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CHAPTER 3

Services and Credit Terms of Federal Credit Agencies

THE purpose of the present chapter is to give a brief description of the various credit services provided by the federal government. With more detailed accounts reserved for Part II (in which Chapters 6, 7, and 8 are devoted in turn to the credit services available to agriculture, business, and urban real estate), the focus here is on the broad, distinguishing features of federal credit programs as a whole, and, especially, on points of similarity and difference among specific programs.

Perhaps the most important feature in which the various credit programs of the federal government differ is the directness of the intervention involved. On this ground one can distinguish sharply between the programs developed in agriculture and in housing and those directed to the assistance of business concerns. In agriculture and urban housing, intervention has been relatively indirect, though the specific methods pursued in the two fields have been quite different. In aiding business, on the other hand, the federal government has, in most cases, employed techniques of direct intervention.

In agriculture, much (though not all) of the government's aid has been given principally through the medium of farmer-owned, cooperative credit institutions. These have operated initially with federal funds but under plans to eliminate government capital, and with a few exceptions this goal has been achieved. The agencies concerned—federal land banks, federal intermediate credit banks, production credit corporations, production credit associations, and banks for cooperatives—are federally sponsored institutions in the language of this study; not only do they closely resemble private financial institutions in organization and management, but in some cases they serve markets that are broadly similar to those served by private finance. Indeed, it is in the agricultural areas that competition between private finance and the federal government is closest and most extensive.

In the housing field, direct intervention has been minimized by using chiefly (though, again, not exclusively) the technique of loan insurance or guaranty. The hand of the federal government is felt

less directly by private finance when the government insures or guarantees a loan than when it is the sole maker of the loan.

Federal credit programs in the business field have been of a quite different character. In this area the government has made no effort to sponsor specialized credit institutions of the cooperative type, though there have been discussions from time to time of the desirability of regional investment companies. And although the technique of loan insurance and loan guarantees has been employed, notably in the guarantee of war and defense production loans, for the most part federal credit programs designed to aid business have consisted of direct loans made under circumstances in which the hand of the federal government has been obvious. It is perhaps this feature which has made them more controversial than the programs pursued in aid of agriculture and of urban housing, despite their small volume in comparison to the total of credit to business.

There is no great difficulty in explaining why federal credit programs have taken such different turns in these three areas. In agriculture, a tradition of cooperatively organized enterprises was already of long standing, here and abroad, when the federal land bank system was set up in 1917. At that time, two types of agencies were established under the Federal Farm Loan Act: the federal land banks, organized on a cooperative basis, and the joint stock land banks, intended to be privately owned and operated. A need was felt for agencies to supplement private lending institutions, and in a spirit of compromise the two types were established, one wholly private and the other aided by federal subsidy.

It is also understandable that federal aid to homeowners followed the course described above. The need in this case was not for the creation of new institutions to fill a gap in credit supply but rather to induce existing institutions to increase their investments in the home mortgage field. Thus financial aid took the form of offering loan insurance as a protection to private lenders. Criticism of the program was held to a relatively minor amount by the indirectness of the federal government's approach.

The situation was quite different when the programs of credit assistance to business were initiated. For the most part these were designed hastily to meet dire emergencies, when there was neither the opportunity to create institutions of the federally sponsored type, nor the practical possibility of inducing an increased flow of private investment funds under the protection of loan insurance. Techniques

of the latter type were used later, but not in the critical days of the early thirties. The firms needing aid at that time were unable to borrow from private financing institutions and probably could not have borrowed even under the protective cloak of a loan guarantee. To some extent this situation was altered in later years, which accounts for the growth of the Reconstruction Finance Corporation's participation lending and, more recently, the Small Business Administration's emphasis on its participation program. But in the early thirties the federal government had no choice except to establish agencies that would make loans directly to business concerns or to stay out of the field altogether.

We may turn now to a comparison of the various services that have been available under federal credit programs.

Agriculture

Whereas federal credit services in the business and urban housing sectors of the economy have been directed to rather limited segments of the market, the federal government has made a full line of credit services available to farmers. Long-term mortgage credit has been obtainable since 1917 through the farmer-owned federal land banks, and short-term production credit since 1933 through local production credit associations, also farmer-owned. These two credit systems lend to farmers of good and often superior credit standing, but other programs are available to assist borrowers less well situated. The Farmers Home Administration offers short- and long-term credit to farmers unable to obtain financing from private sources and in the 1930's other agencies, notably the office of the Land Bank Commissioner, acting for the Federal Farm Mortgage Corporation, supplied large amounts of mortgage credit to farmers experiencing acute difficulties as a result of agricultural depression. Finally, specialized credit services are available to farmers' marketing, processing, and purchasing cooperatives through the banks for cooperatives and to electric light and power coöperatives through the Rural Electrification Administration. A view of the current organization of federal and federally sponsored farm credit agencies and the amount of their credit outstanding on January 1, 1953 is given in Table 11.

