8-1-1958

The effect of monetary policy on the activities of real estate financing institutions

Ralph James Ross
Atlanta University

Follow this and additional works at: http://digitalcommons.auctr.edu/dissertations

Part of the Business Administration, Management, and Operations Commons

Recommended Citation
THE EFFECT OF MONETARY POLICY ON THE ACTIVITIES OF
REAL ESTATE FINANCING INSTITUTIONS

A THESIS
SUBMITTED TO THE FACULTY OF ATLANTA UNIVERSITY IN
PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE
DEGREE OF MASTER OF BUSINESS ADMINISTRATION

BY
RALPH JAMES ROSS

SCHOOL OF BUSINESS ADMINISTRATION

ATLANTA, GEORGIA
AUGUST 1958
Due to the fact that discussion of the topic at hand has been somewhat limited, reference material related directly thereto is rare. Consequently, in addition to the reference listed in the bibliography, it was necessary to rely upon tidbits of knowledge consumed over a period of time as a result of observance of such periodicals as The Wall Street Journal, New York Times, Savings and Loan News, Time Magazine, Business Week, Federal Reserve Bulletin, and others. Much of what is said here is the result of personal discussions with authorities in the field.

In this connection I would like to make grateful acknowledgement of the abundance of insight afforded by Mr. J. B. Blayton, President of Mutual Federal Savings and Loan Association; Mr. Q. V. Williamson, President of Williamson and Company (Realtors); Mr. E. W. Hiles, Executive Vice President of the Georgia Savings and Loan League; Mr. T. R. Blackmar, Atlanta Federal Savings and Loan Association; and Mr. A. C. Ayers, Atlanta Federal Savings and Loan Association (West End Branch).
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. INTRODUCTION</td>
<td>1</td>
</tr>
<tr>
<td>II. STRUCTURE OF THE REAL ESTATE MORTGAGE MARKET</td>
<td>3</td>
</tr>
<tr>
<td>Extent of Urban Real Estate Financing</td>
<td>3</td>
</tr>
<tr>
<td>The Role of Lenders</td>
<td>4</td>
</tr>
<tr>
<td>Institutions Supplying Real Estate Credit</td>
<td>5</td>
</tr>
<tr>
<td>Federal Agencies</td>
<td>6</td>
</tr>
<tr>
<td>III. THE IMPACT OF MONETARY POLICIES UPON THE VARIOUS SECTORS OF THE MORTGAGE MARKET</td>
<td>8</td>
</tr>
<tr>
<td>Distinction Between Conventional Mortgages and FHA and VA Mortgages as to Interest Rates</td>
<td>8</td>
</tr>
<tr>
<td>Distinction Between Conventional Mortgages and FHA and VA Mortgages as to Downpayment and Amortization Period</td>
<td>14</td>
</tr>
<tr>
<td>Distinction Between Commercial and Industrial Mortgages Residential Mortgages</td>
<td>15</td>
</tr>
<tr>
<td>IV. PECULIARITIES OF MORTGAGE FINANCING</td>
<td>17</td>
</tr>
<tr>
<td>The Forward Commitment</td>
<td>17</td>
</tr>
<tr>
<td>The Forward Commitment in the Case of a Switch in the Direction of Monetary Policy</td>
<td>18</td>
</tr>
<tr>
<td>The Forward Commitment and Open-Market Operations</td>
<td>20</td>
</tr>
<tr>
<td>V. FEDERAL CONTROL OF THE MONEY SUPPLY</td>
<td>23</td>
</tr>
<tr>
<td>What Constitutes the Money Supply</td>
<td>24</td>
</tr>
<tr>
<td>The Creation of Money and the Expansion of Credit</td>
<td>25</td>
</tr>
<tr>
<td>VI. FEDERAL CONTROL OF THE SUPPLY OF MORTGAGE CREDIT</td>
<td>30</td>
</tr>
<tr>
<td>Control by the Federal Reserve System and the Federal Home Loan Banks</td>
<td>30</td>
</tr>
<tr>
<td>Control by Other Government Agencies</td>
<td>37</td>
</tr>
<tr>
<td>VII. AN ANALYSIS OF THE EFFECT OF MONETARY POLICY ON THE MORTGAGE MARKET IN AN INFLATIONARY PERIOD</td>
<td>42</td>
</tr>
<tr>
<td>VIII. SUMMARY AND CONCLUSION</td>
<td>59</td>
</tr>
<tr>
<td>BIBLIOGRAPHY</td>
<td>63</td>
</tr>
</tbody>
</table>
LIST OF TABLES

Table                                                   Page
1. Estimates of Private Debt in the United States       4
2. Sources of Urban Real Estate Credit.                 5
3. Changes in FHA Interest Rates (1953-1957)           9
4. Conventional First Mortgage Interest Rates for 20 Large Cities (December, 1952 and January, 1957) 11
5. Sources and Use of Capital and Credit, 1951-1955    32
6. Non-Farm Housing Units Started, Private and Public   43
7. Federal Home Loan Bank System, Liabilities and Capital 51
8. Federal Home Loan Bank System Assets                52
CHAPTER I

INTRODUCTION

As a student of money and banking, the author has observed -- in classroom lectures, textbooks, and periodicals -- that discussions on monetary policy are generally concentrated on its effect upon commercial bank credit and the bond market. For the most part, there appears to be a neglect of the significant effects of monetary policies upon the mortgage market. This may be due to the fact that the effects of monetary policies on the real estate mortgage market are much less direct than in the cases of bank credit and the bond market.

