wished. Loans to finance new structures intended in whole or in part for residential use could have a maturity not in excess of seven years and an interest yield not exceeding 6.69% ($3.50 discount per $100). On other loans the insurance was limited to a period of five years and the interest yield to 9.72% ($5 discount per $100).

<u>The Experiment Began to Prove Out</u>

At the end of 1934 the Federal Housing Administration was a full-grown agency with a record of solid accomplishment.

The new agency had been under terrific pressure to show quick results. The details of the modernization credit plan had been worked out carefully beforehand, and the FHA was able to get outstanding people to conduct the all-out better-housing campaign that was launched at once.

<u>The Better-Housing Campaign</u>

At a time when the country was just beginning a slow climb out of its worst depression, the job of FHA was to sell property owners on the idea of spending money for repairs and improvements even if they had to borrow it; and to sell lending institutions on making consumer credit loans up to $2,000 in amount without collateral, co-makers, or endorsers, with repayment stretched out as long as 5 years. This was almost unheard-of in banking circles--as a matter of fact, less than 1 percent of the banks were organized to make this type of loan when the campaign began.[11] On top of everything else was the fact that relatively few people understood what FHA was all about.

The better-housing campaign reached into every corner of the United States. It was comparable to a Government war bond drive. Volunteers were enlisted, 4,000 communities were organized, 3 million door-to-door canvass calls were made.[12] More than a thousand newspapers carried better-housing sections. Every avenue of publicity was used to make the country housing conscious--movies, radio, exhibits, posters, car cards, magazine articles, meetings.

By the end of 1934 nearly 4,000 financial institutions, representing more than 70 percent of all the commercial banking resources of the country, had FHA

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11. <u>The FHA Story in Summary</u>, p. 9.
12. <u>Loc. cit.</u>

contracts of insurance and had made nearly 73,000 property improvement loans. By December they were being reported at the rate of $398,000 a day.[13]

Mutual Mortgage Insurance

Title II provided for a system of mutual mortgage insurance under which the Administrator was authorized to insure, or to make commitments to insure prior to execution, fully amortized loans secured by property of three types:

(1) Owner-occupied dwellings designed principally as single-family residences. The construction of such dwellings must have begun after February 3, 1938, and the mortgage must have been approved for insurance prior to the beginning of construction, or, if construction was begun between January 1, 1937, and February 3, 1938, the dwelling must not have been sold or occupied since completion. The mortgagor must have paid on the property at least 10% of the appraised value in cash or its equivalent, and the mortgage must have had a maturity not exceeding 25 years. The principal of such mortgages was limited to $8,600 and could not exceed 90% of the appraised value up to $6,000 plus 80% of the appraised value in excess of $6,000.

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13. *Loc. cit.*

(2) Dwellings designed principally for residential use for not more than four families. Mortgages on such property could not exceed $16,000 or 80% of the appraised value and must have had a maturity not exceeding 20 years.

(3) Rental housing projects covered by mortgages up to $5,000,000. The original Act contained a simple authorization for insurance up to $10,000,000 on projects designed to provide housing for persons of low income. The Act of February 3, 1938, added detailed regulations covering this type of insurance and provided for creation of a separate fund, known as the Housing Insurance Fund, in connection with it. While many of the provisions are the same, the following discussion relates only to mortgages of the first two types.

First liens made to and held by approved mortgagees, containing complete amortization provisions and other terms prescribed by the Administrator, bearing interest, exclusive of premium and service charges mentioned below, at a rate not exceeding 5%, and executed in connection with projects which the Administrator considered economically sound, were eligible for insurance. Mortgages of the second type mentioned in the preceding paragraph were to cover either new or existing structures. The 1938 amendment,[14]

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14. Public Law 424, 75th Cong., H.R. 8730 approved February 3, 1938, Sec. 203(a).

however, provided that beginning July 1, 1939, no mortgages could be insured unless they covered property (1) approved for mortgage insurance prior to completion of construction; or (2) the construction of which was commenced after January 1, 1937, and completed prior to July 1, 1939; or (3) previously insured by the Administrator. The law had never limited insurance operations to urban mortgages, but the 1938 amendments specifically provided for the insurance of otherwise eligible mortgages covering farms on which houses or buildings were to be constructed or repaired, providing at least 15% of the principal of the mortgage was to be spent for materials and labor.

The Administrator was authorized to collect an annual premium charge for insurance of from 1/2% to 1% of the amount of the principal obligation outstanding, without taking into account delinquent payments or prepayments. The Administrator required payment of these premiums in advance by the mortgagee, who collected them from the mortgagor. Authorization for the annual service charge of 1/2% of the outstanding principal formerly permitted by the Administrator was removed from the regulations in February 1938.[15] If default occurred on an insured mortgage, the mortgagee was permitted to foreclose or acquire title to the mortgaged property by other means, and upon

15. Loc. cit.

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delivery of acceptable title to the Administrator was entitled to receive debentures equal in face value to the value of the mortgage. These debentures were issued in the name of the Mutual Mortgage Insurance Fund, were fully guaranteed as to principal and interest by the United States, were exempt from all taxes except surtaxes, estate, inheritance, and gift taxes, bore interest at a rate not exceeding 3%, determined at the time the mortgage was offered for insurance, and matured three years after the first day of July following the maturity date of the mortgage.

The aggregate principal obligation of all insured mortgages outstanding at any one time was limited to $2 billion but with the approval of the President this limit could be increased to $3 billion. Mortgages accepted for insurance were divided into groups in accordance with sound actuarial practice and risk characteristics. Separate accounts were maintained for each group. Premium charges and appraisal fees were to be credited to these group accounts, and the payments on debentures and certificates of claim and the expenses of handling property were charged to them. In addition to the group accounts, a general reinsurance account was set up with $10,000,000 of federal funds, which was available to cover deficits in the group accounts. The Administrator could charge his expenses

either to group accounts or to the reinsurance account. When all mortgages in a group had been paid, or when the amount available for distribution was sufficient to pay all mortgages in the group, the Administrator was to terminate the insurance for that group, charge off estimated losses, transfer to the general reinsurance account 10% of the premiums previously credited to the group, and distribute equitably to mortgagees, for the accounts of mortgagors, the balance remaining in the group account.

Preparations for Mortgage Insurance

While the better-housing campaign was going full blast, work that was even more important was in progress at FHA.

Machinery for property improvement loan insurance had been ready even before the Act was passed. It was a simple procedure, with responsibility left largely to the lenders.

Mutual mortgage insurance was something else. Its object was nothing less than a reform of home financing practices.[16] In a sense it was an emergency program, but its long-range aspects were far more important.

The law required that every transaction be economically "sound", and fixed responsibility for determining such

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16. The FHA Story in Summary, p. 10.

soundness upon the Administrator. A system of risk rating, to be discussed later, had to be developed, based on new and untried premises. A "sound" transaction involved "sound" properties and neighborhoods, standards for which had to be established. The mortgagor's willingness and ability to repay the debt were probably the most important elements in the transaction. A basis had to be found for making sure he was not borrowing more than he could repay. The mortgage was to be within a fixed percentage of appraised value, although there was at that time no national system of appraisal available as a standard. The work "value" itself had to be defined (see below).

All these problems were being worked out while the better-housing campaign was making the initial break in the housing logjam. On November 3, 1934, the Guaranty Trust Company of New York became the first FHA-approved mortgagee. On December 21 of that year, a commitment was issued by the Newark office of FHA to Mr. and Mrs. Warren Newkirk for the first house to be built with FHA-insured financing. Mr. Newkirk paid off the balance of his $4,800 mortgage upon retirement from business in 1948 and received a rebate of about $400 from the FHA under the mutual mortgage insurance plan.[17]

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17. *Ibid.*, p. 11.

Handicaps

A serious handicap to FHA mortgage insurance arose from the provisions in state laws which operated so as to prevent lenders from taking full advantage of the provisions of the National Housing Act. The FHA prepared a model bill removing these restrictions and worked with State officials to adapt it for passage. By the end of 1937 the necessary legislation has been enacted in all 48 states.

Another handicap to the attainment of FHA objectives was the scarcity of reliable date on the housing market and housing conditions in general. The Act directed the Administrator to make "such statistical surveys and legal and economic studies as he shall deem useful to guide the development of housing and the creation of a sound mortgage market."[18] This work began as soon as the FHA was set up. Not long afterwards FHA's own statistics of operation came to be some of the most valuable material in the housing field. FHA also took the lead in sponsoring housing surveys, which developed into a national Census of Housing, taken for the first time in 1940.

FHA Helped Recovery

In the seven years from 1934 to 1941, FHA established its programs on what seems to have been a firm foundation

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18. Public Law 479, op. cit., Title II, sec. 209.

and became a strong force in the housing market. Although the National Housing Act has been amended on many different occasions, the basic provisions of the law and the regulations and procedures determined in the early years have never appeared to need radical revision.

The First Full Year

The better-housing campaign continued through 1935. By the end of that year, more than 708,000 property improvement loans with net proceeds to borrowers totaling $229 million had been reported for insurance. Employment in the building trades was 10 to 15 percent higher than at the end of 1934. In May the insurance authority was extended to April 1936.[19]

Home mortgage insurance got under way December 21, 1934, and 23,397 mortgages totaling $93,882,000 were insured during 1935.[20]

In February FHA issued the first commitment to insure a mortgage under Section 207 on a low-cost housing project--Colonial Village in Arlington, Va., a garden-type development financed through the New York Life Insurance Company. There were about 15,000 tenant applications for the first 276 units available for occupancy.[21]

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19. F.H.A. Story in Summary, p. 12.
20. Federal Housing Administration 27th Annual Report for year ending December 31, 1960, p. 16.
21. F.H.A. Story in Summary, p. 12.

Minimum standards were established in 1935 for properties and subdivisions, and research was undertaken in urban land use, housing laws and regulations, construction developments, and costs.

Techniques for gathering and analyzing housing data were developed, and the FHA began to publish its own statistics of operation.

FHA Begins to Pay Its Way

At the end of 1936, revenues from mortgage insurance premiums and appraisal fees were coming in at a rate of about $500,000 a month. In some of the insuring offices, revenues were already equal to expenses.

The number of home mortgages insured during the year 1936 was more than three times that in 1935. Rental housing was also getting started--projects with more than 600 units were insured in 1936. In April the modernization credit plan was extended to April 1, 1937. The liability for losses was reduced from the $200 million authorized in 1934 to $100 million, and the amount of insurance was reduced from 20 percent to 10 percent of all loans made.[22]

Purchases and sales of insured mortgages were increasing. By the end of 1936, about $60 million--about 15 percent of the total amount insured--had changed hands.

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22. Public Law 486, 74th Congress, approved April 3, 1936.

The first housing market analyses were undertaken on an experimental basis, and study also began on the causes of real estate cycles.

The authority to insure property improvement loans expired in April 1937 (except for disaster loans) and was not renewed until the following February.

Home building fell off in the second half of 1937, and, after conferences in which FHA and other Government agencies took part, amendments to the National Housing Act were introduced late in 1937 which became law on February 3, 1938.[23]

Amendments to the Act

The National Housing Act Amendments of 1938 were the first important changes in the original law. Title II was rewritten so as to provide for more liberal terms on new low-cost, owner-occupied homes--90 percent mortgages with maturities up to 25 years. In addition, the Treasury guarantee of FHA debentures was made permanent.

Property improvement loan insurance authority was restored (it has remained in effect ever since by periodic extensions). Loans up to $2,500--the so-called Class 3 loans--to finance the construction of homes were also authorized, under Title I.

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23. Public Law 424, 75th Congress (Chapter 13-3D Session) approved February 3, 1938.

Section 207 was revised to include housing built for profit. A separate Housing Insurance Fund was established for this section.

Provision was also made for setting up a Federal National Mortgage Association to buy and sell insured mortgages. It was incorporated on February 10 and was owned and operated by the Reconstruction Finance Corporation (see below).

Mortgage insurance on both homes and rental projects rose sharply after these 1938 amendments took effect, and helped to bring about a vigorous revival in the housing industry. This aided the economy, which faced a general recession in late 1937 and early 1938.

Two significant amendments were made to the Act on June 3, 1939:[24]

(1) Provision was made for the first time for an insurance premium of not more than 3/4 of 1 percent on property improvement loans. The Administrator fixed the charge at this rate, where it remained until 1954. Several reductions since then have brought it down to 1/2 of 1 percent.

(2) A prevailing-wage provision for multifamily housing under Section 207.

The following year the number of units provided under Section 207 dropped to 3,600 from the 1939 figure of 13,400.

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24. Public Law 111, 76th Congress (Chapter 175-1st Session), approved June 3, 1939.

The President's Reorganization Plan No. I effective June 25, 1939 set up a Federal Loan Agency to coordinate and supervise various agencies, including FHA.[25]

FHA Becomes Self-Supporting

July 1, 1940 was significant as the date when FHA began to pay all its expenses out of income. Since then it has been completely self-sustaining.

Defense and War Housing

War had begun in Europe in September 1939. FHA activities became more and more concerned with defense housing and increasingly significant in the overall housing market.

In March 1941 a new Title VI, Defense Housing Insurance (later renamed War Housing Insurance), was added to the Act and soon became the dominant vehicle for FHA mortgage insurance.[26] The requirement of economic soundness was omitted, and a special insurance fund was established to provide for losses.

The National Housing Agency

An executive order of February 24, 1942 created a National Housing Agency.[27] The FHA, with other housing

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25. Effective June 25, 1939, under the provisions of section 5 of the Reorganization Act of 1939, approved April 3, 1939.

26. Public Law 24, 77th Congress (Chapter 31-1st Session), approved March 28, 1941.

27. Executive Order No. 9070, approved February 27, 1947.

agencies of the Federal Government, was made a constituent agency.

At this time the title of Federal Housing Administrator was changed to Federal Housing Commissioner.

On May 26, 1942, Section 608 was added to Title VI of the National Housing Act to stimulate the production of rental housing for war workers.[28]

As an anti-inflationary measure, the President early in 1942 urged the American people to accelerate payment of mortgages and other debts. The FHA agreed to waive the prepayment penalty of 1 percent when refinancing was not involved.

Restrictions on materials and other wartime regulations made it necessary for the time being to modify FHA underwriting procedures.

FHA-VA Financing

In 1944 FHA, in cooperation with the Veterans' Administration, prepared to extend its facilities to returning veterans by processing cases where VA guaranteed a loan in lieu of equity not over $2,000 and FHA insured the mortgage. When this combination financing was finally discontinued, FHA had insured about 327,000 mortgages, mostly under Section 603.

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28. Public Law 559, 77th Congress (Chapter 319-2nd Session), approved May 26, 1942.

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First Participation Payments

The first participation payments under the mutual mortgage insurance system were made in 1945 to nearly 13,000 mortgagors who had prepaid their loans in 1944.[29]

Veterans Housing

In 1946 the grand push for veterans housing began. FHA was in the middle of it. How to get housing veterans could afford and built by private enterprise in the face of materials and labor shortages and restrictions, not to mention ceilings on prices, rents, and interest rates, was as difficult a problem as any FHA had faced.

The Veterans' Emergency Housing Act of 1946 revised and extended FHA authority to insure mortgages under Title VI of the National Housing Act.[30] "Necessary current cost" replaced "estimated replacement cost" as the basis for determining insurable mortgage amounts.

FHA devoted much of its energies in 1946 to the encouragement of the production of veterans' housing, particularly rental housing.

Because of the emergency, alternatives to minimum property requirements for multifamily housing were made acceptable if the project was structurally sound, well designed, and had permanent rental appeal. Elevator

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29. Twenty Seventh Annual Report of FHA, 1960, p. 109.
30. Public Law 388, 79th Congress (Chapter 268-2nd Session), approved March 22, 1946.

structures became acceptable for the first time. The amortization of Section 608 mortgages was reduced so as to lengthen the maturity by five years or longer. Working capital requirements were reduced. Forms were simplified and procedures streamlined to facilitate quick action on applications.

In 1947 FHA insurance of short-term loans to housing manufacturers was authorized by Congress.[31] About 750 such loans were insured in the seven years in which the insurance was available.

The HHFA

On July 27, 1947, Reorganization Plan No. 3 of 1947 became effective, establishing a Housing and Home Finance Agency in place of the National Housing Agency.

Economy Housing

The Housing Act of 1948 was apparently designed to stimulate the production through private enterprise of housing in the lower price and rental ranges, as well as to aid the transition from emergency to normal peace-time conditions in home financing.[32] A number of its provisions affected FHA.

Section 611 was added to Title VI of the National Housing Act to encourage application of cost-reduction

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31. Public Law 129, 80th Congress (Chapter 163-1st Session, approved June 30, 1947.
32. Public Law 901, 80th Congress (Chapter 832-2nd Session), approved August 10, 1948.

techniques through large-scale modernized site construction of housing. About 2,000 houses were financed under this section before it became inactive in 1953.

Ninety-five percent mortgages and 30-year maturities were authorized for the first time under Section 203 on low-cost homes, and 90 percent mortgages with 40-year maturities under Section 207 on low-cost and cooperative projects.

Various other amendments to the Act were made with the object of increasing the supply of housing for families of limited income. The FHA and the National Association of Home Builders jointly sponsored a series of industry meetings to discuss the purposes of the amendments.

A new Title VII was added, providing for FHA insurance of yields on rental housing for families of moderate income where no mortgage financing was involved. No insurance has ever been written under this title.[33]

FHA's authority to issue commitments on new construction under Section 603 of Title VI expired finally on April 30, 1948.

In January 1949 FHA launched an economy housing campaign with emphasis on economies through efficient operation and large-scale production. It helped to bring

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33. Public Law 901, 80th Congress (Chapter 832-2nd Session) cited as National Housing Act of 1948, approved August 10, 1948.

about a 3 percent reduction in the median value of new homes financed under Section 203, but there was also a reduction in the average house size at the same time.

On August 8, 1949, Title VIII was added to the National Housing Act authorizing the FHA to insure mortgages on rental housing for personnel of the Armed Services, on certification by the Secretary of Defense.[34]

The Korean Crisis

Nineteen hundred and fifty was a year of sharp change in direction.

The unprecedented volume of mortgage insurance written during the year reflected the continuing demand for homes. More housing was started in 1950 than in any previous year or since.[35]

After March 1, new-construction commitments under Section 608 on rental housing could be issued only if the applications had been received on or before that date.

The Housing Act of April 20, 1950 amended the National Housing Act so as to encourage greater production of housing for middle-income families. It added a new Section 8, authorizing FHA insurance of mortgages on low-cost homes in outlying areas, and a new Section 213 for mortgage insurance on cooperative housing projects.

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34. Public Law 211, 81st Congress, (Chapter 403-1st Session), sec. 801, approved August 8, 1949.
35. Thirteenth Annual Report of Housing and Home Finance Agency 1959, p. 5.

The volume of applications received and insurance written in 1951 decreased under the influence of such factors as credit restrictions, control of materials, some tightness of mortgage money, and the decline of Section 608 activity.

Responsibility for administering controls on private multi-unit residential construction was delegated to FHA by the Housing Administrator. This involved processing applications from builders and issuing authorized construction schedules and related allotments of materials.