The federal land banks, one of which is located in each of the twelve districts of the Farm Credit Administration, were the first of the federally sponsored farm credit agencies to be established. Operating since 1917 through a system of national farm loan asso-

TABLE 11

Federal and Federally Sponsored Agricultural Credit Agencies: Organization as of January 1953
(data on amounts outstanding for January 1, 1953)

Agricultural Credit Group
(Assistant to Secretary of Agriculture)

Farm Credit Administration			*Farmers Home Administration*		*Rural Electrification Administration*
			Real Estate Loans	*Non-Real-Estate Loans*	
12 federal land banks 1,164 national farm loan associations ($1,078 million exclusive of purchase money mortgages and real estate sales contracts)	12 federal intermediate credit banks[a] 12 production credit corporations 499 production credit associations ($606 million outstanding)	Central bank and 12 district banks for cooperatives ($419 million outstanding)	($193 million direct farm ownership loans; $52 million insured farm ownership loans; $70 million farm housing loans outstanding)	($294 million production and subsistence loans; $29 million disaster, fur and orchard loans; $30 million emergency crop and feed loans and $8 million loans to cooperatives and defense relocation corporations outstanding)	(1,019 REA-financed systems in operation; $2.2 billion advanced; 3.9 million consumers connected as of January 1, 1953)

From *Agricultural Statistics, 1953* (Department of Agriculture), pp. 652–663 *passim*; covers United States and possessions. Outstandings refer to amounts owed by ultimate borrowers (i.e. interagency loans are excluded). Besides those shown, the Federal Farm Mortgage Corporation, from whose funds Land Bank Commissioner loans were made until the program went into liquidation in 1947, had $23 million outstanding.

[a] In addition to serving as a major source of financing for PCA's the intermediate credit banks make advances to privately capitalized credit corporations ($91 million outstanding) and also may make production loans directly ($2 million outstanding). Organizationally, the intermediate credit banks are a separate service in the Farm Credit Administration from the production credit service.

ciations, which are local farmer-owned institutions now totaling around 1,200, the district banks are at present entirely farmer-owned, though subject to fairly direct and extensive federal control and supervision. They make amortized, long-term mortgage loans (with maturities usually of twenty to thirty-three years) to farm and ranch operators and in special cases to livestock corporations. Perhaps the most interesting feature of the system is that land bank loans must meet credit standards roughly comparable with those employed by private lending institutions.

The coöperative feature of the land bank system is devised along lines that were without a close precedent when first put into effect and have never been exactly duplicated elsewhere in federal credit programs. The farmer who wishes to borrow deals directly with his local national farm loan association and is required to purchase stock in it (which generally has been dividend-paying) equal to 5 percent of the amount borrowed. The association, in turn, makes an equivalent investment in land bank stock, and the loan is made by the land bank, with the endorsement of the local association, under a risk-sharing arrangement which in most cases provides for a division of losses about equally between the two institutions. The land banks were originally provided with capital by the federal government, but under the mutuality feature described they have been able to retire all government capital. From time to time an individual land bank may employ federal funds, but the system is to all intents and purposes now wholly farmer-owned.

Because land bank loans are screened much like those by private agencies, the markets served by the two systems are roughly comparable. Yet there are certain features of land bank policy that reflect the semipublic nature of the banks. Most obvious, perhaps, is the fact that interest rates on land bank mortgage loans are identical throughout given districts and vary only moderately over the country as a whole. In 1953, for example, they were 4 percent in all districts except Springfield, Baltimore, and Columbia, where they were 4½ or 5 percent.[1] There are no differences in rates within districts on loans of different amounts, a practice quite at variance with the methods of private finance, where rates commonly vary with loan size and with the type and quality of the collateral.

[1] *Annual Report* of the Farm Credit Administration, 1952–1953, p. 64.

Secondly, the rates charged by the land banks have been, on the average, lower than those available through private financial channels. Thus, in 1953 the average contract rate on farm mortgage loans for all private lenders was 4.7 percent, in contrast to the 4 percent rate available in nine of the twelve farm credit districts.[2]

Other things equal, uniform or nearly uniform interest rates quoted below the going market level are destined to claim for the lender an increasing share of the market; this has been the case in the farm mortgage field, though other factors as well have affected the competitive position of the land banks. For example, the land banks have been limited by Congress, or by their own administrative decisions, as to the amounts that may be loaned in given situations. From 1917 to 1933 they could not loan more than 50 percent of the current market value of the land plus 20 percent of the current value of the farm's permanent, insured improvements. Under that fairly restrictive limitation, the program accounted for a relatively small portion of farm mortgage lending. In 1933 and 1934, steps were taken to make land bank credit more readily available for refinancing defaulted or distressed farm mortgages. First, the Emergency Farm Mortgage Act of 1933 authorized the land banks to make loans directly to farmers, not only where existing national farm loan associations were unable to accept applications because of their financial condition, but even in areas where associations had not been organized. Second, $200 million was made available to the Land Bank Commissioner (the officer of the Farm Credit Administration having direct responsibility for the land bank program) for emergency loans, a program designed to aid the most distressed farmers, and which was expanded in 1934 with the establishment of the Federal Farm Mortgage Corporation. Under it, loans could be made up to 75 percent of a farm's normal agricultural value, defined as the amount a typical purchaser would be justified in paying for the farm under conditions of customary agricultural use, average yields, and farm product prices such as might prevail in years reasonably free of inflation and deflation.[3] Thus Commissioner loans, as they were called, could be secured by first mortgages on farms not up to land bank standards; and, further, they could be made on second

[2] *Agricultural Finance Review* (Agricultural Research Service), Vol. 16, November 1953, Table 2, p. 92.

[3] In general the period from 1909 to 1914 was accepted as representing normality for farm product prices, although in some cases allowances were made for commodity prospects and for other conditions and prospects in particular regions.

mortgages supplemental to regular land bank loans. Commissioner loans were first available to farmers at a 5 percent rate, but this was lowered to 4 percent from mid-1937 to the end of 1939 and lowered again, to 3½ percent, in 1940–1944. The rate was adjusted back to 4 percent in 1945. Contract terms were set at forty years, and the loans were made repayable over their term by fixed annual or semiannual installments.