The Defense Housing and Community Facilities and Services Act of 1951 added a new Title IX to the National Housing Act providing for mortgage insurance on programmed housing in critical defense areas.[36]

FHA's major objective during 1952 was increased production of housing in the four most critical areas: military housing, defense housing, low-cost housing, and housing available to minority groups.

A New Administration

The first change of presidential administration after FHA was established took place in January 1953, when President Eisenhower came into office.

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36. Public Law 139, 82nd Congress (Chapter 378-1st Session), approved September 1, 1951.

During his term of office the FHA repaid to the Treasury the amounts advanced in its early years to pay its expenses and establish its insurance funds. The total amountpaid to the Treasury was $85.9 million, which included $20.3 million interest.[37]

FHA Crisis and Recovery

Nineteen fifty-four was one of FHA's most eventful years. There were both good and bad events.

On the debit side of 1954 were the investigations of reported abuses under the property improvement program and the postwar rental housing program under Section 608, weakened morale in the agency and threatened public confidence in its integrity.

Immediate steps were taken to solve the problem and by the end of the year FHA was beginning to come back from the shock of the charges made against it. FHA organization and procedures had been studied and revised where necessary, advisory committees representing industry and consumer interests had been called on for recommendations, and new safeguards incorporated in the Housing Act of 1954 had been put into effect.

The Act also made a number of changes in FHA programs. Home financing terms were liberalized, with special provisions included for servicemen's homes. New FHA mortgage

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37. The FHA Story in Summary, p. 20.

insurance programs in conjunction with urban renewal were authorized. Title VI was made inactive.

The military housing provisions of the Act were re-written by the Capehart Act in 1955.

Housing for the elderly was given special consideration in the Housing Act of 1956.

Minimum down payments for home mortgage transactions were reduced in 1957 and again in 1958.

FHA regulations were amended in 1957 to make it possible for the first time for mortgagees to sell securities to the public backed by insured mortgages.

A new Certified Agency program initiated in 1957 in seven trial areas proved so successful in extending FHA services to smaller localities that it was soon made nationwide for this purpose.

In 1958 FHA published a new set of minimum property standards applicable throughout the United States, which became mandatory on July 1, 1959 for FHA-insured home financing transactions.

Today

The following is a digest of the primary insurance terms authorized by the National Housing Act as amended and FHA regulations as of October, 1961.[38] This is intended as a guide only. That is, the appropriate

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38. Federal Housing Administration Pamphlet No. 2575 revised October 1961.

regulations should be consulted for detailed information on current provisions. It is also noted here that the insurable mortgage amounts, ratios of loan to value or loan to replacement cost, and mortgage maturities shown here are subject to underwriting considerations.

Title I is primarily a program of personal unsecured loans. Responsibility for credit approval, approval and inspection of improvements, and approval and disapproval of dealers is delegated by the Commissioner to the insured lenders.

Prior credit approval is required only when the aggregate obligation of the borrower on Title I loans exceeds $5,000. Security is required only for Class 2(b) loans having maturities greater than 7 years and 32 days.

Claims are paid in cash after default, on assignment of all rights to the United States. Security may not be foreclosed without prior FHA approval. A claim must be filed within 9 months and 31 days after default unless an extension is obtained.

A credit application signed by the borrower is required for every loan (except refinancing without an additional advance). The lender may rely on the borrower's statements in the credit application concerning ownership of the property, credit, and the improvements to be financed.

Class of Loan	Purpose of Loan	Type of Structure	Maximum Loan Exclusive of Financing Charges	Maximum Maturity of Note
Class 1(a)	Alterations, repairs, and improvements upon or in connection with existing structures which substantially protect or improve the basic livability or utility	All structures [1]	$3500	5 years and 32 days
Class 1(b)	Same as above	Structure used or to be used as dwelling for two or more families [1]	Average of $2500 per unit not exceeding $15,000	7 years and 32 days
Class 2(a)	Building new structures	Nonresidential and nonfarm structure	$3500	5 years and 32 days
Class 2(b)	Building new structures	Nonresidential farm structure	$3500	7 years and 32 days 15 years and 32 days if secured by first lien

[1] If advance exclusive of financing charges exceeds $600, structure must have been completed and occupied at least 90 days before application for the loan.

The note must be valid and enforceable against the eligible borrower or borrowers and all signatures must be genuine. FHA Title I insurance does not cover losses resulting from unenforceability of the note or from forgery.

Borrower must be owner, or lessee having a lease extending at least 6 months beyond maturity of the loan, of the property to be improved. Owners include persons holding subject to mortgage or other lien and persons purchasing under mutually binding installment contracts.

Dealer approval, borrower and dealer completion certificates, and 6 days advance notice to borrower of disbursement are required unless loan is made directly to the borrower without dealer participation in the application or in the loan disbursement.

The general insurance reserve to the credit of each insured lender is limited to 10% of the aggregate amount advanced on all loans reported for insurance less the amount of claims paid. Insurance reserves of more than $5,000 that have been in effect 30 or more months are reduced by 15% on July 1 of each year.

Maximum Maturity of Refinanced Note	Maximum Financing Charge (Including FHA insurance charge and all other charges) 2/	Insurance Premium (to be included in maximum financing charge)
5 years and 32 days (not more than 7 years from date of original note	$5.00 discount per $100 of face amount per year on first $2500 $4.00 on amount above $2500	50% per annum of amount advanced
7 years and 32 days (not more than 10 years from date of original note)	$5.00 discount per $100 of face amount per year on first $2500 $4.00 on amount above $2500	50% per annum of amount advanced 45% per annum on loans over $3500
5 years and 32 days (not more than 7 years from date of original note	$5.00 discount per $100 of face amount per year on first $2500 $4.00 on amount above $2500	50% per annum of amount advanced
7 years and 32 days (but not more than 10 years from date of original note) 15 years and 32 days (not exceeding 25 years from date of original note, if original and refinanced note are both secured by first lien)	$5.00 discount per $100 of face amount per year on first $2500 $4.00 on amount above $2500 $3.50 on loans having a maturity over 7 years and 32 days	50% per annum of amount advanced .45% per annum if maturity exceeds 7 years and 32 days

2/ If insured takes security, borrower may be required to pay recording fees and cost of title search, but these may not be paid out of proceeds of loan or included in face amount of note; neither may the cost of life insurance be included in the note.

TITLE II Sec. 203

(1) Section of the Act	(2) Purpose of Loan	(3) Type of Construction (urban or rural nonfarm unless specified otherwise)	(4) Minimum Number of Family Units Per Insurance Contract	(5) Amount Insurable	(6) Loan-Value Ratio
Section 203b (I) (II) (III) (IV)	Finance proposed or existing dwellings.	1 - 4 family	1	Occupant mortgagor $25,000, 1 family $27,500, 2- or 3-family $35,000, 4-family $9,000 if property meets only MPS for low-cost housing Non-occupant mortgagor $21,200, 1-family $23,300, 2- or 3-family $29,700, 4-family If escrow commitment procedure is used: Same as for occupant mortgagor, subject to 15% escrow pending sale to an acceptable owner-occupant within 18 months	Occupant mortgagor A. Proposed construction, or construction completed 1 year or more: 97% of $15,000 of appraised value, + 90% of value above $15,000 but not over $20,000, + 75% of value above $20,000 B. Construction begun and completed less than 1 year: 90% of $20,000 of appraised value + 75% of value above $20,000 Non-occupant mortgagor 85% of amount computed under foregoing formula If escrow commitment procedure is used: Same as occupant mortgagor, subject to 15% withheld from mortgage proceeds and placed in escrow pending sale to an acceptable occupant mortgagor within 18 months
Section 203h (I) (II) (III)	Finance dwellings for owner-occupant borrowers (disaster housing)	1 - family	.	$12,000 ($9,000 if property meets only MPS for low cost housing)	100% of appraised value
Section 203i (I) (II) (III) (V)	Finance proposed or existing dwellings.	1-family; nonfarm, or farm of 5 or more acres adjacent to highway	1	Occupant mortgagor $9,000 Operative builder $7,850	Occupant mortgagor A. Proposed construction, or construction completed 1 year or more: 97% of appraised value B. Construction begun and completed less than 1 year: 90% of appraised value Operative builder Proposed construction: 85% of appraised value
Section 203k (VI) (VII)	Alteration, repair, and improvement of existing structures outside urban renewal areas	1- to 4 family	1	$10,000 per family unit (but not more than $35,000 on a 4-family dwelling)	Amount of loan plus any outstanding debt related to the property cannot exceed ratio insurable under Section 203(b)

I Certification to mortgagor of FHA appraisal amount required on 1 and 2 family dwellings.

II Builders' warranty required on proposed construction, 1-4 family dwellings, if approved for mortgage insurance prior to beginning of construction.

III Eligible for open end advances.

IV Down payment may be loaned by corporation or private party if borrower is 62 years of age or older.

V Down payment may be loaned by corporation or private party.

VI Structure must be at least 10 years old, unless loan is primarily for major structural improvements, or to correct faults not known when structure was completed or caused by fire, flood, or other casualty, or for the construction of a fallout shelter.

VII Minimum loan $2,500 unless loan is for construction of a fallout shelter or for repair or replacement required as a result of a major disaster.

(7)	(8)	(9)	(10)	(11)	(12)
MAXIMUM LIMITS				FHA or VA Approval Prior to Construction Necessary	Application Fee
Term of Loan	Interest Rate	Insurance Premium	Initial Service Charge		
30 years, or, for proposed construction, 35 years; but not more than 3/4 of the remaining economic life of the structure	5 1/4%	1/2% on declining balances	$20 or 1%, whichever is greater, for existing construction; $50 or 2½%, whichever is greater, for proposed construction if mortgagee makes partial disbursements and property inspections during construction	No, unless higher ratio of loan to value or longer term is to be insured with respect to properties completed less than one year	$45 proposed $20 existing $10.00 for applications submitted under Certified Agency Program
30 years, or, for proposed construction, 35 years; but not more than 3/4 of the remaining economic life of the structure	5 1/4%	1/2% on declining balances	$20 or 1%, whichever is greater, for existing construction; $50 or 2½%, whichever is greater, for proposed construction if mortgagee makes partial disbursements and property inspections during construction	No	$45 proposed $20 existing
30 years, or, for proposed construction, 35 years; but not more than 3/4 of the remaining economic life of the structure	5 1/4%	1/2% on declining balances	$20 or 1%, whichever is greater, for existing construction; $50 or 2½%, whichever is greater, for proposed construction if mortgagee makes partial disbursements and property inspections during construction	No, unless higher ratio of loan to value or longer term is to be insured with respect to properties completed less than one year	$45 proposed $20 existing $10.00 for applications submitted under Certified Agency Program
20 years or 3/4 of remaining economic life of the structure, whichever is less	6%	1/2% on declining balances	1%	Yes	$20

(1) Section of the Act	(2) Purpose of Loan	(3) Type of Construction (urban or rural nonfarm unless specified otherwise)	(4) Minimum Number of Family Units Per Insurance Contract	(5) Amount Insurable	(6) Loan-Value Ratio
Section 207 (I) (II) (IV)	Finance proposed or rehabilitated rental housing	Detached, semi-detached, row, or multifamily	8	$20,000,000 private mortgagor $50,000,000 Public mortgagor A. Walkup: $9,000 per unit if less than 4 room average, otherwise $2,500 per room B. Elevator: $9,400 per unit if less than 4-room average otherwise $3,000 per room	90% of estimated value
Section 207 Mobile Home Courts (II)(IV)	Finance proposed or rehabilitation of existing mobile home courts	Appropriate to trailer courts or parks	50 or more spaces	$500,000 per project and $1,800 per space	75% of estimated value of property after improvements are completed
Section 213 Project Management (I) (IV)	Finance proposed construction rehabilitation, acquisition of existing structures by a nonprofit cooperative, or acquisition from an investor sponsor	Detached, semi-detached, row, or multifamily	5	$20,000,000 private mortgagor $25,000,000 public mortgagor A. Walkup: $9,000 per unit if less than 4-room average, otherwise $2,500 per room B. Elevator: $9,400 per unit if less than 4-room average, otherwise $3,000 per room	A. Proposed construction 97% of replacement cost B. Existing construction 97% of appraised value
Section 213 Project Management, Supplementary Loans (IV) (VI)	Improvement or repair of property or provision of community facilities	Detached, semidetached, row, or multifamily	5	Estimated cost of improvements repairs, or facilities; or actual cost, or an amount which, added to outstanding mortgage balance, will not exceed original principal - whichever is less	Not specified
Section 213 Project Sales (I) (V)	Finance proposed construction or rehabilitation of dwellings for sale to members of nonprofit corporations	Single family detached, semi-detached, or row	5	$12,500,000. Same as A under management or a sum computed on separate mortgage for each dwelling equal to total of max. mtge. amt. under Sec. 203(b), whichever is greater	97% of replacement cost
Section 213 Individual Sales (III)	Finance individual mortgage on property released from project sales mortgage	1 - family	1	Unpaid balance of project mortgage allocable to the individual property	Unpaid balance of project mortgage allocable to the individual property
Section 213 Project Investor Sponsored (I) (IV)	Finance proposed or rehabilitated housing by corporation intending to sell same to nonprofit cooperative	Detached, semi-detached, row, or multifamily	5	$20,000,000 private mortgagor $25,000,000 public mortgagor A. Walkup: $9,000 per unit if less than 4 room average, otherwise $2,500 per room B. Elevator: $9,400 per unit if less than 4-room average, otherwise $3,000 per room	90% of replacement cost

I Or such higher maximum dollar amounts as the Commissioner may authorize because of cost levels but not to exceed $1,250 per room without regard to the number of rooms being less than 4 or 4 or more per unit

II No discrimination against families with children

III Eligible for open-end advances

IV Certificate of actual cost required

V Certification to mortgagor of FHA Estimate of Replacement Cost required

VI Security required, in a form acceptable to Commissioner

(7)	(8)	(9)	(10)	(11)	(12)
MAXIMUM LIMITS				FHA Approval Prior to Construction Necessary	Fees: (a) Application and Commitment (b) Separate Inspection Fee
Term of Loan	Interest Rate	Insurance Premium	Initial Service Charge		
Satisfactory to Commissioner	5 1/4%	1/2% on declining balances	1 1/2%	Yes	(a) $3 per $1,000 (b) As set by FHA but not to exceed $5 per $1,000
Not to exceed 15 years	5 1/4%	1/2% on declining balances	1 1/2%	Yes	(a) $3 per $1,000 (b) $5 per $1,000
40 years	5 1/4%	1/2% on declining balances	1 1/2%	Yes, if proposed construction	(a) $3 per $1,000 (b) $5 per $1,000
Remaining term of mortgage	6%	1/2% on declining balances	1 1/2%	Yes	(a) $3 per $1,000 (b) $5 per $1,000
35 years	5 1/4%	1/2% on declining balances	1 1/2%	Yes	(a) $3 per $1,000 (b) $5 per $1,000
35 years	5 1/4%	1/2% on declining balances	1%	Yes	(a) None (b) None
40 years	5 1/4%	1/2% on declining balances	1 1/2%	Yes	(a) $3 per $1,000 based upon commitment amount applicable to management project (b) $5 per $1,000

(7)	(8)	(9)	(10)	(11)	(12)
MAXIMUM LIMITS				FHA Approval Prior to Construction Necessary	FEES: (a) Application and Commitment (b) Separate Inspection Fee
Term of Loan	Interest Rate	Insurance Premium	Initial Service Charge		
30 years, or, for proposed construction, 35 years; but not longer than 3/4 of remaining economic life of the structure	5 1/4%	1/2% on declining balances	$20 or 1%, whichever is greater, for existing construction; $50 or 2½%, whichever is greater, for proposed construction if mortgagee makes partial disbursements and property inspections during construction	No, unless higher ratio of loan to value or longer term is insured on properties completed less than one year	(a) $45 proposed $20 existing (b) None
Satisfactory to Commissioner.	5 1/4%	1/2% on declining balances.	1 1/2%	Yes	(a) $3 per $1,000 (b) As set by FHA but not to exceed $5 per $1,000.
20 years or 3/4 of remaining economic life of the structure, whichever is less	6%	1/2% on declining balances	1%	Yes	$20
20 years or 3/4 of remaining economic life of the structure, whichever is less	6%	1/2% on declining balances	1%	Yes	(a) $3 per $1,000 (b) As set by FHA but not to exceed $5 per $1,000
Displaced families, 40 years Other owner occupants: Proposed construction, 35 years (40 years for mortgagor unable to make the payments on a 35-year mortgage) Existing construction, 30 years All maturities limited to not more than 3/4 of remaining economic life of the structure	5 1/4%	1/2% on declining balances	$20 or 1%, whichever is greater, for existing construction; $50 or 2½%, whichever is greater, for proposed construction if mortgagee makes partial disbursements and property inspections during construction	No, except for operative builders.	(a) $45 proposed $20 existing (b) None.
Satisfactory to the Commissioner	5 1/4%: for nonprofit, public, cooperative, or investor sponsor mortgagees the rate may be lowered, after final endorsement for insurance, to 3 1/8%	1/2% on declining balances (For mortgages with submarket interest rate the premium is waived)	1 1/2%	Yes, for new construction	(a) $1,000 (b) $1,000

VIII If loan amount is over $40,000, title evidence is required and construction advances may be insured, in which case a 2% working capital is required.

X Or such higher maximum dollar limits as the Commissioner may authorize because of cost levels but not to exceed:

$15,000, 1-family	$32,000, 3-family
$25,000, 2-family	$38,000, 4-family

XI Minimum down payment (which may be credited to settlement costs): Displaced families, $200 per unit, other families, 3% of total acquisition cost.

XII No discrimination against families with children.

XIII In high-cost areas mortgage amounts may be increased as much as $1,000 per room without regard to the number of rooms per unit.

XIV Structure must be at least 10 years old, unless loan is primarily for major structural improvements, or to correct faults not known when structure was completed or caused by fire, flood, or other casualty.

(1) Section of the Act	(2) Purpose of Loan	(3) Type of Construction (urban or rural nonfarm unless specified otherwise)	(4) Minimum Number of Family Units Per Insurance Contract	(5) Amount Insurable	(6) Loan Value Ratio
Section 220 Home Mortgages (I) (II) (III) (IV)	Aid in elimination of slums and blighted conditions and prevention of deterioration of residential property, or for disaster areas	1- to 11-family	1	Occupant mortgagor $25,000, 1-family $27,500, 2-family $30,000, 3-family $35,000, 4-family + $7,000 per family unit over 4 Non-occupant mortgagor 85% of amount computed under above formula If escrow commitment procedure is used: Same as occupant mortgagor, subject to 15% escrow pending sale to an acceptable occupant mortgagor within 18 months	Occupant mortgagor: A. Proposed construction: 97% of $15,000 of estimated replacement cost, + 90% of cost above $15,000 but not above $20,000, + 75% of cost above $20,000 B. Dwelling under construction. 90% of $20,000 of estimated replacement cost, + 75% of cost above $20,000 C. Rehabilitation of dwelling approved for mortgage insurance before construction began or construction completed more than 1 year: 97% of $15,000 of estimated rehabilitation cost and estimated value before rehabilitation; + 90% of estimated value above $15,000 but not above $20,000, + 75% of value above $20,000 or, Estimated cost of rehabilitation + amount required to refinance outstanding debt secured by the property D. Dwelling not approved for mortgage insurance before beginning of construction and construction completed less than 1 year: 90% of $20,000 of estimated rehabilitation cost + estimated value before rehabilitation, and 75% of value above $20,000; or, Estimated rehabilitation cost and amount required to refinance existing indebtedness against the property Non-occupant mortgagor: 85% of amount computed under any of the above formulae;or, If escrow commitment procedure is used: Same as for occupant mortgagor, subject to 15% escrow pending sale to an acceptable owner occupant within 18 months
Section 220 Multifamily Housing Mortgages (I) (V) (VI)	Aid in elimination of slums and blighted conditions and prevention of deterioration of residential property, or for disaster areas	5 or more detached, semidetached, row, or multifamily units	5	$20,000,000, private mortgagor $50,000,000, public mortgagor A. Walkup: $9,000 per unit if less than 4-room average, otherwise $2,500 per room B. Elevator: $9,400 per unit if less than 4-room average, otherwise $3,000 per room	Proposed construction: 90% of estimated replacement cost Completion of project under construction: 90% of estimated value when completed Rehabilitation: 90% of rehabilitation cost, + estimated value before rehabilitation Refinancing: Estimated rehabilitation cost, + existing indebtedness up to 90% of estimated market value before rehabilitation
Section 220(h) Home Improvement Loans (I) (VII) (XIV)	Alteration, repair, and improvement of existing structures in urban renewals areas	1- to 4-family	1	$10,000 per family unit	Loan + outstanding debt related to property cannot exceed (1) loan-value ratio, or (2) dollar amount for home mortgage insurable under Section 220
Section 220(h) Multifamily Housing Improvement Loans (VI) (VIII) (XIV)	Alteration, repair, and improvement of existing structures in urban renewal areas	5 or more	5	$10,000 per unit	Loan + outstanding debt related to the property cannot exceed ratio for multifamily housing mortgage insurable under Section 220
Section 221 Home Mortgages (II) (III) (IV) (X) (XI)	Finance low-cost homes for families displaced by urban renewal or other governmental action, and other families	Displaced families, 1- to 4-family dwellings Other families, 1-family dwellings	1	Occupant mortgagor Displaced family $11,000, 1-family $18,000 2-family $27,000, 3-family $33,000, 4-family Other (1-family only) $11,000 Operative builder (1-family only) $9,350	Occupant mortgagor: A. Proposed construction or construction completed less than 1 year: 100% of appraised value B. Under construction or construction completed less than 1 year: 90% of estimated value C. Rehabilitation. (1) estimated cost of repair and rehabilitation + estimated value before repair and rehabilitation; (2) estimated cost of repair and rehabilitation + amount required to refinance outstanding debt against property Operative builder (1-family only): 85% of appraised value
Section 221 Multifamily Housing Mortgages (VI) (XII) (XIII)	Finance multifamily rental and cooperative housing for families displaced by urban renewal or other governmental action and for other low- and moderate-income families	5 or more units in detached, semi-detached, row, or multi-family structures	5	$12,500,000 A. Walkup: $8,500 per unit if less than 4-room average, otherwise $2,250 per room B. Elevator: $9,000 per unit if less than 4-room average, otherwise $2,750 per room	Limited dividend corporation or other mortgagor not specified under B below: A. Proposed construction: 90% of estimated replacement cost B. Existing construction: 90% of estimated cost of rehabilitation + 90% of estimated market value before rehabilitation C. Rehabilitation: 90% of estimated cost of rehabilitation + estimated value before rehabilitation Refinancing: Estimated cost of rehabilitation + 90% of estimated market value before rehabilitation Nonprofit, public, cooperative, or investor sponsor mortgagors: A. Proposed construction: Estimated replacement cost Existing construction: Estimated cost of rehabilitation + estimated market value before rehabilitation B. Repair or rehabilitation: Estimated cost of rehabilitation + estimated value before rehabilitation C. Refinancing: Estimated cost of rehabilitation + amount of outstanding debt not in excess of estimated market value before rehabilitation

I Property must be located in an area certified by the Housing and Home Finance Administrator as having a workable program, or be located in an area covered by a Federal-aid contract or having prior approval granted (pursuant to Title I of the Housing Act of 1949, as amended) before the effective date of the Housing Act of 1954.

II Certification to mortgagor of FHA appraisal amount and/or Estimate of Replacement Cost required on 1- and 2-family dwellings.

III Builders' warranty required on proposed construction of 1- to 4-family dwellings.

IV Eligible for open-end advances.

V Or such higher maximum dollar amounts as Commissioner may authorize because of cost levels but not to exceed $1,250 per room without regard to the number of rooms being less than 4 or 4 or more per unit.

VI Cost certification required.

VII Minimum loan $1,000 unless rehabilitation to meet rehabilitation standards for the area will require less, or unless loan is for construction of a fallout shelter or for repair of damage caused by a major disaster.

(1) Section of the Act	(2) Purpose of Loan	(3) Type of Construction (urban or rural nonfarm unless specified otherwise)	(4) Minimum Number of Family Units Per Insurance Contract	(5) Amount Insurable	(6) Loan-Value Ratio
Section 222 (I) (II) (III)	Finance proposed or existing dwellings for mortgagors certified as servicemen by the Secretary of Defense or the Secretary of the Treasury. Not available for refinancing existing mortgages executed or assumed by servicemen	1-family	1	A. For properties meeting the eligibility criteria of Section 203(b) - $20,000. B. For properties meeting the eligibility criteria of Section 203(i) - $9,000	95%, or such higher amount calculated pursuant to Section 203(b)

I Certification to mortgagor of FHA appraisal amount required

II Builders' warranty required on proposed construction

III Eligible for open-end advances.

(7)	(8)	(9)	(10)	(11)	(12)
MAXIMUM LIMITS				FHA Approval Prior to Construction Necessary	Fees: (a) Application and Commitment (b) Separate Inspection Fee
Term of Loan	Interest Rate	Insurance Premium	Initial Service Charge		
30 years, or, for proposed construction, 35 years; but not longer than 3/4 of remaining economic life of the structure	5 1/4%	1/2% on declining balances. Insurance premium paid by the Services during ownership by serviceman. Upon termination of serviceman's ownership, paid by mortgagees	$20 or 1%, whichever is greater, for existing construction; $50 or 2 1/2%, whichever is greater, for proposed construction if mortgagee makes partial disbursements and property inspections during construction	(a) Existing construction: No (b) Proposed construction: Yes	(a) $45 proposed. $20 existing. (b) None

(1) Section of the Act	(2) Purpose of Loan	(3) Type of Construction (urban or rural non-farm unless specified otherwise)	(4) Minimum Number of Family Units Per Insurance Contract	(5) Amount Insurable	(6) Loan-Value Ratio
Section 231 Housing for Elderly Persons (I) (II)	Finance proposed or rehabilitated rental housing designed for use and occupancy by elderly persons	Detached, semi-detached, row or multi-family	8	$12,500,000 private mortgagor $50,000,000 public mortgagor A. Walkup: $9,000 per dwelling unit if less than 4-room average, otherwise $2,250 per room B. Elevator: $9,400 per unit if less than 4-room average, otherwise $2,750 per room	Nonprofit mortgagor: 1. Proposed construction, 100% of estimated replacement cost 2. Rehabilitation: (a) Property owned outright, 100% of estimated completed value, or 100% of estimated rehabilitation cost, whichever is less (b) Property owned subject to indebtedness, (1) the indebtedness (limited to estimated value before rehabilitation) + (2) 100% of estimated rehabilitation cost (c) Property to be acquired, purchase price (limited to estimated value before rehabilitation) + 100% of estimated rehabilitation cost Profit mortgagor: 1. Proposed construction - 90% of estimated replacement cost 2. Rehabilitation: (a) Property owned outright, 90% of estimated completed value or 100% of estimated rehabilitation cost, whichever is less (b) Property owned subject to indebtedness, (1) the indebtedness (limited to 90% of estimated value before rehabilitation) + (2) 100% of estimated rehabilitation cost (c) Property to be acquired, 90% of the purchase price or 90% of estimated value before rehabilitation, whichever is less, + 90% of estimated rehabilitation cost
Section 232 Nursing Homes II	Provide facilities for the care and treatment of convalescents and other persons who are not acutely ill and do not need hospital care but do require skilled nursing care and related medical services	Licensed proprietary facility conforming to standards satisfactory to the Commissioner	Accommodations for 20 or more patients	$12,500,000	1. Proposed construction: 90% of estimated completed value 2. Rehabilitation: (a) Property owned outright, 100% of estimated rehabilitation cost (b) Property owned subject to indebtedness, (1) indebtedness (limited to 90% of estimated value before rehabilitation) + (2) 100% of estimated rehabilitation cost (c) Property to be acquired, 90% of purchase price (limited to 90% of estimated value before rehabilitation) + 90% of estimated rehabilitation cost
Section 233 Experimental Housing (Homes) (III) (IV) (V)	Finance proposed construction using advanced housing technology or experimental neighborhood design, in order to reduce cost and improve quality	1- 4-family	1	Occupant mortgagor: $25,000, 1 family $27,500, 2 or 3-family $35,000, 4-family Non occupant mortgagor $21,200, 1-family $23,300, 2- or 3-family $29,700 4-family	Occupant mortgagor: 97% of $15,000 of estimated replacement cost using comparable conventional construction, + 90% of cost above $15,000 but not over $20,000 + 75% of cost above $20,000 Nonoccupant mortgagor: 85% of amount computed under above formula
Section 233 Experimental Housing (Multifamily) (I) (II) (VII)	Finance proposed construction of rental housing using advanced technology in design, materials, or construction, or experimental property standards for neighborhood design	Detached, semi-detached, row, or multifamily	8	$20,000,000 private mortgagor $50,000,000 public mortgagor A. Walkup: $9,000 per unit if less than 4 room average, otherwise $2,500 per room B. Elevator: $9,400 per unit if less than 4-room average, otherwise $3,000 per room	90% of estimated replacement cost using comparable conventional construction
Section 234 Condominium (I) (V) (VI) (VIII) (IX)	Finance individually owned family units in multifamily structures	Structure with 5 or more units that is or has been insured under any FHA multifamily program except sec. 213	1	Occupant mortgagor $25,000 A. Walkup: $9,000 per unit if less than 4-room, otherwise $2,500 per room B. Elevator: $9,400 per unit if less than 4-room, otherwise $3,000 per room Nonoccupant mortgagor $21,200 85% of amount computed under above formula	Occupant mortgagor 97% of $13,500 of appraised value + 90% of value above $13,500 but not over $18,000, + 70% of value above $18,000 Nonoccupant mortgagor A. 85% of amount computed under above formula B. Same as occupant mortgagor, subject to 15% of mortgage proceeds placed in escrow pending sale to an acceptable occupant mortgagor within 18 months

I Or such higher maximum dollar amounts as the Commissioner may authorize because of cost levels but not to exceed: $1,250 per room

II Certificate of actual cost required.

III Certification to mortgagor of FHA appraisal amount required on 1-and 2-family dwellings

IV Builders' warranty required

V Eligible for open end advances

VI Certification to mortgagor of FHA appraisal amount required

VII No discrimination against families with children

VIII Individual mortgagor cannot own more than 4 units covered by insured mortgages, including 1 for his own occupancy

IX A mortgagor 62 years old or older may borrow the down payment from a corporation or person satisfactory to the Commissioner

(7)	(8)	(9)	(10)	(11)	(12)
MAXIMUM LIMITS				FHA Approval Prior to Construction Necessary	FEES: (a) Application and Commitment (b) Separate Inspection Fee
Term of Loan	Interest Rate	Insurance Premium	Initial Service Charge		
Satisfactory to Commissioner	5 1/4%	1/2% on declining balances.	1 1/2%	Yes	(a) $3.00 per $1,000 (b) As set by FHA but not to exceed $5.00 per $1,000
20 years	5 1/4%	1/2% on declining balances	1 1/2%	Yes	(a) $3.00 per $1,000 (b) As set by FHA but not to exceed $5.00 per $1,000
35 years, or 3/4 of remaining economic life of the structure, whichever is less	5 1/4%	1/2% on declining balances	$20 or 1%, whichever is greater; $50 or 2½%, whichever is greater, if mortgagee makes partial disbursements and property inspections during construction	Yes	$45
Satisfactory to Commissioner	5 1/4%	1/2% on declining balances	1 1/2%	Yes	(a) $3 per $1,000; (b) $5 per $1,000
30 years or 3/4 of remaining economic life of the structure, whichever is less	5 1/4%	1/2% on declining balances	$20 or 1%, whichever is greater	No	$20

TITLE VII

(1) Title of the Act	(2) Purpose	(3) Type of Construction (urban or rural nonfarm unless specified otherwise)	(4) Minimum Number of Family Units Per Insurance Contract	(5) Amount Insurable	(6) Loan-Value Ratio
Section 701	Insured yield and investment in rental housing for families of moderate income. No mortgage loan is involved	Rental units plus such other stores, offices, community buildings, etc., satisfactory to the Commissioner as a necessary or desirable part of the project	25	(a) Minimum annual amortization charge of 2% on established investment (b) An insured annual return of 2¾% on the outstanding investment (c) No dollar limitations per unit or per project	(a) No mortgage liens permitted on developments covered by contract (b) 90% of outstanding investment

TITLE VIII

(1) Section of the Act	(2) Purpose of Loan	(3) Type of Construction (urban or rural nonfarm unless specified otherwise)	(4) Minimum Number of Family Units Per Insurance Contract	(5) Amount Insurable	(6) Loan-Value Ratio
Section 803 (I) (IV)	Finance production of housing for military upon certification of need by Secretary of Defense	8 or more detached, semi-detached, row, or multi-family units	8	The lowest of: A. Replacement cost B. Average of $16,500 per unit for such part of the project as may be attributable to dwelling use C. Amount of the eligible bid	Not applicable.
Section 809	Finance production of owner-occupied housing for civilian employees at a research or development installation of one of the military departments or a contractor thereof, on certification by Secretary of Defense or NASA Administrator Economic soundness or acceptable risk not required	1 - 4 family	1	Occupant mortgagor: $25,000, 1-family $27,500, 2-3-family $35,000, 4-family	Occupant mortgagor A. Properties approved for insurance before beginning of construction or more than 1 year old: 97% of $15,000 of appraised value + 90% of value above $15,000 but not over $20,000, + 75% of value above $20,000 B. Properties not approved for insurance before beginning of construction and less than 1 year old: 90% of $20,000 of appraised value + 75% of value over $20,000
Section 810 (II) (III)	Finance production of single and multifamily rental housing for military personnel and essential civilian personnel serving or employed in connection with a defense installation, upon a finding by the Commissioner of need. Economic soundness is not required	8 or more detached, semi-detached, row or multi-family.	8	$5,000,000 A. 1-family release-clause projects: $25,000 per family unit B. Multifamily projects: $9,000 per family unit if less than 4-room average, otherwise $2,500 per room	A. 1-family release-clause projects: 97% of $15,000 of appraised value + 90% of value above $15,000 but not over $20,000, + 75% of value above $20,000 B. Multifamily projects: 90% of value

I Occupancy preference to civilian or military personnel of Army, Navy, Marine Corps, Air Force, NASA, or Atomic Energy Commission, including Government contractors' employees.

II The Commissioner may increase the mortgage limits for multi-family projects by an amount not to exceed: $1,000 per room in any geographical area where cost levels require.

III Certificate of actual cost required.

IV Established cost of family unit contracted for after June 7, 1960 may not exceed $19,800

(7)	(8)	(9)	(10)	(11)	(12)
MAXIMUM LIMITS				FHA Approval Prior to Construction Necessary	Fees: (a) Application & Commitment (b) Separate Inspection Fee
Term of Insurance	Rate of Return	Insurance Premium	Initial Service Charge		
Until the outstanding investment amounts to not more than 10% of the established investment	Insured annual return 2 3/4% of outstanding investment plus 2% min. amortization of established investment	1/2% of the outstanding investment	None	Yes	(a) $3 per $1,000 (b) $2 per $1,000

TITLE VIII

(7)	(8)	(9)	(10)	(11)	(12)
MAXIMUM LIMITS				FHA Approval Prior to Construction Necessary	Fees: (a) Application & Commitment (b) Separate Inspection Fee
Term of Loan	Interest Rate	Insurance Premium	Initial Service Charge		
30 Years	4 1/2%	On declining balances as agreed between Commissioner and Military	1 1/2%	Yes	(a) $3 per $1,000
30 years or, for proposed construction, 35 years; but not longer than 3/4 of remaining economic life of the structure	5 1/4%	1/2% on declining balances	$20 or 1% whichever is greater for existing; $50 or 2½% whichever is greater for proposed if mortgagee makes partial disbursements and property inspections during construction	No, unless higher ratio of loan to value is to be insured with respect to properties completed less than one year	(a) $45 proposed $20 existing (b) None
Satisfactory to the Commissioner	5 1/4%	1/2% on declining balances	1 1/2%	Yes	(a) $3.00 per $1,000 (b) $5.00 per $1,000

Determining Eligibility for Mortgage Insurance

FHA's insurance operations are conducted by field insuring offices, each headed by a Director who is responsible to the FHA Commissioner for the successful operation of his office. The examination of mortgage loan applications to determine their eligibility for mortgage insurance is performed by the Underwriting Division of the insuring office under the direction of the Chief Underwriter. Assisting him are appraisers; construction examiners who examine drawings and specifications of proposed construction; construction inspectors who inspect the construction for compliance with the drawings and specifications; construction cost examiners who gather and assemble cost data; land planners who examine proposals for new subdivisions and site planning of rental housing developments.

Through the years the FHA organization has grown in accordance with the diversity of the problems presented in its wide insurance operations until today in addition to the technicians mentioned above, there are engineers, street and drainage engineers, sanitary engineers, and mechanical engineers.

To help in the underwriting determinations FHA has market analysts on its field office staffs who make special studies of the economic background of housing market areas and estimates of the probable demand for new housing units of various types, size, and rental or price range.

The Mutual Mortgage Insurance System

FHA has had many different insurance programs which the Congress has enacted to meet special needs such as Military Housing, Cooperative Housing, Urban Renewal, Housing for the Elderly, etc. The basic insurance program, however, and the one which has accounted for the bulk of FHA mortgage insurance operations is the program under Section 203(b). This program differs from other FHA programs in that it is a mutual program under which all net income is credited and all net losses charged to a mutual mortgage insurance fund. This means that upon termination of the insurance obligation by payment of any mortgage insured under the fund, the Commissioner is authorized to distribute to the mortgagor a share of the participating reserve account. These distributions are required to be made in a manner which is equitable and in accordance with sound actuarial and accounting practice. Substantial distributions have been paid back to mortgagors out of this mutual mortgage insurance fund.

In order to provide for an equitable distribution of the participating reserve account, the mortgages are grouped according to maturity and risk characteristics. This makes it necessary to analyze and estimate the probable degree of risk involved in the insurance of each mortgage loan transaction under Section 203(b). This is done by means of a

mortgage risk rating system under which all hazards which contribute to mortgage loan default are given consideration.