Appraisal of regular land bank loans, too, was put on the normal agricultural value basis in 1933, and the interest rate was lowered from 4½ to 3½ percent in mid-1935 and remained there through mid-1944.

The Land Bank Commissioner was also authorized by Congress in 1935 to make loans to part-time farmers on what was termed a "prudent investment value" basis. The intention was to give special assistance to farmers who were supplementing their farm income by means of off-farm work and so to strengthen a group of farm borrowers regarded as being especially hard-pressed. In all, around 5,300 such loans were made during the period of the program, from early 1935 through mid-1946.

As a result of liberalization in appraisal policies, low interest charges, and the adoption of emergency measures which made it possible for farmers' debts to be scaled down to the point where they could be refinanced with district land banks or with the Land Bank Commissioner, the proportion of all farm mortgage credit extended by federal and federally sponsored agencies increased greatly during the mid-thirties.

In 1945 the limit on land bank mortgage loans was increased to 65 percent of a farm's normal agricultural value. By then, however, inflationary trends were evident in the farm economy and the appraisal method employing normal agricultural value was more restrictive than a method employing current value. As a result the land banks in recent years have had a surplus of loanable funds. As would be expected, the appraisal policy has had the effect in some districts of limiting land bank lending to well-established farmers whose mortgage requirements were modest compared with the collateral they could offer.

The second farm credit network developed by the federal government is the production credit system, consisting of: local production credit associations, presently numbering around 500, from which farmers may obtain short-term production loans; the federal inter-

mediate credit banks, district banks from which a good part of the funds loaned by local associations are obtained; and the production credit corporations, one in each farm credit district, through which the federal government provides equity funds to local associations. As in the land bank system, there is a cooperative element in the production credit system, though it has not been carried as far: farmers borrowing from local associations are required to purchase capital stock in their association (usually a dividend-paying investment) equaling at least 5 percent of the amount borrowed, but the PCA's do not, in turn, buy stock in the FICB's. Stock purchases by farmer borrowers have enabled the PCA's to retire virtually all government capital.

There is somewhat greater variability in the rates charged by PCA's than in those charged by the land banks; furthermore, PCA rates are relatively close to those charged by commercial banks, with which they are in close competition. In 1951, for example, PCA loans carried contract interest rates of between 4½ and 6 percent, and in 1952 and 1953 the range had been raised to from 5 to 6¾ percent. In a certain sense, this relatively high level of rates symbolizes the fact that PCA's do not operate as emergency lending institutions. Indeed their average loan is so large in comparison to the average commercial bank loan that there is strong reason for believing that PCA's serve farmers who are on the whole operating larger, and presumably better established and more profitable, farms. The average PCA loan in 1950 was around $3,700 and an average commercial bank farm production loan was around $2,300; in some farm credit districts, the difference was even greater.

Loans made by the production credit associations are usually secured by a first lien on crops, livestock, or equipment and are generally written on a basis which requires repayment or extension within one year. It was calculated that, taking account of both interest and other charges, the average total cost of PCA loans to borrowers was 6.4 percent during the calendar year 1952.[4]

The resources of the local PCA's are obtained largely, as has been indicated, from district federal intermediate credit banks. The latter discount notes not only for the PCA's but for federally sponsored banks for cooperatives and also for private financial institutions, though the great bulk of their activity is in the discounting of PCA paper. Just under 85 percent of the total credit extended by the

[4] *Annual Report* of the Farm Credit Administration, 1952–1953, p. 31.

FICB's through mid-1953 went to the local PCA's.[5] For the most part these loans mature in one year, but the term may extend up to three years. The discount rates are determined by reference to the cost of money to the intermediate credit bank, which raises its funds mainly through the sale of debentures in the open investment markets. In mid-1953 the cost of intermediate credit bank borrowing for the PCA's was between 2½ and 3 percent with some variation from one district to another.

A third federally sponsored farm credit system—the central and regional banks for cooperatives—lends to cooperatives engaged in marketing agricultural products, purchasing farm supplies, or furnishing farm business services. Three kinds of loans are provided. Long-term facility loans for the construction or acquisition of buildings or equipment for storing or marketing of farm commodities and food products are made on first mortgage security, usually at the same interest rate as on land bank mortgage loans and with a similar cooperative arrangement (i.e. the borrower must purchase stock in the lending bank, or make a guaranty fund payment, equal to 5 percent of the loan). Short-term, operating capital loans, which may or may not be secured, are available at rates of 3 to 3½ percent (1954), with a stock purchase or guaranty fund payment equal to 5 percent of the loan amount. Commodity loans secured by first liens or other title to storable commodities are made to mature at the end of the current marketing year or season and have carried relatively low interest rates: 1½ percent during most of the forties, 2¾ to 3¼ percent (depending on the credit district) in 1954, with a stock purchase or guaranty fund payment equal to 1 percent of the loan.

Evidence by which to compare public and private lending to farm cooperative associations is limited as to area and time, but there are some indications (as will be seen in Chapter 6) that the federally sponsored banks have tended to serve more the larger associations borrowing comparatively large amounts, and constituting presumably better than average credit risks. This may be due to the relatively large resources of the public banks for cooperatives as compared with local, private banking institutions and to the fact that the commercial banks, unlike the banks for cooperatives, cannot (with but few exceptions) make loans in excess of 10 percent of their capital.

[5] *Ibid.*, p. 36.