All insurance underwriters set up various bench marks, or criteria, which are appropriate for use in the measurement of the degree of risk anticipated in connection with any insurance transaction. FHA has set up such criteria for the measurement of mortgage risk. The application of these risk criteria and the estimation of the final over-all risk in connection with each individual application for mortgage insurance constitute UNDERWRITING in FHA.

Qualifying the Project

FHA's basic mortgage insurance program under Section 203(b) contains another requirement which reads "No mortgage shall be accepted for insurance unless the Commissioner finds that the project with respect to which the mortgage is executed is economically sound."[39] Various efforts have been made in the past to provide a short, meaningful definition of the term "economic soundness". The FHA Underwriting Manual covers the subject at some length but fails to provide a concise definition.

Before discussing the term "economic soundness" it might be well to consider what is meant by the term "project" which appears in this requirement. The dictionary

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39. Public Law 479, 73d Congress, National Housing Act, Title II, Sec. 203, approved June 27, 1934.

meaning of the word "project" is "A planned undertaking". It is this meaning of the word "project" which the Congress had in mind when it wrote the Economic Soundness Requirement. It is the planned undertaking which must be economically sound. In other words the Commissioner must find that the planned undertaking with respect to which the mortgage is executed is economically sound.

The FHA Underwriting Manual approaches the subject of economic soundness from the point of view of analysis of the planned undertaking. It considers all elements of the mortgage loan transaction, the credit risk, as well as the mortgage security in determining whether economic soundness is present or lacking.

Since economic soundness is bound up with considerations of risk, FHA thinks of degrees of soundness in mortgage loan transactions. The National Housing Act, however, requires a clear-cut separation of loans which are economically sound from those which are not economically sound. When risk is present to an excessive degree, FHA says that the transaction is not economically sound. So FHA provides its risk rating system--a method of determining if there is a degree of risk beyond the limits of economic soundness.

FHA does not make a mortgage sound merely by insuring it. Mortgages are selected for insurance only when underwriting analysis results in a conclusion that the mortgage

transaction is sufficiently sound to warrant insurance. From the point of view of long-term financing, the FHA believes that the qualities which produce satisfactory housing from the home owner's standpoint also provide assurance of economic soundness. Consideration of the mortgagor's satisfaction with his investment is held to be an important element that avoids undue risk in a mortgage transaction. To this end, FHA underwriting operations stress the construction of structurally sound dwellings that meet family needs, provide healthful conditions, and are suitably located. Meeting these objectives, together with assurance that the borrower is able to meet the mortgage obligation, holds promise of a successful conclusion of the planned undertaking. Under these conditions a mortgage obligation that is sound for the borrower to undertake will generally be a sound risk for the lender and the FHA to assume.

FHA Mortgage Risk-Rating System[40]

To determine whether or not a mortgage transaction is sound, an orderly process of considering all hazards must be followed as opposed to a method which merely seeks for apparent deficiencies at random. Such an orderly process is necessary to provide assurance that full weight be given to the combined effect of many risk

40. This discussion based on address by Alfred W. Jarchow, Director, Appraisal & Mortgage Risk Division, FHA, to the Society of Residential Appraisers in Baltimore, entitled, "Current FHA Appraisal Concepts", Oct. 25, 1957.

elements. In the FHA underwriting system a simple means is provided for giving consideration to over one hundred separate elements of risk expressed in numerical ratings.

A system of mortgage risk-rating was established early in the history of the FHA. It is the first known system of its kind and, in brief, expresses consistently in the form of a numerical summary, on a scale of 100, the estimated degree of risk in a mortgage transaction, and segregates unacceptable risks from those that are insurable. This summary figure varies inversely to the risk involved in insuring a given mortgage, that is, the risk of foreclosure and loss.

In analyzing mortgage risk FHA underwriters examine three groups of risk elements. An analysis of the mortgage credit elements leads to a conclusion as to the borrower's past, present, and probable future willingness and ability to meet his obligations. Then analysis of the real estate elements, which relates to the property and its location, leads to conclusions as to the value of the property at the time of the mortgage transaction and as to the probable continuing marketability of the property. The third group of elements analyzed are the amount, repayment plan, and term of the loan, and their relationship to the real estate and borrower risk elements.

The FHA risk-rating system is not a formula. It is a guide to judgment which is intended to bring about a

maximum possible degree of accuracy and consistency in evaluating risk in mortgage transactions. The system requires that conclusions be built up from a step-by-step analysis of component elements. It is based upon the use of major groups, or risk categories, which are in turn broken down into elements or risk features. Each element of risk comprising a feature is analyzed in order to derive a rating of the risk which it contributes within its category by relationships and deficiencies in quality.

The risk categories and risk features analyzed are:

Rating of Property:
- Visual Appeal of Property
- Livability of Property

Natural Light and Ventilation
Structural Quality
Resistance to Elements and Use
- Suitability of Mechanical Equipment
- Adjustment for Nonconformity

Rating of Location:
- Protection Against Inharmonious Land Used
- Physical and Social Attractiveness
- Adequacy of Civic, Social and Commercial Centers
- Adequacy of Transportation
- Sufficiency of Utilities and Services
- Level of Taxes and Special Assessments
- Relative Marketability

Rating of Mortgagor:
- Credit Characteristics of Mortgagor
- Motivating Interest in Ownership of the Property
- Importance of Monetary Interest to Mortgagor
- Adequacy of Available Assets for Transaction
- Stability of Effective Income
- Adequacy of Effective Income for Total Obligations

Rating of Mortgage Pattern:
Ratio of Loan to Value
Ratio of Term of Mortgage to Remaining Economic Life of Building
Ratio of Total Payment to Rental Value
Rating of Economic Background
Lowest Category Rating
Intermediate Category Rating
Highest Category Rating

An economic background rating is made to determine the degree of economic stability of the community in which the property is located. This rating takes into account the employment opportunities in the community as a whole, the stability of employment, and trends of industrial, commercial, and other activities which influence all real estate mortgage transactions in the area. This analysis is not repeatedly made for each mortgage loan transaction, but is made for an entire community. The resulting rating applies to all of the mortgage-loan transactions in the community and re-analysis is necessary only periodically to reflect material changes in conditions.

A rating of the specific location of the property is made by considering the degree of attractiveness the neighborhood will hold for the typical occupant; the degree of protection provided by zoning restrictions or resulting from the neighborhood being substantially built up; the presence of conditions which would be regarded by the market as nuisances or hazards to health or safety; the adequacy of utilities and street improvements; and

the accessibility of employment centers, schools, stores, churches, and recreation facilities. Ratings are made to reflect the attitudes of the typical neighborhood occupant and the market. Therefore, the qualities of any particular location are measured in comparison with locations having approximately the same price range of typical properties. In other words, locations which appeal to families having incomes of $3,600 per year are not compared with locations appealing to families having incomes of $6,000 per year.

A rating of the physical security takes into account the soundness and durability of the structure and its equipment, the attractiveness of the design of the building, the degree to which the room arrangement and equipment contributes to comfortable living and the adequacy of natural light and ventilation, all considered in relation to the prospects for continuing marketability. Provision is made for lowering the rating if the property is not appropriate to its immediate environment. This adjustment to a lower rating is made if the building is unattractive when viewed in relation to its surroundings, or inappropriate, as when the property is too costly for the neighborhood, or if the property does not conform to the type which would be most marketable at the location. The qualities of the buildings are measured by comparison with structures of approximately the same type and size;

for example, a house of 900 square feet is not judged against one of 1800 square feet.

A rating is made which expresses the risk of mortgage credit factors such as the borrower's ability to meet comfortably the housing expenses and other fixed charges from his current incomes; the probability of his continuing income; his attitude toward his obligation; the amount of equity he has invested in the property; the purpose for which he wants the mortgage loan, whether for home ownership, investment or refunding; and the suitability of the property to his housing needs.

The Rating of Mortgage Pattern

A final summation of mortgage risk involved in the proposed mortgage loan transaction is determined by completing a "Rating of Mortgage Pattern Grid". This gives a summary figure, numerically stated, of the degree of mortgage risk estimated to be present in an individual mortgage transaction. The "Mortgage Pattern" which relates the risk contributed by the economic background, location, property and borrower to three factors indicating the degree of security in the loan, namely, the ratio of the amount of loan to the value of the property, the ratio of the total monthly mortgage payment to the property's monthly rental value, and the relation of the term of the mortgage to the estimated remaining useful life of the property.

Obviously, mortgage applications do not fall into two simple classes, those that are acceptable for the maximum loan which FHA can legally insure, and those which would not be acceptable for any loan at all. There is an area between these two classes of loans where the nature of the risk indicates that insurance liability can be accepted for a loan in an amount somewhat less than the maximum legal loan value ratio.

Risk control as of the time of the making of a mortgage is made possible on a sound, logical, and uniform basis by means of the FHA risk-rating system. The system is so devised that the quality of the real estate security and the mortgage credit elements are first determined and rated in the scale of risk. When it is found that they do not contribute mortgage risk to an unacceptable degree, the Mortgage Pattern analysis indicates what maximum loan amount and term in years would entail a degree of mortgage risk up to, but not beyond, the margin of economic soundness and insurability. Thus, after the Ratings of Property, Location, Mortgagor, and Economic Background have been made (and, in addition, the Rating of Net Income Expectancy in the case of a rental-income dwelling), it can be determined by means of the Rating of Mortgage Pattern whether or not the loan deSSribed in the application is insurable. A rating of

under 50 with respect to the Mortgage Pattern indicates a lack of economic soundness, and accordingly an uninsurable risk. If a loan is found uninsurable because the amount is too large or the term too long, or both, the Rating of Mortgage Pattern provides the means of determining the maximum amount and term of loan which can be insured.

Operations

The FHA experiment has been successful. It has proved itself under every kind of stress except a major depression, and its stabilizing influence is one of our chief bulwarks against the onset of depression. It has helped to give us the greatest years of progress we have ever had in housing. It has been the outstanding single influence on American housing in this century.

FHA has helped to make it possible for three of every five American families to own their homes.

FHA, by providing a demonstration of sound financing methods for homes, multi-family housing, and property improvements, has helped to bring about a revolution in conventional lending practices.

FHA has helped homebuilders to broaden and improve their services. Its minimum property standards and land planning services have been influential in raising housing and neighborhood standards.

FHA has focused attention on the housing needs of minority groups, older people, families with limited incomes, and other special groups.

FHA has helped to make older city neighborhoods better places to live in.

The amount of insurance written by FHA from its beginning through 1960 totaled $67,312,016,000. FHA mortgage insurance had helped to provide homes for 5,631,519 families and housing for 830,589 other families in rental and cooperative projects. It had helped to repair or improve 24,368,433 properties.[41]

In all this, FHA operates strictly a do-it-yourself program. FHA is a helper only.

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41. Twenty-seventh Annual Report of FHA, op. cit., p. 31.

TABLE 9. FHA-INSURED MORTGAGES AND LOANS
(In Millions of Dollars)

Year	Total	Property Improvement Loans (Net Proceeds)	Home Mortgage Programs	Project Mortgage Programs
1934-49	$18,384	$3,825	$12,233	$2,326
1950	4,343	694	2,492	1,157
1951	3,219	707	1,928	584
1952	3,112	848	1,942	322
1953	3,882	1,334	2,289	259
1954	3,067	891	1,942	234
1955	3,807	646	3,085	76
1956	3,461	692	2,639	130
1957	3,717	869	2,251	597
1958	6,322	868	4,545	909
1959	7,689	997	6,017	675
1960	6,297	983	4,602	712
1934-60	$67,300	$13,354	$45,965	$7,981

Source: Federal Housing Administration

TABLE 10. HOME LOAN DEFAULTS

Year	Number of insured or guaranteed home mortgages in force at end of year			Percent of insured or guaranteed home mortgages in force at end of year	
		In default			
	Total	Total	Serious	In default	In serious default
FHA insured					
1938	296,590	8,545	2,334	2.88	0.79
1939	437,472	8,617	2,926	1.97	.67
1940	582,936	10,949	3,164	1.88	.54
1941	755,480	9,405	3,378	1.24	.45
1942	935,669	8,105	1,798	.87	.19
1943	1,022,877	7,301	695	.71	.07
1944	1,058,972	10,725	421	1.01	.04
1945	1,037,030	10,500	532	1.01	.05
1946	940,014	6,132	428	.65	.05
1947	911,905	4,443	544	.49	.06
1948	1,088,243	5,380	577	.49	.05
1949	1,302,203	12,461	1,245	.96	.10
1950	1,511,402	17,058	4,633	1.13	.31
1951	1,654,276	18,007	3,828	1.09	.23
1952	1,787,568	10,562	2,846	.59	.16
1953	1,925,485	10,778	3,581	.56	.19
1954	2,007,812	16,231	5,574	.81	.28
1955	2,140,936	14,988	6,839	.70	.32
1956	2,229,599	11,973	5,107	.54	.23
1957	2,310,367	10,333	4,180	.45	.18
1958	2,574,857	14,455	5,761	.56	.22
1959	2,873,788	16,969	6,666	.59	.23
1960	3,093,021	26,850	11,920	.87	.39

Source: Federal Housing Administration

FEDERAL NATIONAL MORTGAGE ASSOCIATION

The Federal National Mortgage Association, sometimes referred to as "Fanny May" (nickname derived from the initials FNMA) was originally established on February 10, 1938, pursuant to the then Title III of the National Housing Act, to engage in the purchase and sale of FHA guaranteed mortgage loans.

The purpose of this operation has been to aid the home mortgage credit system by furnishing liquidity to lenders seeking additional funds for investment, and by affording investment outlets for lenders with surplus funds. This type of operation is referred to as a secondary mortgage market.

The need for such a market was established in the 1930's when (as discussed in Chapter I of this paper) lenders found themselves with frozen mortgage and real estate assets and no means of converting them into cash or liquid security.

The National Housing Act of 1934 authorized the creation of private national mortgage associations that would assume the functions of secondary lenders. No private organizations ever availed itself of these enabling provisions of the Act. Therefore, the responsibility of establishing a secondary mortgage market fell on the government.

The first step in establishing a government financed market was the creation of the Reconstruction Finance Corporation Mortgage Company in 1935.[42] The Reconstruction Finance Corporation, however, was not geared to meet the needs of the building industry, so on February 10, 1938 the Federal National Mortgage Association was chartered by the Federal Housing Administration, as a subsidiary of the Reconstruction Finance Corporation and was given a statutory charter on July 1, 1948.[43] By the same act the activities of FNMA were expanded to include certain types of loans guaranteed by the Veterans Administration.

On September 7, 1950 the Association was transferred to the Housing and Home Finance Agency (HHFA) pursuant to the Reorganization Plan No. 22 of 1950 for the purpose of coordinating housing programs.

The need for a privately financed and privately owned and managed corporation to provide assurance of continuity to the broad general secondary market for housing mortgages had been urged, over a period of many years, by various mortgage, housing, and allied groups. In 1954, to meet this need and simultaneously to take advantage of the FNMA's years of experience and profitable

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42. Information circular regarding activities of the Federal National Mortgage Association, p. 1.

43. Public Law 560, 83d Congress, Ch. 649, 2nd Session, Title III, Sec. 301-311.

operations in buying and selling mortgages, the Federal National Mortgage Association Charter Act approved August 2, 1954 was enacted.[44] FNMA was chartered by that act as a constituent agency of the Housing and Home Finance Agency, i.e., the capitalization is now provided only in part by the Federal Government (preferred stock); all of the common stock is held by private investors.

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44. Fourteenth Annual Report - 1960, Housing and Home Finance Agency, p. 242.

TABLE 11. FNMA PURCHASE AND SALE OPERATIONS

(In Millions of Dollars)

Year	Purchases			Sales			Balances of Mortgages Held on December 31			
	Total	FHA	VA	Total	FHA	VA	Total	FHA	VA	Other
1948	$ 198	$ 187	$ 11	---	---	---	$ 199	$ 188	$ 11	---
1949	672	253	419	$ 20	$ 19	$ 1	828	403	425	---
1950	1,044	49	995	469	261	208	1,347	169	1,178	---
1951	677	74	603	111	28	83	1,850	204	1,646	---
1952	538	168	370	56	36	20	2,242	320	1,922	---
1953	543	355	188	214	32	182	2,462	621	1,841	---
1954	614	353	261	515	134	381	2,476	802	1,632	$ 42
1955	412	185	227	61	14	47	2,655	901	1,714	40
1956	609	153	456	15	3	12	3,086	978	2,069	39
1957	1,096	313	783	3	2	1	4,012	1,237	2,737	38
1958	623	469	154	482	155	327	3,938	1,483	2,417	38
1959	1,922	1,163	744	5	4	1	5,582	2,546	2,985	51
1960	1,391	960	288	357	33	324	6,341	3,355	2,803	183

Source: Savings and Loan Fact Book, 1961.

CHAPTER VI

VA OR GI MORTGAGES

The Servicemen's Readjustment Act of June 22, 1944 provided for an extensive program of partially guaranteed mortgage loans (referred to as "GI" or "VA" loans) to World War II veterans.[1] Sections 500 and 514 of Title III set forth the full text of the law that controls the basic operations of the program which became effective June 22, 1944 and expiring on July 25, 1960. This act was amended later to include servicemen in the Korean conflict.[2]

Five brief paragraphs cover the home loan guarantee provisions. However, the regulations are voluminous. They cover every detail of the loan guarantee procedure and have full force of law.

To make it possible for veterans to acquire homes on generous credit terms and at the same time preserve the nation's traditional private enterprise in the home

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1. _Savings and Loan Fact Book, 1961_, p. 119.
2. _Ibid._, p. 118.

mortgage financing, the VA program provided, through the loan guaranty feature, for the protection of mortgages against possible loss. For the borrower, the provisions included a low effective interest rate, little or no down payment, a long amortization period, absence of guaranty charge, prohibition of mortgage brokerage commissions, option of accelerated payment without penalty and appraisal of property by the Veterans Administration in accordance with the "reasonable value" rule.

Protection to the lending institution in the making of loans carrying the above favorable terms was achieved through the creation of a contingent liability of the government as set forth in the guaranty contract and the provision for prompt cash settlement of claims filed after default.

Guarantee

Real estate home loans to $7,500 and other real estate loans up to $4,000, or a prorated portion thereof or loans of both types or combinations thereof, may be guaranteed with interest at not more than 5-1/4 percent per annum, repayable in not more than 30 years, except in case of farm realty, which may run for 40 years. If the proceeds of the loan are to be used for the acquisition or improvement of residential property, the amount guaranteed may be 60 percent of the loan and not over $7,500.

In other words, the loan is divided into two sections: the guaranteed portion and the unguaranteed portion. The unguaranteed portion of the loan represents the lender's risk. Although there is a prorating of the amortization payments to the guaranteed and unguaranteed portions of the loan, there is no pro-rating of any potential loss. If loss is incurred on any such loan, the government assumes the entire loss until the full guarantee has been exhausted.

To give an example, assuming that a $10,000 mortgage loan has been made with the full permissive guarantee of $6,000, the lending institution has an unguaranteed loan of $4,000. If the property were foreclosed and subsequently sold at $5,000, there would be a loss of $5,000 which would fall entirely on the government.