Also serving cooperative enterprises, but lacking the cooperative feature of the banks for cooperatives and other federally sponsored farm credit agencies, is the Rural Electrification Administration, a direct agency of the federal government. The REA extends mortgage loans to persons, corporations, states, territories, municipalities, public utility districts, and cooperative, nonprofit or limited dividend associations, to finance generating plants and electric transmission and distribution lines for furnishing electric service to persons in rural areas not receiving central station electric service. REA loaned to 1,080 borrowers from 1935 to mid-1953, and over nine-tenths of them were cooperatives.[6] Loans for telephone facilities were authorized on October 28, 1949 and had been made to 112 cooperatives and 107 commercial companies as of June 30, 1953. The credit policy has been a liberal one: the interest rate is currently at 2 percent, and loans are made in amounts up to 100 percent of the cost of constructing the facilities involved. The basic policy of REA has been to extend service throughout each area entered, even though certain of the power lines may prove unprofitable, the aim being to serve farm families in outlying districts as well as those located near the main lines.

With the exception of the so-called Commissioner loans and some of the REA loans, all of the programs described above have served borrowers equally well or better established creditwise than the average client of private lending institutions. The federal government has also extended credit to farmers unable to borrow from private agencies of finance. One such program is that of the Farmers Home Administration, which was formed in 1946 in a reorganization of the Farm Security Administration and which has operated as a direct lending and loan-insuring agency in the long- and short-term fields. In addition to farm mortgage loans to farmers unable to obtain credit from other sources, the program has made disaster loans (in designated areas) to enable farmers suffering losses from drought, flood, or other disaster to continue production; supplied credit for the development of water facilities; and relieved conditions of acute economic distress, as with the livestock loans of 1953. In 1949 the agency was authorized to make loans for the construction and repair of farm houses and other farm buildings, where such credit was unobtainable from private sources.

Interest rates and other contract terms on Farmers Home Ad-

[6] *Agricultural Statistics, 1953* (Department of Agriculture), p. 662.

ministration loans have varied according to the purpose, water facility and disaster loans being made in 1952 at 3 percent, real estate loans at 4 percent, and the production and subsistence and fur and orchard loans at 5 percent. Farm ownership loans have been made for as long as forty years on an amortized basis in amounts not to exceed $12,000; farm housing loans have also been made for long terms, ranging up to thirty-three years. Water facility loans have had a maximum limit of $100,000 (but have averaged much less), and have been made for terms up to twenty years. Production and subsistence loans have been made for terms up to seven years and on a basis which requires repayment coincidental with the receipt of income. Disaster loans and the fur and orchard loans have been made up to five to ten years. In general, the loan contracts have been designed to meet the special circumstances that gave rise to the programs.

Since 1947, when a program of mortgage insurance became active, the Farmers Home Administration has insured loans made by private lenders, and has made direct loans to help tenants to become farm owners, to finance farm enlargement, to finance farm capital improvements, and to aid in project liquidation. The loans made or insured under this program have been smaller than the usual farm mortgage loans made by private lenders and have been made for the most part in areas of relatively low income. As of January 1953 over half of the agency's $258 million of farm ownership and farm housing loans outstanding in continental United States were in the twelve southern states extending from the Carolinas to Texas.[7]

Similarly, farmers obtaining non-real-estate loans from the Farmers Home Administration have for the most part been those faced with emergency situations arising from crop failure, low farm product prices, and other adversities. It should be mentioned, finally, that in addition to its lending services the Farmers Home Administration has aided borrowers in farm and home planning through its advisory services.

Business

Federal credit programs for business, in contrast to those for agriculture, have almost all been administered through agencies that are integral parts of the federal establishment. The only exceptions are a program of industrial loans begun in the mid-1930's and a guar-

[7] *Agricultural Finance Review,* Vol. 16, November 1953, p. 93.

antee program during and after World War II, both involving the Federal Reserve Banks. Yet this directness of action through its own agencies has not brought the federal government into such close competition with private financial institutions as have the quasi-public programs in agriculture. For one thing, its business loans have been directed predominantly to concerns which, either because they were newly established or had encountered some special difficulty, have been unable to obtain private credit of the type, or in the amount, which they sought; second, the extensive use of the technique of loan guarantees and the sharing of loans with private banking institutions has given the business lending programs a less abrasive effect as far as private lenders are concerned.

The limited line of credit services available to business through federal agencies contrasts both with the completeness and variety of those in agriculture and with the broad array of credits conventionally employed by business concerns. Short-term working capital loans from banks and long-term debt financing obtained through the open market, and, particularly for small and medium-sized firms, trade or mercantile credit obtained from suppliers, have been the traditional sources of funds for business, types of credit offered seldom or not at all in federal business lending programs. The latter have operated mainly in the comparatively small field of intermediate-term loans, with maturities ranging from one to ten years. Term lending has been more widely practiced by private lending institutions during the past fifteen years or so than before, which accounts in good part for the somewhat more intense competitive relationship between public and private credit agencies at the end of the thirties and in the postwar period than prevailed when the federal government's programs were started in the early thirties. A brief description of federal credit services to business follows, treating separately of the direct lending programs and of the programs in which federal agencies function in collaboration with private lenders.

The principal agencies through which the federal government has made direct loans to business firms have been the Reconstruction Finance Corporation, the Federal Reserve Banks, the Export-Import Bank of Washington, the Maritime Administration, and the Small Business Administration (formed in 1953 on the termination of RFC).

RFC, at first narrowly restricted by law in its lending field and credit standards, in 1934 received very broad powers to aid all types

of businesses unable to obtain credit from private sources. In volume of direct business loans its program was by far the most important of those named, totaling $15 billion from 1934 through 1953. Export-Import Bank loans financing foreign trade with United States firms, extended partly to help reconstruct and stabilize foreign economies or facilitate lend-lease termination, were second in volume, totaling $4.6 billion from 1934 through 1953. The Federal Reserve Banks have extended working capital loans, comparatively small in total volume, where unavailable from private lenders; and the Maritime Administration has financed the construction or reconditioning of American-owned vessels, especially for use in foreign service.

The predominantly medium-term character of federal loans to business has been mentioned. For instance, about 70 percent of the total amount loaned by RFC carried maturities of 4 years, 7 months or longer.[8] Though some Export-Import Bank loans were for as much as twenty years, about 70 percent of the bank's loans outstanding at the end of 1953 had original maturities of ten years or less. Federal Reserve working capital loans were of shorter contract length, not exceeding five years.

On the average the loans have been of medium size, as compared to business term loans of private lenders, which suggests that medium-sized businesses have been the main group of borrowers served. The average size of commercial bank business term loans made during 1946 was about $27,000.[9] Since about half of the total amount was in very large loans, it is apparent from the smallness of the average that the great majority of the bank term loans were small loans, to small firms. In contrast, the average size of direct business loans made by RFC during 1934–1951 was some $70,000,[10] and of industrial loans approved by the Federal Reserve Banks through 1950, about $175,000.[11]

RFC maintained a uniform interest rate for all types and sizes

[8] See Table B-2. In comparison, 46 percent of all commercial bank credit to business outstanding in 1946 had been written for terms of five years or less (Duncan McC. Holthausen, "Term Lending to Business by Commercial Banks in 1946," *Federal Reserve Bulletin*, May 1947, Table 14, p. 513).

[9] From a sample survey of member banks in the Federal Reserve system (Holthausen, *op.cit.*, Table 6, p. 505). An estimated 119,000 loans with maturities of one year or more were made, totaling $3.2 billion exclusive of repayments during the year.

[10] See Table B-1.

[11] *Federal Reserve Bulletin*, December 1951, p. 1541. Up to December 31, 1950, 3,698 applications had been approved for a total of $651,389,000.

of loans and in all regions; adjusted from time to time—from 6 to 5 percent in 1935, to 4 percent in 1939, and to 5 percent in 1950—usually it was below the average bank rates on roughly comparable credit. Interest charges on Export-Import Bank loans varied rather widely, with rates of 3½ to 4 percent the most frequent for loans outstanding in 1953. The Maritime Administration discriminated in favor of ships used in foreign service, these having credit available at 3½ percent as compared with 5¼ percent for ships used in domestic service. Rates on Federal Reserve Bank working capital loans ranged from 4 to 6 percent when the program was most active.

The stated policy of federal agencies supplying business credit has been to lend only where credit was unavailable from private sources. At the same time, federal statutes have embodied credit standards limiting the agencies' operations. The RFC Act required that loans should be "so secured or of such sound value as reasonably to assure repayment," and RFC in practice required the borrower to provide collateral security adequate in its estimation to protect the loan. Not that the current market value of collateral had to equal or excel the amount of a loan; rather, the long-run anticipated value should exceed it. Similar provisions for the other business lending agencies, as well, show that Congress has not viewed business credit programs as disguised grants, but has intended that normal banking measures be taken to assure their repayment; and in practice, collateral has been required.

The fact that the Reconstruction Finance Corporation regarded its business loans as sufficiently secured to assure repayment did not necessarily mean that the loan was of such high standing that it should have been available through private sources. In the first place, a private banking institution might well have questioned the adequacy or acceptability of the collateral regarded as sufficient by RFC. Moreover, the legal framework within which banking institutions operate, the policy of bank examining authorities, the liquidity needs imposed by slender capital resources and high ratios of demand deposits to total liabilities, unfamiliarity with a particular type of credit, and other such factors may affect the availability of bank credit. At any rate, it seems clear that RFC undertook to make loans involving higher risks than many banks could or would assume. Broadly speaking, the same appears true of other federal business lending agencies.

Unlike the federal loan programs in agriculture and in housing,

which in several outstanding cases were introduced and administered in large part with the object of relieving financial institutions of illiquid assets and loans of dubious quality, federal business credit programs have tended to avoid the policy of "bailing out" private credit institutions. Nonetheless, a fairly substantial part of the funds advanced by federal agencies to business was used to pay existing debt.

Finally, federal loans to business have been used rather extensively to finance new businesses and firms establishing themselves in new industries. In this respect the programs differ from those pursued in other sectors of the economy and, to a very considerable extent, from the activities of commercial banking institutions.

COLLABORATIVE FINANCING ARRANGEMENTS BETWEEN PUBLIC AND PRIVATE AGENCIES

In every one of the federal business lending programs an effort has been made to extend credit, whenever possible, under some form of collaborative arrangement with private financing institutions. To do so was not possible in all cases, but the participation of private lenders has been obtained in a high proportion of all loans. The RFC did it through entering into immediate or deferred participations with private lenders, and this technique has been continued, with somewhat greater emphasis, by the Small Business Administration. Furthermore, for roughly two years beginning in March 1945, the RFC offered automatic guarantees to commercial banks under its so-called blanket participation agreements, which provided that a commercial bank was automatically assured of a deferred participation by RFC of up to 75 percent of the amount of any business loan which it made in conformity with RFC statutory loan restrictions and subject to certain size limitations. The Federal Reserve Banks and the Export-Import Bank have also made a special point of participation with private agencies. In amount, however, the most extensive program of this type was that under which the War and Navy Departments and the U.S. Maritime Commission, through the Federal Reserve Banks as agents, guaranteed loans to war contractors under Regulation V, working capital loans for the transition from defense to civilian activities, and loans to release funds tied up in terminated government contracts.