Insurance Provision

At the option of the lender and the borrower the loan may be insured instead of guaranteed. Briefly, this provision of the Law operates as follows:

The Veterans Administration creates an insurance account for each supervised lender who desires to have his loans insured. The insurance account is credited with an amount not exceeding 15 percent of the amount of each loan insured. Incidentally, the maximum base for computing the 15 percent is $4,000 for home loans.

This insurance fund is then applicable against any loss that the lender may take even up to 100 percent on a single loan--but the total that will be paid out by the government may not exceed 15 percent of all the loans so insured.

Eligibility

Any person is eligible who served in the Armed Services at any time on or after September 16, 1940, and prior to July 26, 1947, or on or after June 27, 1950, and prior to February 1, 1955, and was discharged under conditions other than dishonorable, after active service of 90 days or more, or because of disability incurred in the line of duty. Generally, loans must have been made prior to July 26, 1960, for World War II veterans; veterans of Korea have until January 31, 1965. Widows of deceased veterans whose death was due to service may also qualify. Under certain conditions a veteran may be eligible for another loan, if his present loan is paid in full and he has a compelling reason.

Security

A real estate loan must be secured by a first mortgage. At one time the VA guaranteed second-mortgage loans that were subordinate to FHA-insured first mortgages. These loans were made under Section 505(a) of the Act. Authority to make these loans has been terminated, so that all future real estate loans must be first- mortgage loans.

In certain states it is the custom to construct homes on leased land. The lessee in these instances obtains a life interest in the property via a 50- or 99-year lease. The VA takes cognizance of this situation by classifying liens on these leasehold interests as first mortgages. Loans for alteration, repair, or improvements for more than $1,000 and more than 40 percent of property value, must be secured by a first mortgage. Alteration loans for more than $1,000 but 40 percent or less of property value, can be secured by either a first or second mortgage. Alteration loans for less than $1,000 do not need to be secured.

Operations

In 1960, 145,000 veterans acquired homes with the VA-guaranteed mortgage, bringing the total number since the beginning of the program to 5,574,000 and the aggregate loan volume to $49.2 billion (Table 12).

Repayments, including monthly amortizations and prepayments, on VA mortgages mount with the years. For the period 1944-1960 they came to approximately $19.5 billion, of which $10.8 billion represented mortgages completely paid off. Almost one-third (30%) of all borrowers had retired their debt *in toto* by the close of 1960 (Table 12.).

TABLE 12. VA-GUARANTEED HOME MORTGAGE LOANS

Year	Loans Made		Repayments	Outstanding at Year End	
	Number (Thousands)	Amount (millions)	Amount (Millions)	Number (Thousands)	Amount (Millions)
1944-49	1,623	$9,078	$ 978	1,532	$ 8,100
1950	497	3,073	873	1,968	10,300
1951	448	3,614	714	2,336	13,200
1952	306	2,718	1,318	2,538	14,600
1953	322	3,062	1,562	2,740	16,100
1954	411	4,256	1,056	3,019	19,300
1955	650	7,154	1,854	3,466	24,600
1956	507	5,866	2,066	3,789	28,400
1957	313	3,842	1,542	3,949	30,700
1958	139	1,780	2,080	3,910	30,400
1959	214	2,787	3,187	3,915	30,000
1960	144	1,983	2,283	3,895	29,700
1944-60	5,574	49,214	19,514	3,895	29,700

Source: Veterans Administration.

Although the annual volume of VA-guaranteed mortgage lending has fluctuated widely, ranging from $1.8 billion in 1958 to $7.2 billion in 1955, these loans have come to comprise a very significant sector of all home mortgages outstanding. At the end of 1960 30% of the aggregate mortgages on one- to four-family houses was accounted for by the VA-guaranteed loan; and of the $140 billion total volume of mortgage recordings during the past five years, VA-underwritten loans comprised 12%.[3]

Savings and loan associations in recent years have accounted for 20% to 25% of the total VA volume. In 1960 their $422 million of such lending represented 21% of the year's aggregate VA-guaranteed loans. Mortgage companies led with 55% of the total. Mutual savings banks and commercial banks were in third and fourth place, respectively. (Table 15.)

The mortgage program of the Veterans Administration comprises the financing of both new (including proposed) and existing houses. While the trend is not an unbroken one, the past five years have seen the new dwelling bulk somewhat larger in this financing than existing housing. In 1960 72% of all home loan applications for guaranty represented the financing of new or proposed homes as against 66% in 1958 and 61% in 1955.[4]

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3. <u>Ibid.</u>, p. 119.
4. <u>Ibid.</u>, p. 120.

The number of loans with no down payment continues to gain. In 1960 approximately 60% of the mortgages made were 100% loans, as compared with 55% in 1959 and with only 20% in 1958. The loan-to-purchase-price ratio in the case of loans made with some down payment averaged 89%, a percentage which has changed but little in recent years.

The trend toward the longer maturities which have characterized FHA-insured mortgages has also prevailed in the case of VA-guaranteed loans. In 1960 fully 75% of the VA-guaranteed mortgages were written with a term of over 25 years, in contrast to around 60% in 1958 and 45% in 1955. The rising cost of housing purchased by veterans is revealed in the fact that in 1960, 90% of all properties acquired (existing, new and proposed units) carried a purchase price of $10,000 or higher, whereas in 1955 not more than 73% of the acquisitions were in this price range.

In the matter of defaulted VA-guaranteed home loans, the record continues favorable. Gross claims filed with the Veterans Administration from the beginning of operations through 1960 amounted to $297 million, which is the equivalent of just over 1/2 of 1% of total loans closed.[5]

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5. Loc. cit.

TABLE 13. HOME LOAN DEFAULTS

Year	Number of insured or guaranteed home mortgages in force at end of year			Percent of insured or guaranteed home mortgages in force at end of year	
	Total	In default		In default	In serious default
		Total	Serious		
VA guaranteed					
1946	450,748	467	n.a.	.10	n.a.
1947	971,807	8,460	n.a.	.87	n.a.
1948	1,288,389	17,888	n.a.	1.39	n.a.
1949	1,526,689	31,826	3,343	2.08	0.22
1950	1,958,715	38,735	2,689	1.98	.14
1951	2,323,892	39,639	2,673	1.71	.12
1952	2,503,387	33,789	2,183	1.35	.09
1953	2,723,006	28,541	1,980	1.05	.07
1954	2,999,178	34,204	2,382	1.14	.08
1955	3,441,453	33,346	2,384	.97	.07
1956	3,759,784	35,169	3,295	.94	.09
1957	3,906,536	38,189	3,401	.98	.09
1958	3,870,730	48,182	5,648	1.24	.15
1959	3,859,235	44,775	4,572	1.16	.12
1960	3,829,107	48,984	6,025	1.28	.16

n.a. Not available.

Source: Veterans Administration

CHAPTER VII

OTHER DEVELOPMENTS

Housing and Home Finance Agency[1]

The Housing and Home Finance Agency was established as successor to the National Housing Agency on July 27, 1947. It is easily the most important government organization having to do with real estate finance. With its establishment the Agency took over the direction of three existing and important organizations that were thereby made constituent divisions of HHFA. These are the Home Loan Bank Board, Federal Housing Administration, and the Public Housing Administration. Subsequently, it took over the operation of the Federal National Mortgage Association from RFC.

The Administrator of HHFA is charged with a wide range of duties--supervisory, coordinating, advisory, and operating--in this role as the principal housing official of the United States Government. In addition, the Administrator's office has direct responsibility for the operation of two important programs, the Division of Slum Clearance and Urban Redevelopment, and the Division of Housing Research.

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1. Thirteenth Annual Report-1959, Housing and Home Finance Agency, page IX.

FHA Mortgage Discounts[2]

In recent years an increasing number of questions have been raised concerning mortgage lenders' practices of charging discounts or, as they are sometimes called, "points" or "finance fees".

Discounts come into existence because of the problems investors face in choosing ways of investing their money. Everyone who has a savings account with a bank, a savings and loan association, a building and loan association, or has a life insurance policy or a share in a retirement or pension fund probably is an investor to some degree.

Most investors attempt to place their money in loans or investments which will produce the greatest amount of income, usually called "yield". In addition to a high yield, investors are concerned about the safety and liquidity of investments. Notwithstanding the fact that the yield from mortgages may be lower than the yield from other investments, investors usually want to keep a considerable portion of their money in home mortgages. At the same time they attempt to match the yield which may be received from other investments such as high-grade corporate bonds. When the interest rates on home mortgages drop, investing institutions, to protect their

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2. Federal Housing Administration Pamphlet entitled, "Mortgage Discounts", dated July 20, 1961.

depositors or policy holders, will channel funds into loans which produce higher yields than low interest rate mortgages.

For example, assume that an investor has a choice of investing $10,000 in a high-grade corporate bond which will earn 6%, or of investing $10,000 in a mortgage having an interest rate of 5-1/4%. The investor favors the bond unless it is possible to buy the mortgage at a reduced price so that the 5-1/4% interest and the repayment of the $10,000 will give the same yield as the 6% interest on the bond. (In computing yield, lenders generally assume that the average home mortgage will be paid in full in 12 years rather than the full term of the mortgage, which may be 30 years or more.) Standard investment tables show that 5-1/4% interest and the principal repayment will give a 6% return if the $10,000 mortgage can be purchased for $9,400, or 6% less than the amount of the mortgage. This difference is called discount or "points".

What Does FHA Do About Discounts?

The law requires FHA to set ceilings on interest rates for FHA-insured mortgages. As of July, 1961, FHA regulations restricted interest rates to not more than 5-1/4%. Reductions from 5-3/4% to 5-1/2% and from 5-1/2% to 5-1/4% became effective on February 2 and

May 29, 1961, respectively, in recognition of the money market improvements which had occurred since early 1960.

Discounts are not set by or received by FHA. Any "points" that are charged, as well as the mortgage interest, are retained by the investor and not by FHA. FHA regulations permit charges to the mortgagor for appraisals, title insurance, recording, surveys and other charges which are customary in a locality. The regulations also permit an initial service charge not to exceed 1% or 2-1/2% if the lender makes advances during construction. These charges are intended to cover the lender's expenses in originating the loan.

FHA prohibits the collection of discounts from <u>home buyers</u> since such charges would circumvent the purpose of interest rate regulations. On the other hand, there is no prohibition against payment of discounts by builders of new homes, sellers of existing homes, mortgagees, or others having an interest in the transaction. Whether discounts are paid and in what amount are matters for negotiation between lenders and these other parties to the transaction. FHA has no requirements nor assumes any responsibility concerning these negotiations other than to prohibit payment of "points" by the FHA mortgagor or <u>home buyer</u>. VA discounts are commonly much higher due to lower ceiling on interest rate.

Second Mortgages[3]

A second or junior mortgage is one which in all respects is subordinate to the claims of a first mortgage. Property revenue is applicable first to the payment of first mortgage charges and then to the payment of second mortgage charges. Foreclosure of a second mortgage in no way disturbs the position of the holder of the first mortgage. On the other hand, if the first mortgagee forecloses, he wipes out the claim of the junior mortgage holder. The junior mortgage holder must satisfy the first mortgage in order to protect his interest.

The second mortgage is a long established device for bridging the gap between a permissible first mortgage amount and the purchase price or value of a property. Second mortgage financing is essential to many deals, particularly on larger income producing properties where institutions may be limited to 66-2/3 percent on first mortgage loans. Return or yield on second mortgages is generally higher than on first mortgages because of the secondary nature of the lien and because without an established and recognized market, there is no check on lenders' charges.

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3. North, Nelson L. and Ring, Alfred A., Real Estate Principles and Practices (5th Ed.), p. 157 and Hoagland, Henry E., Real Estate Finance, pp. 87-105.

The role of the second mortgage in real estate financing has been one of diminishing importance since the 1930's. This has been caused by three significant changes in financing techniques.

Increase in Legal Loan Ratio

The legal loan-ratio on one-family houses was increased for most institutions at the time that the self-liquidating loan was introduced into our economy. In most areas of the United States today, the purchaser can get a first mortgage loan of 80 percent of appraisal. The relatively small equity required today has practically eliminated the second mortgage from the one-family house financing field. In the 1920's it was the almost universal practice to sell one-family houses with two mortgages, the second mortgage in most cases being taken by the builder. In order to obtain cash after completing his operation the average builder discounted these mortgages with a professional second-mortgage man. The amount of the discount was included in whole or in part in the sales price paid by the purchaser. Overall financial charges on many homes sold at this time were burdensome to the purchasers.

Government Insurance and Guarantee of Loans

FHA insured mortgages on one-family homes were authorized up to 97 percent of appraisal. VA-guaranteed

loans can be made on a 100 percent basis. FHA specifically prohibits any second mortgage financing on properties in which it has an interest. FHA Title I modernization loans have made it possible for private homeowners to secure three-year loans for repairs or remodeling at primary interest rates. Theretofore, most owners had been forced to go to second-mortgage lenders to secure such funds. FHA and VA procedures, and the increased loan-to-value ratio of lending institutions have effectively eliminated the necessity of a second mortgage on residential property.

Title Insurance[4]

Title insurance may be defined as a contract of indemnity against loss or damage arising out of defects in or liens upon the title to real property. However, such a definition is grossly inadequate for a comprehensive understanding of the subject. A title insurance policy describes the estate or interest secured and sets forth a state of facts substantially reflecting the status of the title; and it indemnifies the insured against loss arising out of any different state of facts which may exist at the effective date of the policy.

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4. North and Ring, op. cit., pp. 100-104; and conferences with A. Simpson Williams, Jr., Vice-president, American Title Insurance

History

The first title insurance company was organized in Philadelphia in 1876. During the next ten years title insurance companies were organized in Chicago, Minneapolis, San Francisco and Los Angeles.

The growth of the title insurance idea was very slow until after World War I, when life insurance companies and other national lenders on real estate securities extended their activities over wide areas following a general rise in land prices. These large lenders, being unfamiliar with title practices and the character and solvency of individuals engaged in title services in areas remote from their home offices, began requiring the dependability and protection of title insurance issued by financially sound companies. This increased demand caused the formation of additional small title insurance companies which were organized primarily to serve their own localities. A few of these companies later expanded into the national field by qualifying to transact business in two or more states. Some of them, in addition to insuring titles, started the practice of guaranteeing the payment of mortgage loans. This was directly responsible for the failure of a number of title companies during the 1930's. No title insurance company confining its business to title insurance and allied services has ever failed.

The spread of the demand for title insurance by mortgagees brought this form of evidence of title to the attention of large segments of the public with the result that in some areas in the United States title insurance has replaced the opinions of title by attorneys and the formal abstracts as the property purchaser's evidence of title. In fact, title insurance is now used extensively throughout the United States. There are approximately 170 title insurance companies of which some 31 issue policies in two or more states.

Security Afforded

In Virginia all title searching is performed by an attorney and it is on the attorney's certificate of title that title insurance policies are issued. Title insurance protects the insured against any loss because of any oversight or error in judgment on the part of the title examiners. But it goes far beyond that in that it also protects the insured against matters outside the record which might make the title defective and cause the insured a loss such as a forged deed, lost will, lost instruments, incompetence or insanity of parties to the transactions.

Three Types of Policies

Title insurance policies fall into three broad classifications: The Mortgagee Policy, the Owner's Policy, and the Leasehold Policy.

The Mortgagee Policy insures the lender against loss due to a defect or encumbrance affecting the priority of the lien of the mortgage or deed of trust securing the debt of the insured; it also insures against loss due to unmarketability of the title; and it covenants to defend the lien of the mortgage in any court action brought attacking the title.

Obviously the title policy issued to a mortgagee initially for the full amount of the mortgage is a policy of diminishing liability for the title insurance company. The coverage of the policy is periodically decreased and finally is extinguished at the time the mortgage is paid off. If the mortgage lien is foreclosed or the property is voluntarily conveyed to the mortgagee in lieu of foreclosure, the Mortgage Policy becomes an Owner's Policy and affords the mortgagee all of the Owner's Policy protections.

The Owner's Policy is a policy issued to the purchaser of the property always in the full amount of the purchase price of the property and it insures him, up to the face amount of the policy, for any loss which he may

sustain by reason of a defect or defects in the title of the insured to the property being purchased. These defects can be liens or encumbrances spread on the record or adverse claims of any kind existing at the date of purchase but hidden in the records so that even the most astute title examiner might overlook them or they may be caused by matters not of record. The insurer also covenants to defend in court against any attack on the title as insured.

The Leasehold Policy can be issued either to the tenant or leaseholder or to the mortgagee. The leaseholder's interest is insured on a regular form Owner's Policy with the face of the policy amended to show the estate or interest insured is a leasehold. The Mortgagee Leasehold Policy is issued on the regular form of Mortgagee Policy with the face of the policy amended to show the title vested in the mortgagor to be leasehold rather than fee simple.

Difference in Coverage

While the title insurance coverage afforded the mortgagee and owner is somewhat the same, it is also substantially different in important areas. Because of the diminishing lien of the mortgage and the increasing equity of the owner in property, it is apparent that there could be a complete title failure with

the mortgagee suffering no loss because of title insurance coverage and the owner suffering substantial loss because he had no title insurance coverage. In fact, if the owner is not protected with an Owner's Policy, it is entirely possible that payments made by the title insurance company in the process of perfecting title under a Mortgagee Policy can be made a lien against the property subordinate only to the mortgage under which the Mortgagee Policy was issued. The lien becomes, in effect, a junior or second mortgage secured by the property, and must be paid off by the owner after the prior liens are paid or before the property can be sold.

<u>Comparisons</u>

Most property in Virginia is transferred under a General Warranty Deed. With a general warranty deed the grantor passes on to the grantee only such title as he holds. It is true that if title fails, the purchaser may under special circumstances have a cause of action against the grantor but his chance of recovery is dependent entirely upon the financial ability of the grantor to pay at the time that judgment is acquired and this commonly follows a long and expensive court action. On the other hand, title insurance is a corporate guarantee of a company operating in Virginia under the rules and

regulations of the Insurance Commissioner. The security afforded by any policy is limited only by the integrity and financial structure of the company issuing the policy.

A purchaser sometimes accepts property after its title has been searched and the attorney searching the title has issued an opinion or certificate of title stating that the record title is good. The chance of recovery in the event of a title loss in this case largely depends upon the solvency of the attorney examing the title and furthermore, the attorney's liability is limited to errors and oversights that would not be made by a diligent attorney. The attorney is not liable for any loss arising from hidden defects.

In both of these cases it will be seen that liability is limited to defects in the record title; and it must be pointed out that in the case of individual liability the statute of limitations grants immunity to the grantor or examiner after the statute has tolled its six years. Moreover, in both instances action against the previous grantor or the examining attorney can be instituted only after a loss has actually occurred. The expense of the defense of a law suit resulting in a loss must be borne by the purchaser. Title insurance coverage extends to hidden and unknown matters whether

or not they are of record. "An honest mistake" is no defense for a title insurance company, and it cannot hide behind a statute of limitations. In addition, by the terms of the policy, a title insurance company must undertake and bear the expense of the defense of any attack on the title.