The fees charged for guarantee or deferred participation commitments have varied considerably on different types of transactions. In

the case of the RFC the portion protected varied from 50 to 90 percent of the total loan amount, with the fee charged for the guarantee commitment being graduated, at first, from a lower limit of $\frac{1}{2}$ percent, depending upon the duration of the proposed guarantee; during the thirties the fees were raised, then lowered, and finally in 1950 they were sharply raised, to a flat 2 percent. Most of the industrial advances which carried Federal Reserve Bank guarantees involved protection of 50 percent of the loan amount, and commitment fees ranged from $\frac{1}{2}$ to 2 percent in the early years of the program and from $\frac{1}{2}$ to $1\frac{1}{4}$ percent after 1945.

A special study of loans made by private lenders with immediate or deferred RFC participation revealed that they were predominantly of medium and large size, averaging about twice the size of loans made wholly by RFC and well over three times the size of term loans made independently by banks. The banks involved were usually institutions of medium and large size, located in cities of medium or large populations. Only a small fraction of the banks eligible for RFC participation chose to use it; 99 banks accounted for roughly a third of the number and half of the amount of loans involving RFC participation. The fact that a quarter of the participation loans were for amounts which exceeded the legal loan limit of the bank involved suggests that the opportunity of making larger loans than the statutes or the diversification policies of bank managements would ordinarily permit was a major reason why RFC collaboration was sought out.

Special interest attaches to the program initiated in 1944 under which the Veterans' Administration guarantees up to 50 percent of the amount of a business loan made to an eligible veteran provided the guarantee does not exceed $4,000 on a loan secured by real estate or $2,000 on a loan secured by other collateral or unsecured. This program is distinctive in that VA was not given the authority to lend directly to business but only to guarantee loans made by private institutions, and in that the program was unrestricted as among eligible borrowers. The business loans guaranteed by VA have consisted mainly of credits to very small firms, made in relatively small amounts, and on maturities that run in the neighborhood of three years. They have been marked by an unusually high application to the financing of new businesses and have probably served to attract considerably more funds into this area than would otherwise have been directed to it.

Housing

The federal credit aids available to homeowners, home financing institutions, and builders are also fairly limited in scope and variety; but whereas the narrowly focused programs of credit aid to business have had little influence outside of the immediate area to which they have been directed, the impact of federal housing credit programs has been felt throughout the housing field. The general arrangement of the program through which credit aids to housing are currently administered is shown in Table 12.

The Home Loan Bank system—which consists of the Home Loan Bank Board, the eleven Home Loan Banks, the Federal Savings and Loan Insurance Corporation and the member savings and loan associations (all those federally chartered and state associations choosing to affiliate themselves)—was the first of the housing credit programs to be established. It was set up in 1932 to provide credit to home financing institutions on a plan similar in some respects to that by which commercial banks obtain credit through the Federal Reserve Banks. The facilities of the Home Loan Banks have been used extensively: in mid-1936, 64 percent of the eligible members were indebted to the Home Loan Banks; at the end of 1949, 47 percent and at the end of 1953, 52 percent.[12] Although the Home Loan Banks were set up with the immediate object of aiding home financing institutions hard hit by depression, the bulk of their lending came in the housing boom which followed World War II. The system was designed for ultimate ownership by the member associations using its facilities, and at the present time all federal capital has been eliminated. Borrowing members have been required to hold Federal Home Loan Bank stock equal to one-twelfth of the amount of their indebtedness to a district bank or to 1 percent of their home loan outstandings. The advances outstanding at the end of 1953 were divided about equally as between those having maturities of one year or less and those extending for longer periods of time, up to ten years. Interest rates ranged in the various districts during 1953 from 2¾ to 3½ percent; and the system has always provided that the charge to a nonmember borrower should be at least ½ percent, but not more than 1 percent higher than the rate charged to a member.

[12] *Sixth Annual Report*, Federal Home Loan Bank Board, 1938, p. 112; *Fourth Annual Report*, Housing and Home Finance Agency, 1950, p. 173; and *Seventh Annual Report* (*id.*), 1953, pp. 136 and 143.

TABLE 12

Federal Housing Finance Agencies: Organization as of the End of 1953
(amounts of transactions through December 31, 1953, or of outstandings on that date)

Housing and Home Finance Agency (Office of the Administrator)				*Veterans' Administration*
Home Loan Bank Board *Federal Home Loan Banks* ($952 million of loans to member institutions outstanding) *Public Housing Administration* ($667 million of loans and investments, advances, and other credits outstanding, mainly to local authorities, and guarantee commitments of $1.7 billion for local authorities)[a]	*Federal Housing Administration* ($33 billion of insurance written on residential mortgage and property improvement loans) *Federal National Mortgage Assn.* ($3.9 billion of FHA-insured and VA-guaranteed mortgages purchased, $1.0 billion sold)	*Division of Community Facilities and Special Operations* *College Housing Program* ($29 million of loans made) *Defense Community Facilities* ($2.8 million of applications approved for loan funds that are sole responsibility of HHFA and $0.9 million that are joint responsibility of HHFA and Dept. of Health, Educ. and Welfare)	*Division of Slum Clearance and Urban Redevelopment* *Slum Clearance and Urban Redevelopment* ($7.6 million in preliminary and final planning and $30.8 million in project loans disbursed)	*Loan Guaranty Program* ($21.5 billion of guarantees written on home loans) ($289 million of direct home loans closed)

From *Seventh Annual Report* of the Housing and Home Finance Agency, 1953, *passim*, and *Loan Guaranty*, Veterans' Administration, December 1953, pp. 69 and 75.

In basic tables (Appendix A) and in general sections of the text, classification of loan programs by economic sector served refers to the immediate recipient of credit, so that the FHA, defense community facilities, and slum clearance programs are under "minor governmental units," the federal home loan bank program under "financial institutions," and college housing under "miscellaneous." Here such programs are included to give a functional view of federal credit activities affecting housing. Excluded because in liquidation are: the prefabricated housing, first and second advance planning, and Alaska housing programs of the Division of Community Facilities of the HHFA.

[a] As of June 30, 1953.

The Home Loan Banks are also responsible for the supervision and examination of member associations, and the Federal Savings and Loan Insurance Corporation provides insurance of shares in member savings and loan associations. While the facilities of the federal intermediate credit banks in agriculture and of the Federal Reserve Banks in commercial banking resemble the Home Loan Bank system in several significant respects, the latter provides, within the scope of its own operations, a set of federal financial aids unmatched in coverage by those developed for any other sector of the economy.

In contrast to the Home Loan Bank system, which was conceived and has operated as a permanent agency for strengthening the network of savings and loan associations, the Home Owners' Loan Corporation was created as a temporary agency to refinance home mortgage loans in default as a result of deep depression, and which would wind up its operations as quickly as possible. This, too, was the history of the corporation, though the conclusion of its affairs perhaps took longer than was at first expected.

The need for the services of the corporation was dramatically proven when within four months of its establishment in 1933 over 400,000 applications for refinancing home mortgage loans were received. Altogether, 1,017,821 loans, for a total of $3.1 billion, were made; it is estimated that 21 percent of all homeowners eligible for HOLC assistance actually received it. It was this unprecedented refinancing operation—comparable only with the Land Bank Commissioner program in agriculture—that was the substance of HOLC's activities.

Although the HOLC was designed to refinance defaulted mortgages for distressed mortgagors generally, the fact is that the individuals who availed themselves of its assistance came mainly from a middle income group. It was in the intermediate zone of property values—from $3,000 to $8,000—that HOLC activities were concentrated, at least in the New York region, where it was possible to study the loan characteristics in detail. Little more than 40 percent of all the properties in the New York region in the mid-thirties fell within that price class, but over 60 percent of HOLC properties were found there. This fact is especially interesting because, as will be seen below, mortgage loan insurance too has served mainly a middle section of the housing market.

The loan insurance and guarantee programs of the federal gov-

ernment consist of the Federal Housing Administration's facilities for insuring home modernization and repair loans and long-term residential mortgages, and the Veterans' Administration's program of guarantees of loans on owner-occupied residences. The FHA programs were started in 1934 to offset the effects of economic depression on the construction industry and, incidentally, to encourage the adoption of methods of home financing that would help avoid a repetition of the mortgage collapse of the early thirties.

The insurance of property improvement loans, which got under way first, was intended to be temporary, but the program is still in effect; under it, approved lending institutions have been insured, at no cost to them or to the borrowers, up to 20 percent (later, 10 percent) of the aggregate amount they loaned. In 1939 a fee intended to put the program on a self-supporting and permanent basis was established; and in 1954, after exposure of widespread abuses in the program, a principle of loss-sharing between the federal government and lending institution was introduced.

The property improvement loan insurance program was launched with considerable, and sometimes spectacular, publicity and soon reached sizable proportions. In the first three years well over a million loans were insured, and by the end of 1953 nearly 16,600,000 loans, with net proceeds over $7.4 billion, had been insured.[13] As of 1953, insurance was available under the Title I program for loans to repair, alter, or improve existing residential and other structures, single or multifamily, in amounts up to $10,000 and for terms mainly of three years.

Most of the insured property improvement loans—in fact, three-quarters of them, by amount, during 1934–1953—were made by commercial banks, though a variety of financial institutions have participated in the program.[14] The insured loans have been predominantly small, with terms averaging eighteen months, and for the most part have been for the improvement of one-family structures, though very early in the program some emphasis was placed on loans for the improvement of small commercial buildings.

One of the most interesting aspects of the Title I program is that it is frequently credited with having introduced banking institutions to, or at least encouraged them to extend their activities in, the

[13] *Seventh Annual Report*, Housing and Home Finance Agency, 1953, Table 61, p. 297.

[14] *Sixth . . .* and *Seventh Annual Reports*, Housing and Home Finance Agency, 1952, p. 337, 1953, p. 304.

installment financing field. The loans have almost all been of the installment credit type, involving some down payment and repayment in equal monthly amounts.

Turning to the main field of housing finance, home mortgages: more than the fact that federal insurance and guarantee programs now in effect provide protection for approximately one-third of the mortgages on small residential structures in the United States, a summary of the particular services rendered, and borrowers and lenders affected, will suggest the influence such programs have exerted on the home mortgage market. Under FHA, lenders are insured for the full amount of their mortgage loans in return for a premium charge which is paid into an insurance fund. Losses are met out of these funds, but should they prove insufficient the federal government would be responsible for the full amount of the loss. Under VA, which is a nonfunded plan, approved lenders are guaranteed at no cost up to 60 percent of the amount of the loan which they made to an eligible veteran, but the guaranteed portion may not exceed $7,500. Under either agency's program, to qualify for protection the loan must be made within terms specified by the guaranteeing agency. These encompass the interest rate charged, the maximum ratio of loan amount to value of underlying security, and the maximum maturity. All loan contracts must provide for full repayment by maturity and must permit the mortgagor to repay in advance of maturity without penalty. The two schemes vary somewhat with respect to the liens that can be taken: FHA loans must be of a first mortgage type, but second mortgages may be guaranteed under VA. Finally, only when the properties being financed meet certain physical specifications laid down by the insuring and guaranteeing agency is loan protection granted.