MORTGAGE COMPANIES[5]

The liberalization of investment laws permitting insurance companies and banks of one state to acquire mortgage loans in other states, particularly FHA insured or GI guaranteed, created a need for financial middlemen who could initiate mortgage loans and service them for the investing companies. This need was filled by the development of "mortgage companies" or "mortgage correspondents".

Mortgage correspondents secure applications for loans, negotiate with the investor, and also arrange for appraisals and inspection of the properties. Although final approval must be given by the home office of the lender, the mortgage correspondent is sufficiently conversant with home office policy that he can deal confidently with prospective borrowers. If a loan

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5. From interview with staff of Mortgage Investment Corporation, Richmond, Virginia, Spring, 1961.

application does not fit the pattern of one lender's policy, it may be quite acceptable to another lender.

The mortgage correspondent generally receives his initial compensation through brokerage fees paid either by the borrower or the company, or both, depending on the conditions of the mortgage "market" at the time. If he is a correspondent, he also receives compensation for "servicing" the loan. Servicing usually includes the collection of interest and principal payments, tax, insurance and other deposits, and negotiation between the borrower and lender regarding adjustments, renewals, extensions, releases and sometimes foreclosure. Fees for such "servicing" range from 1/2 of 1% down to 1/8 of 1% of the loan balance, depending on the size and type of mortgage involved.

These mortgage companies generally deal in mortgages which are most readily salable in the secondary market. As a result, these "temporary" lenders prefer government insured or government guaranteed mortgages as well as conventional or uninsured mortgages for which they have advance purchase commitments.

Mortgage companies generally operate as correspondents of many different permanent investors such as life insurance companies, savings banks, pension funds, or in some cases, private individuals.

TRADE-IN HOUSING PROCEDURE[6]

The benefits of the trade-in housing program apply to Sections 203(b) and 220 of the National Housing Act.

To assist trade-in financing and to avoid duplicate closing costs, FHA may insure a mortgage of a builder or realtor in the same amount as that available to an owner-occupant. To be eligible for a high-ratio mortgage, the mortgagee shall withhold from the mortgage proceeds, prior to insurance, in an escrow, trust, or special account acceptable to the Commissioner, a sum not less than 15% of the unpaid principal balance of the mortgage after application of the 18th amortization payment. FHA will show the amount of such escrow on the commitments.

The mortgagor taking the house in trade must certify that (a) he acquired the property as trade-in house; and (b) he will obtain the prior written approval of FHA if he rents, sells, or occupies the property prior to the 18th amortization payment of the mortgage. If the rental agreement specifies a term of not less than 30 days or more than 60 days, or if the mortgage is paid in full upon sale of the traded-in property, then prior approval of FHA is not required.

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of F.H.A. Summary of Requirements for Insurance or Guaranty 1961), Mortgage Finance Committee, American Bankers Assn., p. 33.

This section was added by Sec. 101 of 1957 Housing Act, Public Law 85-104, 85th Cong., approved July 12, 1957, sec. 8.

Where the property is not sold by the due date of the 18th payment and the mortgagee applies the escrow, FHA should be promptly notified of the application of such escrow, so that future mortgage insurance premium billings will be based on the reduced mortgage amount.

CERTIFIED AGENCY PROGRAM[7]

The Certified Agency Program is designed to extend the benefit of FHA-insured mortgages to small towns and rural communities which are located in areas distant from FHA offices. This program provides an arrangement whereby processing functions are carried out by local lending institutions using appraisers and inspectors employed on a fee basis.

A lending institution acting as an authorized agent is empowered to accept applications for insured mortgage loans eligible under Section 203 of the National Housing Act. Qualified lending institutions which are FHA approved mortgagees will be designated as authorized agents upon application to and approval by the Central FHA insuring office. Fee appraisers and inspectors will also be certified by the Central FHA office.

Upon application for a loan, Certified Agents arrange for an appraisal and perform a credit analysis at the same

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7. Summary of Requirements for Insurance or Guaranty of F.H.A. and V.A. Mortgage Loans, op. cit., p. 33.

time. After a review of the credit and appraisal reports, a commitment will be issued by the agent in accordance with FHA regulations. Fee inspectors are used for new construction cases. All documents are forwarded to the local FHA office and endorsement is given provided the statutory and regulatory requirements for an insurable loan are met.

VOLUNTARY HOME MORTGAGE CREDIT PROGRAM[8]

V.H.M.C.P. was established by Congress under Title VI of the Housing Act of 1954 and was extended to October 1, 1965 by authority of the Housing Act of 1961. This program is designed to help make mortgage money available for FHA and VA endorsed loans to persons in small communities and remote areas, and for minority groups who have been unable to obtain loans through normal means. The V.H.M.C.P. also acts as a mortgage clearing house to help bring about private financing of mortgages eligible for special assistance under the Federal National Mortgage Association, particularly Elderly Housing, Urban Renewal Rental Housing and the Home Improvement Loan Program authorized by the Housing Act of 1961.

The responsibility for making funds available to such groups rests with private mortgage financing institutions. General operating policy is determined by a National Committee and several Regional Committees which act as clearing

8. Ibid., p. 34.

houses bringing together applicants with participating financial institutions. Applications are circulated by the Regional Committees to private lenders who have indicated a willingness to cooperate and who apply their own credit standards.

It is essential that participating continue on a voluntary basis, otherwise direct government lending is likely to fill the gap. As of October 1, 1961, V.H.M.C.P. has placed over 50,000 loans and helped to provide over $510 million in loans.

Disappearance of Lots for Sale

A phenomenon of the 1920's that has disappeared in the post-war era has been the subdivision of land into building lots for sale. A great deal of this business was automatically eliminated when state or local laws were enacted setting up rigid requirements for lot sales.

Experience has shown that the old-time subdivider aimed to sell his land at a maximum profit with a minimum of physical improvements. In most localities today ordinances require the installation of acceptable streets and utilities before the land can be sold.

But the entire idea of land subdivision as a separate business has--with a few exceptions--become somewhat archaic. With today's modern financing methods, the builder becomes the subdivider. He buys the land, puts in the improvements, arranges necessary financing, constructs the home, and sells the finished product. There are still, of course, many sales of building plots for the construction of homes, but this is generally done on an individual or case basis and in built-up areas. The creation of a new home community through the sale of lots to individuals and the subsequent construction of homes by these individuals is now almost unknown.

CHAPTER VIII

THE PART PLAYED BY VARIOUS LENDING INSTITUTIONS IN THE FINANCING OF RESIDENTIAL REAL ESTATE

The primacy of mortgage financing in the steady furtherance of home ownership during the past decade is pointed out by three facts. First, out of the annual aggregate total mortgage indebtedness outstanding on all property including commercial properties, the proportion accounted for by one- to four-family dwellings has constantly exceeded 70%. (Chart 2) Secondly, of all the one- to four-family houses in the U. S. at the close of 1950, 35.4% were mortgaged, compared with 38.6 in 1955 and 41% in 1959. (Table 14) Thirdly, the increase in the average debt on one- to four-family dwellings is indicated by the 1959 average of $6,952 as compared with $3,614 in 1950. (Table 14) This increase in the average debt reflects both the increases in cost and quality of housing and the trend toward higher loan-to-value ratios.

This rise in home mortgage indebtedness is attributable to a number of factors:

1. A constantly high and rising level of income has enabled former tenant families to avail themselves of

mortgage facilities and become home owners; it has also enabled those already owning their homes to upgrade their housing.

2. A progressive redistribution of income in favor of the much more numerous lower-income groups.

3. A steady demand for housing stemming from family formation.

4. A willingness of lenders to liberalize financing terms so as to fall within the reach of lower-income people.

5. The availability of funds to be put to these uses.

Types of Loans

Conventional mortgages[1] comprised the major portion of the aggregate debt outstanding on one- to four-family houses throughout the entire decade. At the close of 1961, they surpassed the previous $84.8 billion peak recorded in 1960 to reach a new peak of $93.9 billion. Moreover, conventional mortgages accounted for 61.3% of the total outstanding indebtedness on such dwellings, representing the highest proportion attained within the past 13 years.[2]

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1. A conventional loan is one where the only security offered for the loan is the property which the mortgagor or borrower is purchasing.
2. Federal Reserve Bulletin, Vol. 48, No. 4, April 1962, p. 451.

FHA-insured loans[3] outstanding amounted to $29.5 billion at the end of 1961. Their proportion of the aggregate mortgage debt increased fractionally to 19.2%.[4]

The proportion of VA-guaranteed loans[5] relative to the total outstanding fell from 23% in 1959 to 19.5% at the close of 1960. In 1961 they amounted to $30.0 billion.[6]

Mortgage Lenders

Since 1920, there have been significant shifts among the holders of mortgage loans. The most prominent of these shifts is one common to all property classes of loans--the shift away from the miscellaneous category "Individuals and Others" (which includes individuals, trust, trust departments of banks, pension funds, philanthropic and educational institutions, fraternal and beneficial organizations, casualty and fire insurance companies, real estate

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3. FHA loans, as opposed to the conventional type, are loans where not only the property secures the loan, but the loan is underwritten by the federal government, insuring the investor against loss through foreclosure of the property.

4. Federal Reserve Bulletin, op. cit., p. 451.

5. A VA loan is similar to an FHA with the exception that it can only be made to an eligible veteran and on a portion of it (60% not to exceed $7,500.00) the investor is guaranteed by the federal government against loss.

6. Federal Reserve Bulletin, op. cit., p. 451.

and mortgage companies and others) toward the more specialized institutional investors. These institutional lenders (life insurance companies, commercial banks, mutual savings banks, and savings and loan associations) held 36.1% of the total mortgage debt outstanding at the end of 1922 as compared to 61.2% held by individuals and others. At the close of 1960 the institutional investors had increased their share of a considerably larger debt total to 84% while individuals and others had fallen to 12%. FNMA held only 4% of the total. (Table 15)

Of the specialized institutional investors, savings and loan associations and life insurance companies have shown the most striking growth in the extension of mortgage loans.

SAVINGS AND LOAN ASSOCIATIONS

Savings associations have gained a substantial margin over other financial institutions in holdings of one- to four-family home mortgages, with $55.9 billion of such indebtedness in their portfolios at the end of 1960. Their holdings represented 39.4% of the aggregate home mortgage debt as compared to only 7.5% in 1922. (Chart 3.)

Since 1950 the amount of home mortgages held by these associations has quadrupled, and at the end of 1960 accounted for 93% of their $60.1 billion aggregate mortgage portfolio.

While the typical mortgage loan of savings associations is for the financing of single-family, owner-occupied houses, lending is also carried on to finance other classes of properties. Various limitations on these latter loans are prescribed by statute and regulation. For example, federally chartered associations may lend for the purpose of financing commercial and multi-family structures which, together with other types of exceptional lending, may not exceed the equivalent of 20% of aggregate assets. Moreover, these institutions have been authorized since 1959 within limitations to make loans to finance the acquisition and development of land.

<u>Mortgage Portfolio</u>

The 1960 lending volume of savings and loan associations amounted to $14.3 billion and brought their outstanding mortgage balances up to $60 billion by year end. This portfolio represented some 7,985,000 mortgages with an average balance of $7,525. The typical loan placed on savings and loan books throughout recent years has been steadily rising, as has also the average balance. (Table 16.)

Thirty three percent or $4.7 billion of the year's total represented loans for the financing of new house construction. This type of loan made by associations in 1960 financed approximately 360,000 new dwelling units, accounting for 30% of all the private units put in place.

Since 1955 the proportion has ranged narrowly from 30% to 32%. Altogether, since 1950, associations have furnished the mortgage credit for approximately 3.5 million new houses.[7]

Another 43% ($6.1 billion) consisted of lending for the purpose of acquiring existing properties. Thus, the major purpose of loans by savings and loan associations is to finance the purchase of homes already built. Modernization and reconditioning of residential properties, together with the refinancing of loans, accounted for the remaining $3.5 billion or 24% of the total.[8] Property improvement loans made by savings associations are of two types: unsecured loans made up of FHA Title I loans and "own plan" loans; and secured loans, usually under an open-end advance clause in the mortgage contract.

In their lending operations, savings associations also make advance commitments for loans. These take the form of contractual agreements to provide credit to borrowers, and they are typically extended for the period of construction.

Types of Loans

Of the aggregate loan balance on December 31, 1960, conventional mortgages, amounting to $49.3 billion, comprised 82%. This proportion has been steadily increasing

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7. Savings and Loan Fact Book, 1961, p. 53.
8. Loc. cit.

to the highest position since the VA program was established. (Table 15.)

In 1960 the conventional mortgage accounted for \$13.2 billion or 92% of the aggregate loan and volume of associations establishing a new high for this bulwark of savings and loan lending. (Table 15.)

These nongovernment-underwritten mortgages, which are specialized in by associations and which accounted for more than one-half (based on aggregate lending of associations rather than their mortgage recordings) of the nation's total of this type of loan in 1960, continue to provide a dependable source of housing credit at the hands of savings associations.

Government-underwritten mortgages made by associations in 1960 totaled only \$1.1 billion. (Table 15.) VA-guaranteed loans made by associations amounted to even less (\$422 million), the smallest volume of any year since 1949. The 3% proportion of this lending to the savings and loan aggregate in 1960 was the lowest since the VA program began.

FHA-insured mortgages placed on the books of associations in 1960, amounting to \$658 million, were at a fairly well sustained level. Although the volume was 22% under the record of 1959, it nevertheless was the associations' second largest of any year for this type of lending.

Representing 4.6% of the year's total closings by these institutions, it was the second highest FHA proportion since the 5.1% of 1950.

Recent Loan Authorizations

Three important new or enlarged powers have been granted to associations within the past few years which expand their lending operations: (1) An authorization to acquire participating interest in mortgage loans; (2) the power to make loans for the purpose of acquiring and developing land; and (3) the authority to make conventional loans in excess of 80% of appraised valuation.[9]

Since March 1957 FSLIC-insured associations have been empowered to acquire participating interests in first mortgage home loans held by other insured institutions. While the original authorization carried the provision that the selling association retain an interest of at least 50%, a revision of March 1, 1961, lowered the requirement to 25%. This program of participation lending was designed to increase the mobility of funds between regions of the country.

On November 6, 1959, federally chartered savings associations were given authority, within certain limitations, to grant conventional loans to finance the

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9. Ibid., p. 59.

acquisition and development of land primarily for residential usage. As of December 31, 1960, 395 loans in the aggregate amount of $31 million had been made under this authorization. The average loan was approximately $77,730.

Federally chartered associations were also granted (as of October 23, 1958) the authority, within well-defined restrictions, to make conventional home loans in excess of 80% of appraised property value. During a little more than two years (through December 31, 1960) that this provision was in effect, the associations made 14,729 such loans amounting to the total of $202 million.[10]

LIFE INSURANCE COMPANIES

Second to savings and loan associations, life insurance companies held 18% of all home mortgage indebtedness at the end of 1960 with a portfolio of $24.9 billion.

Their holdings of mortgages have seen important shifts since the 1920's with respect to the classes of property covered. In 1925 the mortgages on farm properties made up 42.2% of the total holdings by insurance companies; multifamily and commercial properties accounted for 40.4% of the total while mortgages on one- to four-family homes made up only 17.4%. By 1960 the distribution was drastically changed: farm mortgages were only 7% of

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10. *Ibid.*, p. 61.

the total, multifamily and commercial were 33%, and mortgages on one- to four-family homes had expanded to 60%.

The laws of various states relating to the investments by insurance companies usually prescribe the type of investments a company may make, the percentage of its assets that it may put into any type of investment, and the maximum ratio of loan to value in the case of mortgage investments.

Conventional mortgage loans are generally permitted up to 66-2/3% of appraised value and for periods not exceeding twenty-five years, provided the loans are amortized. In a few states this ratio is lower, and an increasing number of states are permitting ratios of loan to value up to 75%. Nearly all states permit their life insurance companies to make mortgages insured by the Federal Housing Administration or guaranteed by the Veterans Administration. Such FHA or VA loans are not subject to the limited loan ratios provided for conventional loans.

Most larger insurance companies spread their activities and investments into ever-expanding areas. They seek opportunities in areas where the economy is healthy and in need of more mortgage capital. They provide a needed public service and diversify their portfolios at the same time.

Except for those companies which have insufficient funds for investment beyond the limits of their own home office cities, life companies secure new loan business through one or both of two methods:

1. Brokers or correspondents; and
2. a system of branch offices.

Mortgage correspondents (1) of a life insurance company are generally brokers who represent one or more companies in their respective communities. Some correspondents act exclusively for one large life insurance company: others represent a number of different investors. Some act as brokers only and receive their compensation in the form of a commission or finder's fee for initiating loans. Others act as mortgage bankers to provide the additional services of loan approval, closing and servicing for the institutional investor. Some correspondents deal in mortgage loans only; others maintain an active real estate, insurance or building business and even engage in commercial banking.

COMMERCIAL BANKS

Since World War I commercial banks in the United States have participated to an increasing extent in the financing of urban real estate. This development parallels

in some measure the widened activities of commercial banks in the field of term lending and in other types of secured lending, which they entered mainly because of changes in the credit requirements of potential users of bank credit. These new activities were stimulated also by changes in federal and state laws. Thus the National Housing Act induced changes in state laws allowing banks to make and hold loans insured under the Federal Housing Administration.[11]

There have been three fairly distinct periods in the development of urban mortgage lending by commercial banks since the National Bank Act was passed in 1863. The first--1863 to 1913--was one in which state banks largely dominated bank activity in the mortgage field; the second--1914 to 1931--showed few changes in state and national banking laws and these were mainly in the direction of liberalizing the restrictive legislation; in the third period--covering the years since 1931--there have been many changes in banking laws and practices relating to mortgage investment.[12]

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11. Behrens, Charles F., Commercial Bank Activities in Urban Mortgage Financing, p. 14.
12. Ibid., p. 15.

<u>State-chartered Institutions 1863-1913</u>

The National Bank Act of 1863 conferred authority on national banks to lend money on "real and personal security", but the words "real and" were struck out in the act of 1864 and it was not until the passage of the Federal Reserve Act, at the end of 1913, that national banks situated elsewhere than in central reserve cities were permitted by statutory law to make loans secured by farm real estate.

However, they were permitted to accept real estate mortgages as secondary collateral to prevent losses on loans previously made in good faith on legal types of collateral and, if necessary, to acquire title to the property. Property acquired in the manner had to be disposed of within five years.

The law was strictly interpreted in the early years of the National Bank Act, but later was given more liberal interpretation when trust companies and state-chartered commercial banks operating under more liberal corporate powers, forced many national banks doing business in the same area into undertakings foreign to the legitimate functions of commercial banks. National bank supervisors began to experiment with real estate loans, disguised as secondary collateral. This was particularly true of

localities where mortgage loans were the principal securities dealt in by savings banks and trust companies.[13]

Meanwhile state-chartered commercial banks were given still more flexible powers in the making of real estate loans. From their earliest beginnings they had been permitted to make such loans in the areas in which they operated. According to the 1910 digest of banking laws covering the forty-six states, the District of Columbia, and the territories of Arizona and New Mexico, only eleven states were reported to have restrictions on real estate lending by commercial banks.[14] According to the reports of the Comptroller of the Currency, as of June 4, 1913 the state banks, stock savings banks and loan and trust companies, many of which were under no legal restriction as regards real estate lending, had real estate loans amounting to $1,620 million or 15.6 percent of their total assets, whereas national bank holdings of real estate loans amounted to only 77 million or 0.7 percent of total assets.

Liberalization of the Legislative Basis of Mortgage Lending by National Banks 1914-1931.

As originally enacted in 1913, the Federal Reserve Act opened the door to real estate loans by national banks

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13. Kane, Thomas P., The Romance and Tragedy of Banking, 3rd Ed., p. 90.
14. Hoagland, Henry E., Real Estate Finance, p. 224.

by providing that members could make loans on improved and unencumbered farm land situated within the same federal reserve district for periods up to five years and for amounts not in excess of 50 percent of their value. No member could invest for this purpose more than one-fourth of its capital and surplus or one-third of its time deposits.[15]

In 1916 this provision was amended to permit member banks to make loans on improved and unencumbered real estate other than farms. The same limitations were imposed as stated above for farm loans, with the further restriction that the maturity of the loans was limited to one year instead of five. The lending area was extended to a one-hundred-mile radius of the federal reserve district in which the bank was located.

Since one-year loans on urban real estate were the common practice of that time for many of the competitors of member banks in some areas, the one-year limitation placed member banks in a competitive framework in such markets. However, not all state banks limited real estate loans to one year and there arose a demand almost immediately for further liberalization of the lending powers of member banks in the real estate field. Nevertheless, no

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15. Welldon, Samuel A., Digest of State Banking Statutes, Senate document No. 353, 61st Congress, 2nd Session (1910).

changes were made until the passage of the McFadden Act of 1927 which amended section 24 of the Federal Reserve Act to permit member banks to make five-year, 50 percent loans on urban real estate.

In 1935 the Federal Reserve Act was further amended to permit member banks to make ten-year, 60 percent amortized loans secured by either urban or farm real estate. The five-year, 50 percent limitation was retained for unamortized loans.

Since 1920 several significant changes have been made in the character of real estate mortgage loans made by commercial banks. Some of these have paralleled the changes in loans made by competing institutions during the same period.

These include the decline in interest rates, increased loan to value ratios, lengthened loan maturities, and the introduction of loan amortization.

Mortgage lending policies of commercial banks differ widely, depending on the size of bank operations and community financial needs since commercial banks are principally concerned with the financial needs and welfare of the local community. In active and growing communities, commercial banks find it more profitable to seek and meet local short-term financial needs since, as compared with other institutional lenders, commercial banks

are required by law to maintain their assets in a relatively liquid basis so as to meet withdrawal requests by their depositors. National banks (and most state banks) cannot make loans in excess of 75 percent of their time or saving deposits, or of their combined capital and surplus, whichever is the greater. Generally, regulations governing both national and state banks provide that loans do not exceed 66-2/3 percent of the appraised value of improved real estate, and that the loan maturity cannot exceed five years unless provision is made for loan amortization. National Banks and many State Banks are now permitted to make loans in an amount not to exceed 75% of the appraised value of the real estate offered for security providing the loan is fully amortized for a term not longer than 20 years. FHA insured and GI guaranteed loans are accepted at government-allowed loan-to-value ratios and loan periods.

FHA and GI loans through a commercial bank are commonly for a shorter term and have a larger down payment requirement than those of other lenders, but probably have off setting advantages such as less strict requirements as to living space and location. It should be remembered that under the FHA program the lender can establish his own policies as toterms and down payments within the limitations of the minimums set forth by the Administration.

The position of commercial banks as home mortgagees compared with the lending institutions previously discussed, has fallen as indicated by a drop from 21% of the total home mortgage debt in 1950 to 14% at the end of 1960. For further comparison as to commercial banks as a residential lender---see the following tables and charts.

MUTUAL SAVINGS BANKS

The influence of the mutual savings banks in the field of residential mortgage financing is felt principally in the 17 northeastern states in which these banks operate. The majority of the mutual savings banks are located in New York and Massachusetts, where approximately 70 percent of total savings bank assets are concentrated. Mutual savings banks are restricted by law to invest their funds only in home states or adjoining states. However, this geographical loan restriction does not apply to FHA insured or GI guaranteed mortgage loans.

Since mutual savings banks have state charters, the laws regulating their operation provide quite a wide range of mortgage lending programs. The ratio of maximum loan-to-value ratio varies from 50 to 90 percent (except for FHA and GI loans). In most states the laws restrict savings bank loans to 66-2/3 percent of the appraised value of the improved real estate, but in a few states conventional loans may be made up to 90% of appraised value. Loans generally have to amortized over periods not exceeding twenty-five years.

Mutual savings banks, with only 13% of the total home mortgage debt in 1960, have shown the slowest growth as compared with other institutional lenders. (Chart 2.)

INDIVIDUAL LENDERS

Individual (private) lenders at one time accounted for the lion's share of funds outstanding on mortgage loans, but at the present time such lenders account for less than one-ninth of the total mortgage debt. They still are, however, important as a source of prime mortgage funds and continue to be the largest source of junior mortgage loans, by far.

Many individuals with money to invest are willing to loan on real estate. They feel that real estate is more desirable than other investments because it is possible to see the property which is pledged as security for the loan. To others land seems more secure because it will not depreciate or be destroyed by many common hazards.

Individuals sometimes loan on real estate which institutional lenders will not or cannot legally accept as collateral. Thus private money sometimes fills the need for loans which would not otherwise be made. Many such loans entail more than average risk and, therefore, carry a higher interest rate than those made by institutional lenders. Individuals are also willing to make loans on terms so short that ordinary lenders are not interested because of the expense of placing the loan on their books.

Although loans made by individuals comprise only a small segment of all loans, they help to round out the loan market and fill in gaps left by the organized lenders. Vital as this is, they do not actively compete with the institutional lenders.

TABLE 14
NUMBER OF NONFARM DWELLING UNITS AND AVERAGE DEBT per UNIT

(Units in Millions)

Year (Dec. 31)	Total Number	Units in One- to Four-Family Dwellings			
		Total	Mortgaged	Debt-Free	Avg. Debt per Unit
1950	40.5	35.3	12.5	22.8	$ 3,614
1951	41.9	36.5	13.1	23.4	3,935
1952	43.1	37.6	13.8	23.8	4,252
1953	44.4	38.8	14.4	24.4	4,595
1954	45.6	40.0	15.2	24.8	4,993
1955	47.2	41.6	16.1	25.5	5,492
1956	48.6	42.9	16.8	26.1	5,886
1957	49.7	44.0	17.4	26.6	6,181
1958	50.9	45.0	18.1	26.9	6,516
1959	52.2	46.2	18.8	27.4	6,952

Source: Federal Home Loan Bank Board

CHART 1. TOTAL NONFARM MORTGAGE DEBT OUTSTANDING AT YEAR END

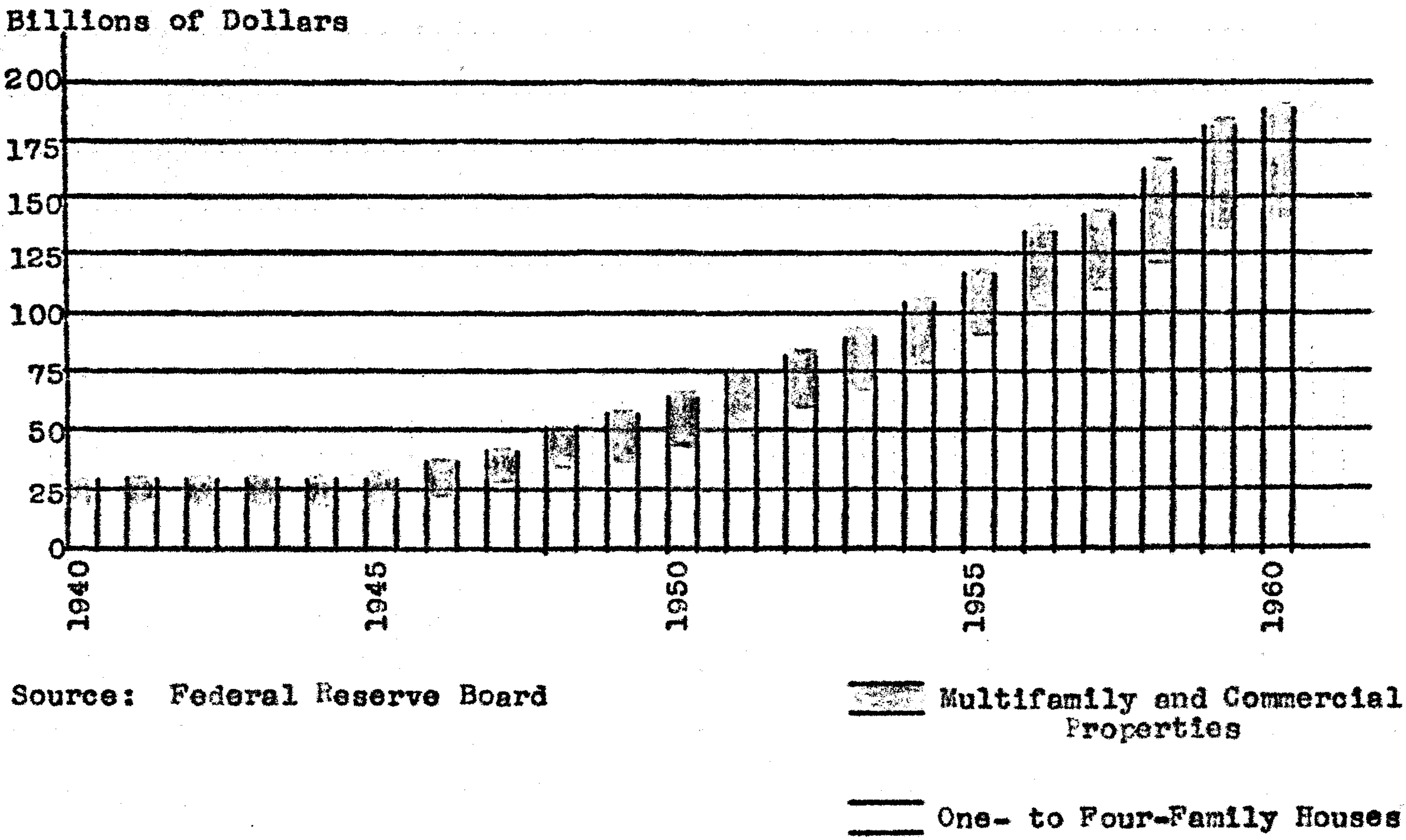


TABLE 15. MORTGAGE DEBT

1 - 4 Family Nonfarm Homes by Type of Lender

($000,000 Omitted)

Dec. 31	Total	Savings Assns.	Life Insurance Companies	Mutual Savings Banks	Commer-cial Banks	HOLC	FNMA	Individuals and othrs
1925	$ 12,984	$ 3,994	$ 837	$ 1,547	$ 1,376	--		$ 5,230
1930	18,891	6,082	1,732	2,341	2,199	--		6,537
1935	15,437	3,127	1,281	2,089	1,541	$2,897		4,502
1937	15,518	3,291	1,246	2,111	1,786	2,398		4,686
1938	15,775	3,433	1,330	2,119	1,910	2,169	$ 80	4,734
1939	16,342	3,616	1,495	2,128	2,096	2,038	144	4,825
1940	17,391	3,919	1,803	2,162	2,363	1,956	178	5,010
1941	18,351	4,349	1,969	2,189	2,672	1,777	203	5,192
1942	18,212	4,349	2,241	2,128	2,752	1,567	206	4,969
1943	17,811	4,355	2,386	2,033	2,706	1,338	60	4,933
1944	17,924	4,617	2,435	1,937	2,703	1,091	50	5,091
1945	18,591	5,156	2,306	1,894	2,875	852	7	5,501
1946	23,034	6,840	2,545	2,033	4,576	636	6	6,398
FHA	3,692	415	1,108	288	1,361	--	6	514
VA	2,400	977	254	194	890	--	0	85
Conventional	16,942	5,448	1,183	1,551	2,325	636	0	5,799
1947	28,199	8,475	3,497	2,283	6,303	486	4	7,151
FHA	3,781	409	1,281	275	1,394	--	4	418
VA	5,500	2,035	843	477	1,870	--	0	275
Conv.	18,918	6,031	1,373	1,531	3,039	486	00	6,458
1948	33,279	9,841	4,943	2,835	7,396	369	197	7,698
FHA	5,269	545	2,043	467	1,707	--	186	321
VA	7,200	2,397	1,104	755	2,230	--	11	703
Conv.	20,810	6,899	1,796	1,613	3,459	369	0	6,674

TABLE 15. MORTGAGE DEBT (Continued)

1 - 4 Family Nonfarm Homes by Type of Lender

($000,000 omitted)

Dec. 31	Total	Savings Assns.	Life Insurance Companies	Mutual Savings Banks	Commercial Banks	HOLC	FNMA	Individuals and Others
1949	$37,621	$11,117	$ 6,093	$ 3,364	$ 7,956	$ 231	$ 808	$ 8,052
FHA	6,906	685	2,785	605	2,002	---	383	446
VA	8,100	2,586	1,224	1,077	2,350	---	425	438
Conv.	22,615	7,846	2,084	1,682	3,604	231	0	7,168
1950	45,175	13,116	8,478	4,312	9,481	10	1,333	8,445
FHA	8,563	812	3,683	1,009	2,510	--	156	393
VA	10,300	2,973	2,026	1,457	2,630	--	1,177	37
Conv.	26,312	9,331	2,769	1,846	4,341	10	0	8,015
1951	51,718	14,844	10,610	5,331	10,275	--	1,825	8,833
FHA	9,677	840	4,120	1,543	2,812	--	181	181
VA	13,200	3,133	3,131	1,726	2,921	--	1,644	645
Conv.	28,841	10,871	3,359	2,062	4,542	--	0	8,007
1952	58,508	17,645	11,757	6,194	11,250	--	2,218	9,444
FHA	10,770	885	4,365	1,793	3,194	--	298	235
VA	14,600	3,394	3,347	2,237	3,012	--	1,920	690
Conv.	33,138	13,366	4,045	2,164	5,044	--	0	8,519
1953	66,102	20,999	13,195	7,373	12,025	--	2,365	10,145
FHA	11,990	1,020	4,673	2,020	3,529	--	526	222
VA	16,100	3,979	3,560	3,053	3,061	--	1,839	608
Conv.	38,012	16,000	4,962	2,300	5,435	--	0	9,315
1954	75,677	25,004	15,153	9,002	13,300	--	2,327	10,891
FHA	12,778	1,149	4,802	2,234	3,790	--	697	106
VA	19,300	4,709	4,643	4,262	3,350	---	1,630	706
Conv.	43,599	19,146	5,708	2,506	6,160	--	0	10,079

TABLE 15. MORTGAGE DEBT (Continued)

1 - 4 Family Nonfarm Homes by Type of Lender

($000,000 omitted)

Dec. 31	Total	Savings Assns.	Life Insurance Companies	Mutual Savings Banks	Commer-cial Banks	HOLC	FNMA	Individuals and Others
1955	$88,249	$30,001	$17,661	$11,100	$15,075	--	$2,443	$11,969
FHA	14,337	1,390	5,104	2,576	4,286	--	730	251
VA	24,600	5,883	6,074	5,773	3,711	--	1,713	1,446
Conv.	49,312	22,728	6,483	2,751	7,078	--	0	10,272
1956	99,001	34,004	20,130	12,990	16,245	--	2,867	12,765
FHA	15,505	1,472	5,381	2,897	4,515	--	799	441
VA	28,400	6,643	7,304	7,139	3,902	--	2,068	1,344
Conv.	55,096	25,889	7,445	2,954	7,828	--	0	10,980
1957	107,617	37,996	21,441	14,110	16,385	--	3,777	13,908
FHA	16,501	1,603	5,541	3,140	4,370	--	1,041	806
VA	30,700	7,011	7,721	7,790	3,589	--	2,736	1,853
Conv.	60,416	29,382	8,179	3,180	8,426	--	0	11,249
1958	117,687	42,890	22,374	15,640	17,628	--	3,580	15,575
FHA	19,725	2,157	6,279	3,829	4,846	--	1,164	1,450
VA	30,400	7,077	7,433	8,361	3,335	--	2,416	1,778
Conv.	67,562	33,656	8,662	3,450	9,447	--	0	12,347
1959	130,909	49,587	23,586	16,887	19,200	--	4,953	16,696
FHA	23,854	2,944	7,125	4,631	5,442	--	1,954	1,758
VA	30,000	7,187	7,086	8,589	3,161	--	2,984	993
Conv.	77,055	39,456	9,375	3,667	10,597	--	15	13,945
1960	142,000	56,160	24,985	18,395	19,295	--	5,536	17,629
FHA	26,750	3,130	7,945	5,055	6,020	--	2,673	1,927
VA	29,700	7,155	7,045	8,555	3,145	--	2,803	997
Conv.	85,550	45,875	9,995	4,785	10,130	--	60	14,705

Sources: Federal Home Loan Bank, Veterans Administration, Federal Housing Administration (HHFA), Federal National Mortgage Association (HHFA), and Office of the Administrator (HHFA)

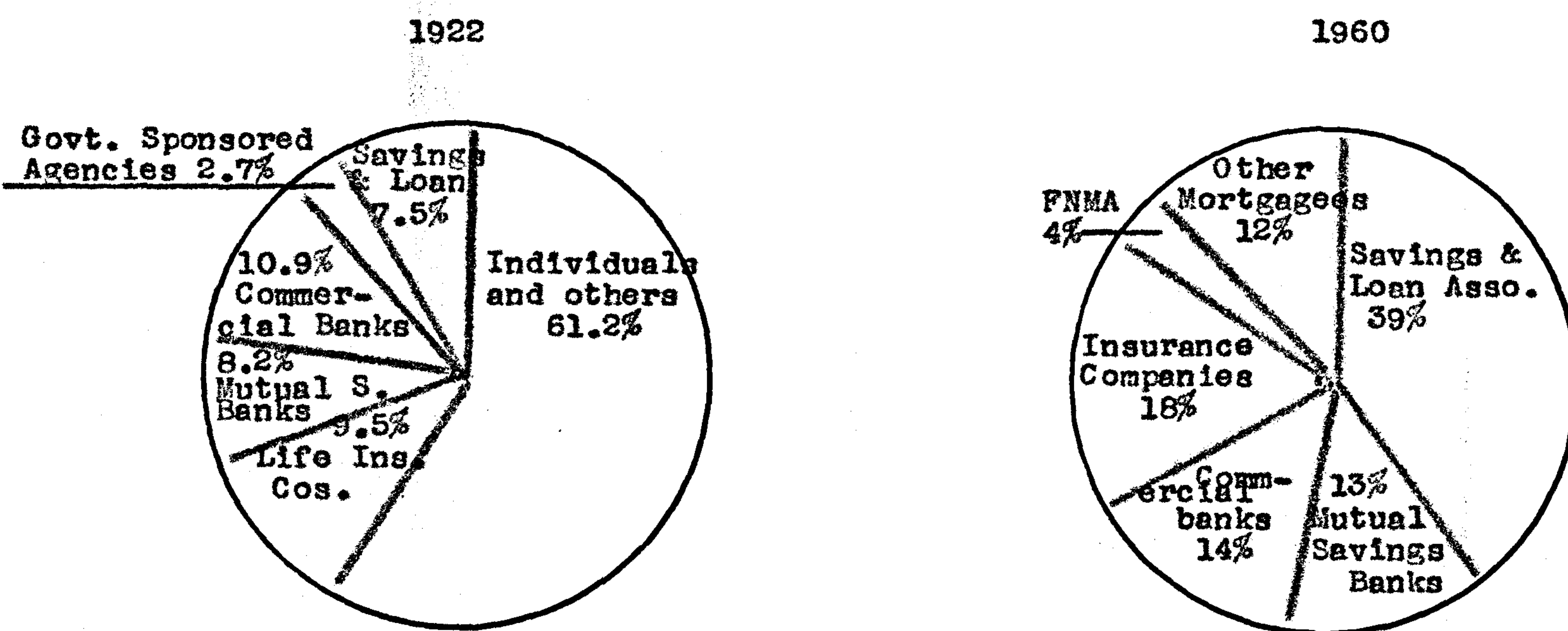
TABLE 16. MORTGAGE PORTFOLIO OF

SAVINGS AND LOAN ASSOCIATIONS

Year (Dec. 31)	Total Mortgage Portfolio		
	Amount (In Millions)	No. of Loans (In Thousands)	Av. Loan Balance
1948	$10,409	3,027	$3,439
1949	11,714	3,364	3,482
1950	13,714	3,763	3,644
1951	15,610	4,054	3,851
1952	18,416	4,452	4,137
1953	21,957	4,820	4,555
1954	26,088	5,308	4,915
1955	31,354	5,859	5,351
1956	35,719	6,303	5,667
1957	39,969	6,700	5,966
1958	45,478	7,269	6,257
1959	53,194	7,607	6,993
1960	60,084	7,985	7,525

Source: Federal Home Loan Bank Board.