Perhaps the most interesting fact about the federal programs of loan insurance is that they have been employed mainly by a middle class of home buyers. Between October 1950 and March 1951, for example, FHA insured 27 percent and VA guaranteed 30 percent of the loans given on homes costing between $10,000 and $12,500. In the lower and higher price brackets of houses the incidence of federal insurance or guarantee activity was substantially lower. Thus, only 10 percent of the loans on houses costing less than $5,000 were financed through FHA, and only 11 percent were guaranteed by the VA; similarly, only 19 percent of the houses costing $15,000 and over were financed by loans carrying FHA insurance, and VA

guarantees aided in the purchase of but 8 percent.[15] Conventional lending (that is, lending without benefit of federal insurance or guarantee) was more important as a financing technique in the lower and upper grades of construction.

The terms on which home mortgage loans are made under the protection of federal insurance or guarantee are naturally more liberal than those characteristic of conventional lending, and in general the loans guaranteed by VA are more liberal than those insured by FHA. In a comparison of loan-to-value ratios for loans on single family, owner-occupied homes acquired during 1949 and the first half of 1950, well over half of the conventional loans had loan-to-value ratios lower than 65 percent, as against less than a tenth of the federally protected loans. About seven out of ten VA-guaranteed loans were in amounts equaling 90 percent or more of the value of the property; but of FHA-insured and conventional loans, only about one in ten had such a liberal ratio.[16] As to contract maturity, periods of about twenty years have been characteristic for both agencies. Among the conventional home loans of private lenders, only those by life insurance companies show more than a small frequency of such long terms (31 percent).[17] The Housing Act of 1954 liberalized FHA loans on one- to four-family properties to the extent of permitting loans up to 30 years with amounts loaned equal to 95 percent of the first $9,000 of value of the property and 75 percent of the excess of value over that amount.

Probably the most active recent controversy in the mortgage insurance and guarantee field has concerned the interest rates at which federally protected loans can be made. The specification of maximum rates on FHA-insured home mortgages at 4¼ percent in the early fifties required either that funds be diverted from investment in such loans or that mortgages be sold at discounts to the lenders. This situation was temporarily remedied in early 1953 when interest rates were raised to 4½ percent. Similarly the maximum rate on VA-guaranteed loans was raised in May 1953 from 4 to 4½ percent.

Extensive use of the loan insurance facilities of the federal government has also been made in the apartment house field. There are no

15 Data are for purchases of new and existing one- and two-family nonfarm homes for owner occupancy, from a sample survey by the Board of Governors of the Federal Reserve System. See *Federal Reserve Bulletin*, July 1951, Table 19, p. 793.

16 *Housing Research*, Housing and Home Finance Agency, Winter 1951–52, Table 1, p. 9.

17 See footnotes 23 and 24, Chapter 8.

systematic data with which to describe the units that are built outside of the FHA insurance system, but it is probably safe to say that they consist either of very low-cost structures which fail to conform to FHA standards, or are luxury apartments in which the cost per dwelling unit is so high that the FHA financing would have little practical value.

Under the FHA program, there is provision for the insurance of loans on rental properties and also for those operated on the cooperative plan, and over the years special provisions have been made for the insurance of loans for war or defense production needs. It is primarily in connection with the latter programs that the terms of loan insurance were deliberately made liberal and that allegations of abuse have been most frequently heard. The institutions making use of the project mortgage programs are primarily commercial banks and savings banks. These institutions originated 73 percent of the total insured project mortgages in 1953, as compared with 4 percent for insurance companies and 12 percent for mortgage companies. However, at the end of 1953 banks held only 50 percent of the total outstanding compared with 36 percent for insurance companies and 6 percent for mortgage companies, indicating that the banks (commercial banks, at least) and mortgage companies tended to sell their holdings in part to the longer-term investors.[18]

There has been considerable interest since the early thirties in establishing secondary mortgage market facilities within the federal government. The RFC Mortgage Company, a subsidiary of RFC created in 1935 primarily to make direct loans on income properties, soon after became also a secondary market facility in the home mortgage field, with authority to purchase and sell FHA-insured home and housing project mortgages, and later, VA-guaranteed home mortgages.

This operation was discontinued in June 1947, and on July 1, 1948 the Federal National Mortgage Association, the so-called "Fanny May," which had been set up in 1938 to provide a market for FHA-insured home mortgages, was authorized to purchase VA-guaranteed home mortgages. Later it was authorized to conduct operations in all types of FHA-insured mortgages. Through December 31, 1953, it had purchased $3.9 billion of mortgages and at that time was holding about $2.5 billion.[19]

[18] *Seventh Annual Report*, Housing and Home Finance Agency, 1953, Table 49, p. 278.

[19] *Housing Statistics* (Housing and Home Finance Agency), January 1954, p. 67.

FNMA was reorganized under the Housing Act of 1954 with the object of making it eventually a privately owned institution by the device of requiring stock purchase by the users on the pattern of the federal land banks. In addition, its powers were widened so that it might serve as a secondary facility in the sense of providing liquidity for holders of existing insured and guaranteed mortgages.

Since the expiration of the HOLC the federal government has been involved but little in the direct extension of credit to homeowners. FHA direct loans have been incidental to disposing of foreclosed properties acquired through its loan insurance responsibilities. After 1950, a VA program supplied home loans to veterans in areas where VA-guaranteed loans were unavailable from private sources on what are determined to be reasonable terms.

The Voluntary Home Mortgage Credit Program authorized by the Housing Act of 1954 is specifically designed to obviate the need for direct lending such as practiced by the Veterans' Administration.