Chart 2 TOTAL HOME MORTGAGE DEBT, BY TYPE OF LENDER
(Percentage Distribution)



Source: Federal Home Loan Bank Board

CHAPTER IX

SUMMARY AND CONCLUSIONS

Out of the economic crises of the early thirties there evolved a series of radical changes in the techniques of financing American real estate.

Although there was a substantial growth in mortgage debt outstanding during the 1920's, particularly from 1925 to 1929 when debt on 1- to 4-family nonfarm homes increased by 45%, financing terms then in use did not permit a rate of growth such as has been experienced during the current post-war period. Typical mortgage-loan terms rarely extended beyond ten years, and three- to five-year maturities were more common. Renewal at maturity provided a long-term characteristic, but the uneasy thought of refusal to renew was an obstacle to many borrowers--an obstacle which fully materialized in the 'thirties in the form of a flood of foreclosures leading to direct Government action. In addition to short terms, loan-to-value ratios were considerably lower than is common today. Loan amounts rarely exceeded two-thirds of the appraisal value and frequently were no more than fifty per cent. Interest rates were considerably higher than now.

The increased activity of the Federal Government in the mortgage market has been accompanied, in fact has induced, a near revolution in the methods of mortgage financing represented by longer maturities, lower equity requirements, and monthly payments covering not only interest and amortization of principal but also insurance and real property taxes.

The first action of the Government to alleviate the distress in the mortgage market during the depression was the creation in 1932 of the Federal Home Loan Bank System, the function of which was to assist member institutions, principally savings and loan associations, by lending to them on the security of their mortgages. Thus the Bank became a central reservoir of credit for the member associations which constitute the only national system of thrift institutions.

The Federal Savings and Loan Insurance Corporation established to insure savings and loan associations accounts has no doubt been a means of stimulating the rate of growth of these organizations and those that carry this insurance.

The first direct action of the Government in the mortgage field was the establishment of the Home Owners' Loan Corporation, the function of which was to make direct, monthly-amortized, 15 year loans to individuals faced with

foreclosure. More than 1,017,821 home loans were made by this agency for $3,500,000,000. No new loans were made after June 1936, when the necessity for the agency was passed, and by 1951 its entire portfolio had been liquidated--and at a profit.

With the change in emphasis from relief to recovery, Government action in the mortgage lending field changed from direct lending to action which would encourage private lenders to make funds available in adequate quantity and on terms which would meet the needs of lower-income people. The Federal Housing Administration was organized in 1934 principally to stimulate private mortgage lending on one- to four-family dwellings and on large rental properties, by insuring private loans. Loans for repairs to real property were also later included in the insurance program.

The Federal National Mortgage Association was set up in 1938 to create a better secondary market for mortgages as a further inducement to private lenders to extend their activities in this field. This agency has been one of the principal instrumentalities in developing the geographic redistribution of capital. It is authorized under prescribed conditions to engage in the purchasing and selling of FHA insured or VA guaranteed mortgages. As a general rule, its purchases have been made in areas where there is

a shortage of mortgage capital--where institutions have become over-invested in mortgages. Its sales have been made to institutions in capital surplus areas which are seeking an outlet for surplus funds.

An additional stimulus was given private lenders by a program similar to FHA through the Servicemen's Readjustment Act of 1944 in which provision was made for the guarantee of a specified percentage (with a maximum guarantee now of $7,500) of mortgage loans by the Veterans Administration.

Growth of Mortgage Capital

Life insurance companies, mutual savings banks, savings and loan associations, and the savings departments of commercial banks, constitute the main reservoir of the nation's savings. They are also the principal investors in mortgage securities. Over a 30-year period they have experienced a phenomenal growth. This period has also seen an equally amazing growth in such resources as pension and benefit funds. They, too, seek long-term investments and have recently shown a tendency to look to the mortgage market as an outlet for funds.

Geographic Shifts of Mortgage Capital

In some areas of the country, notably the northeast and middle-east, there is a surplus of mortgage capital.

In other areas, such as the southeast and southwest, there is a marked deficit. There is a heavy concentration of insurance companies and mutual savings banks in the northeast. A generation ago these mortgage investors conducted their business operations "in their own backyards". Insurance companies are now nationwide investors. The lending territory of mutual savings banks has been broadened by new legislative enactments. Much of the postwar residential development throughout the United States would have been impossible to finance without this re-allocation of mortgage capital.

Improved Appraisal and Lending Standards

Although the appraisal has always been an essential element of mortgage lending, it is only in recent years that lenders became concerned with the appraisal process itself. It is not so long ago that appraisals generally were unsubstantiated opinions. Appraisers were qualified in the sense that they had a broad experience in the real estate field. However, estimates of valuation were oftentimes arrived at by the "inspirational" system, or by the application of simple rules of thumb, such as multiples of income.

Today the appraiser's qualifications are still essential but he must also marshal, analyze, and present the

facts that will support his opinion. Appraisals have become more scientific with the passing of years, and mortgage lending institutions have been of material assistance in improving appraisal standards. In most institutions today the staff appraisers are trained men with specialized education in appraisal techniques and economics. Many of them are professional men, such as architects or engineers.

Since the appraisal is the foundation on which the loan is based, it follows almost automatically that lending practices in our institutions have been greatly improved. Many larger institutions have adopted a definite system of risk rating. In every institution where proper appraisal procedure is insisted on, there is a tacit recognition of the principle of risk rating, even though there may not be any exact mathematical calculation of the risk. Another progressive development in lending practice has been the growing recognition of the necessity of looking to the credit rating of the borrower, as additional security for the loan. Prior to 1930, mortgages generally were made with real estate as the sole security. The institution was apparently not too concerned with the borrower's ability to pay interest. If there was a default, the mortgage was foreclosed. The borrower might or might not be sued under the bond. Today, it is an

almost universal requirement in the case of one-family house loans that the borrower have a satisfactory credit rating. Such credit rating is also an essential feature in certain business and commercial loans. It is less often required in the case of income-producing property.

Loan Amortization

Today most lenders require that mortgage loan be amortized or reduced in full or in part during the term of the loan.

One-family house loans usually are "self-liquidating," i.e., the entire mortgage indebtedness is paid off during the time for which the loan runs. The majority of loans are written for 15 or 20 years. Because of the increased security derived from the regular repayment of the loan, institutions have increased loan maturities. Before 1930 the customary term was five years or less. Home owners faced a periodic threat that the loan would be called by the holder of the mortgage. A home owner today is secure in the knowledge that he will never face such a demand if he makes his regular monthly payments.

The importance of this comparatively new method of lending to both borrower and lender cannot be over-estimated. Depreciation in property value--particularly if the property is well maintained--is much slower than the rate of mortgage

repayment. The result is that the bank's aggregate risk, measured in terms of ratio of total loans to total value of mortgage properties is constantly being reduced.

Research

People who earn their livelihood from real estate have become more research-minded. This is true of those who finance real estate as well as of those who build and own it. There is a growing recognition of the fact that basic studies made by professionally trained persons such as economists, engineers, and architects can be of immense value in the day-to-day normal business operation. Research can not only develop new techniques but can also study existing operations, analyze them, and arrange for a transfer of information between organizations with common interests.

Research programs may be academic in their approach--that is, in the sense that they proceed along well defined scientific lines--but in their applications they can be extremely practical. Well-documented material is now available on such down-to-earth and basic questions as, "Where should I build my house?" "What kind of a house should I build?" "How should I build it?" and "How should I finance it?"

Many of the research programs are engaged in directly by government agencies or departments. Constituent agencies under the Housing and Home Finance Agency such as the FHA and the Federal Home Loan Bank have their own research departments. The Housing and Home Finance Agency's own central research bureau became active during 1953. Similarly, the Labor Department and the Commerce and Treasury Departments develop data that have application in the field of real estate finance. Private organizations also have research programs. Among these are the American Bankers Association, the National Association of Mutual Savings Banks, the Mortgage Bankers Association, and the National Association of Home Builders.

Large universities, with a growing awareness of the importance of real estate in our general economy, have gradually increased the number of courses available to undergraduates and graduate students on real estate subjects. Out of this there has naturally developed a wide variety of real estate research projects. Many of these projects have been sponsored and underwritten by private organizations or by the Federal Government.

Elimination of Unsound Practices

The far-reaching developments described above have all been beneficial to real estate interests. By making capital more readily available for soundly conceived

ventures, they have also had the beneficial effect of eliminating certain unsound practices that characterized real estate activity prior to 1930; practices such as secondary financing on one-family homes, excessive speculation in land subdivisions, and mortgage bond issues as a means of financing large projects.

In the days when 50 or 60 percent mortgages prevailed in the one-family house field, it was necessary for most purchasers to arrange for some sort of second mortgage financing. This complicated and raised the cost of legal arrangements prior to a sale. The carrying charges on these second mortgages were generally heavy because of the relative insecurity of the investment and because such money came from private sources. With the first mortgages available today (conventional in excess of 80 percent, FHA 97 percent and VA 100 percent), such financing is unnecessary. Indeed, under many forms of first-mortgage agreements on one-family houses second mortgages are prohibited.

The abundance of mortgage capital in lending institutions makes it unnecessary to resort to the device of selling first-mortgage bonds to the public as a means of obtaining necessary financing. Although there is nothing wrong with first-mortgage bonds in themselves, there was a great deal of over-financing by this method during the 1920's. Many thousands of persons sustained serious losses

through such investments. It seems unlikely that there will be much need for this financing device during the foreseeable future, excepting in individual cases.

In conclusion it seems that the desires of President Hoover, as set forth in his opening address to his conference on home finance and ownership of December 2, 1933 have been largely accomplished. This goal--to make it possible for anyone in the United States of sound character and industrious habits to own his home--has been brought about by the combined efforts of the various government agencies and private lending institutions herein discussed. In fact, they may have made it too easy to purchase homes as indicated by the sharp rise in foreclosures in the past three years, and by the fact that the Federal Housing Administration has publicly expressed concern over the increased foreclosure of FHA loans. This probably will mean more strict compliance to existing risk-rating procedures or possibly an increase in the required down payment. In the opinion of the author both of these steps will and should be taken in the near future.

APPENDIX A

Address of President Hoover at opening meeting of the President's Conference on Home Building and Home Ownership, Washington, D. C., Wednesday, December 2, 1931.

> You have come from every State in the Union to consider a matter of basic national interest. Your purpose is to consider it in its long view rather than its emergency aspects. Next to food and clothing the housing of a nation is its most vital social and economic problem. This conference has been called especially to consider one great segment of that problem--that is, in what manner can we facilitate the ownership of homes and how can we protect the owners of homes?
>
> The conference also has before it some phases of that other great segment of housing; that is, the standards of tenement and apartment dwellings. While at this time we give primary emphasis to home ownership in city, town, and farm, we are all of us concerned in the improvement of city housing. I hope we may at some future time subject the question of city housing to more definitely organized national intelligence through which we shall further establish standards which will give impetus to public understanding and public action, this, the question of blighted areas and slums in many of our great cities. I am confident that the sentiment for home ownership is so embedded in the American heart that millions of people who dwell in tenements, apartments, and rented rows of solid brick have the aspiration for wider opportunity in ownership of their own homes. To possess one's own home is the hope and ambition of almost every individual in our country, whether he lives in hotel, apartment, or tenement.
>
> While the purpose of this conference is to study and advise upon the very practical questions of home design, of materials, of building regulations, of zoning, of taxes, of

transportation, of financing, of parks and playgrounds, and other topics, yet behind it all every one of you here is impelled by the high ideal and aspiration that each family may pass their days in the home which they own; that they may nurture it as theirs; that it may be their castle in all that exquisite sentiment which it surrounds with the sweetness of family life. This aspiration penetrates the heart of our national well-being. It makes for happier married life, it makes for better children, it makes for confidence and security, it makes for courage to meet the battle of life, it makes for better citizenship. There can be no fear for a democracy or self-government or for liberty or freedom from home owners no matter how humble they may be.

There is a wide distinction between homes and mere housing. Those immortal ballads, Home, Sweet Home, My Old Kentucky Home, and the Little Gray Home in the West, were not written about tenements or apartments. They are the expressions of racial longing which find outlet in the living poetry and songs of our people. They were written about an individual abode, alive with the tender associations of childhood, the family life at the fireside, the free out of doors, the independence, the security, and the pride in possession of the family's own home--the very seat of its being.

That our people should live in their own homes is a sentiment deep in the heart of our race and American life. We know that as yet is not universally possible to all. We know that many of our people must at all times live under other conditions. But they never sing songs about a pile of rent receipts. To own one's own home is a physical expression of individualism, of enterprise, of independence, and of the freedom of spirit. We do not in our imagination attach to a transitory place that expression about a man's home being his castle, no matter what its constitutional rights may be.

But to return to our practical problems. Over 30 committees embracing the collective skill and experience of our country have been

voluntarily engaged for the past year in collecting the best of national experience from every part of our country, in collating it into definite recommendations for your consideration. Like the solution of all practical problems, the facts first must be discovered; they must be assembled in their true perspective; and the conclusions to be drawn from them must be the inexorable march of logic. This conference has not been called primarily on legislative questions. Its major purpose is to stimulate individual action. It seeks a better planned use of our Nation's energies and resources, especially those that are rooted in neighborliness and mutual help, and those that find expression in our great national voluntary organizations, in our schools and colleges, and in our research laboratories. The conference represents a place in our mastery of the forces that modern science and modern technology place at our disposal. It is not to set up government in the building of homes but to stimulate individual endeavor and make community conditions propitious. The basis of its action is to collate the whole of our experience to date, to establish standards, to advance thought to a new plane from which we may secure a revitalized start upon national progress in the building and owning of homes.

About a year ago we held in Washington such a conference as this in relation to the health and protection of children. That conference established new standards and a new and higher plane of understanding and action. It presented a set of standards and conclusions, and those conclusions, I am informed, have now been printed in literally millions of copies-- through the associations which were interested, through State authorities, and municipal authorities. They have penetrated the thought and permeated the practice of the Nation. Many conferences have been called by the governors of many States, by the mayors of many cities, to consider and apply their conclusions. Their actions have already wielded a powerful influence in the administrative functions of government from the Federal Government down to the smallest community. They have been made the basis of

legislative action. They have lifted the sense of public and individual responsibility in the Nation. And it is a result of this kind which we are confidently expecting from this conference.

I notice that some--not the members of these committees--have contended that the development of city and urban life necessarily has driven us to less and less possible ownership of homes. I do not agree with that. The very development of transportation, the advantages of distribution of industry to-day make the ownership of homes far more feasible and desirable than ever before. But it involves vast problems of city and industrial management which we should have the courage to face. It involves also a great problem of finance. The newly married pair setting out upon the stream of life seldom come to their new state with sufficient resources to purchase or enter upon that great adventure of life of building a home.

It has long been my opinion that we have fairly creditably solved every other segment of our credit structure more effectively than we have solved this one. In normal times the Federal Reserve System has given mobility to financing of commercial transactions. The agricultural banks and the insurance companies have given mobility to farm credit. The public exchanges have given mobility to the financing of industrial credit through stocks and bonds. Through various discount companies we have established mobility for the sale of automobiles and radio sets and fur coats on the installment plan, where 20 or 25 per cent cash payments are gratefully accepted.

We have in normal times, through the savings banks, insurance companies, the building and loan associations, and others, provided abundant and mobile finance for 50 per cent of the cost of a home through the first mortgage. But the definite problem is not presented by those who can find 50 per cent of the cost of a home. Our chief problem in finances relates to those who have an earnest desire for a home, who have a job and therefore possess sound character credit, but whose initial resources run to only 20 or 25 per cent.

These people would willingly work and ally all their rent and all their savings to gain for themselves this independence and security and social well-being. Such people are a good risk. They are the very basis of stability to the Nation. To find a way to meet their need is one of the problems that you have to consider; that is, how we can make a home available for installment purchase on terms that dignify the name credit and not upon terms and risks comparable to the credit extended by a pawnbroker. Our building and loan and many other associations have made an effort to find a solution for this group, but it is as yet largely unorganized and the question substantially unsolved.

I recently made a public proposal for the creation of a system of home loan discount banks. That proposal is familiar to you, and I will not traverse its details at the present time. It was brought forward partially to meet the situation presented by the present emergency, to alleviate the hardships that exist amongst home owners to-day, and to revitalize the building of homes as a factor of economic recovery, but in its long-distance view it was put forward in the confidence that through the creation of an institution of this character we could gradually work out the problem of systematically promoted home ownership on such terms of sound finance as people who have the home-owning aspiration deserve in our country.

And there are many other problems involved in your investigations which bear equal importance to the problem of home financing. The surroundings in which such homes are to be built; the very method of their building; transportation and other facilities which must be provided for them; and the protection that must be given to them from the encroachment of commerce and industry. All of these and many other subjects you will compass. You should be in a position when you complete your work to advise our country of new standards and new ideals for our country.

I wish to express our gratitude, in which I know you will all join, to the hundreds of committee members who have labored so devotedly and capably in preparation for your conference. I assure you of my appreciation for your coming and my confidence of the high results that will flow from your deliberations.

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