Although monetary theorists are universally inclined to limit their discussions of monetary policy in the above fashion, reference to the publications of those active in the real estate mortgage market reveal that they have become cognizant of the important influence exerted on their activities by Federal Reserve policies. In the recent years since World War II these proponents of the mortgage market have become increasingly aware of the impact of monetary policy. Consequently, they have expended a great deal of effort toward understanding and appraising the effects of Federal Reserve policies.

The extent and importance of the mortgage market sector of the economy makes it seem imperative that there be a broad understanding of the effects of monetary policies upon this sector. Investigation has disclosed that this topic is more pervasive than initially expected. Therefore, in this thesis I will attempt only a surface review of these effects. The scope will be definitely limited to the lending activities of the
institutions involved, with little or no reference to the effects upon the fund-gathering activities of these institutions.

Since the savings and loan associations are the predominant institutions in the mortgage financing field much of the material included will have special reference to savings and loan associations.
CHAPTER II

STRUCTURE OF THE REAL ESTATE MORTGAGE MARKET

1

Extent of Urban Real Estate Financing. — More than 75 per cent of residential and 50 per cent of commercial and industrial real estate transactions are completed through credit arrangements. The relative importance of real estate financing in the United States is indicated in Table 1, which shows a classification of the amount of indebtedness outstanding at the end of the years 1939, 1949, and 1954. Figures for "corporate debt" exclude mortgage loans, so that the comparison between urban mortgage debt outstanding and the total gives a reasonable picture of the relationship of urban real estate loan credit to all credit. It is impressive to note that 23 per cent of all credits to private borrowers outstanding at December 31, 1949, and 31 per cent of those outstanding at December 31, 1954, were based on urban mortgages.

A second indication of the extent of real estate financing is provided by a comparison of the new financing for different types of users. For the year 1954, for example, $25.0 billion was advanced on home loans; $9.6 billion was the total amount of new issues of corporate securities; and the total amount of funds obtained by corporations from all sources was $31.4 billion. States, counties, cities, towns, villages, and districts of the United States borrowed $7.0 billion, part of which amount was used to pay off existing debts. Although not strictly comparable, these figures serve to show, in an approximate way, the relative importance of real estate financing.

TABLE 1
ESTIMATES OF PRIVATE DEBT IN THE UNITED STATES*

Amounts Outstanding at Year-End
(Billions of Dollars)

<table>
<thead>
<tr>
<th></th>
<th>1954</th>
<th>1949</th>
<th>1939</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate, nonmortgage</td>
<td>$166.8</td>
<td>$111.5</td>
<td>$69.6</td>
</tr>
<tr>
<td>Urban mortgage</td>
<td>105.3</td>
<td>57.1</td>
<td>28.9</td>
</tr>
<tr>
<td>Noncorporate, nonmortgage</td>
<td>62.6</td>
<td>37.2</td>
<td>19.2</td>
</tr>
<tr>
<td>Farm mortgage</td>
<td>8.2</td>
<td>5.6</td>
<td>6.6</td>
</tr>
<tr>
<td>Total private debt</td>
<td>$340.5</td>
<td>$211.4</td>
<td>$124.3</td>
</tr>
</tbody>
</table>

*Source: Based on Survey of Current Business, September, 1953, Table 1, p. 14 and Table 6, p. 18; ibid., May 1956, Table 1, p. 9 and Table 6, p. 12.

The Role of Lenders. — An adequate supply of funds at reasonable rates of interest is largely responsible for the significant growth in the total housing supply that took place since World War II. Although home mortgage credit, to an ever-increasing extent, is underwritten (insured) or guaranteed by government agencies, nearly all direct financing is supplied by private lenders.

The sources of credit are many. Each source has its peculiarities which may be caused by state of federal laws, or by internal organizational rules of the lending institutions which forbid mortgage lending in excess of certain amounts or in certain geographical areas.

Private Sources of Real Estate Credit. — As stated above, the principal sources of real estate credit are private investment agencies: savings and loan associations, commercial banks, insurance companies, mutual savings banks, individual investors and firms making occasional investments in real estate although not principally engaged in real estate financing. Only a small amount of actual financing is handled by federal agencies -- but federal agencies play an important role in this field. The amounts invested by different lenders in the credits outstanding at the ends of 1959, 1949, and 1939 are shown in Table 2. The changes in the relative amounts are shown in Table 2.

**TABLE 2**

**SOURCES OF URBAN REAL ESTATE CREDIT***

Amounts of Debt Held at Year-End

(Billions of Dollars)

<table>
<thead>
<tr>
<th></th>
<th>1954</th>
<th>1949</th>
<th>1939</th>
</tr>
</thead>
<tbody>
<tr>
<td>Savings and loan associations</td>
<td>$26.1</td>
<td>$11.6</td>
<td>$3.8</td>
</tr>
<tr>
<td>Life insurance carriers</td>
<td>23.9</td>
<td>11.8</td>
<td>4.8</td>
</tr>
<tr>
<td>Commerical banks</td>
<td>17.5</td>
<td>10.7</td>
<td>3.7</td>
</tr>
<tr>
<td>Mutual savings banks</td>
<td>14.9</td>
<td>6.7</td>
<td>4.8</td>
</tr>
<tr>
<td>Federal agencies</td>
<td>2.6</td>
<td>1.1</td>
<td>2.2</td>
</tr>
<tr>
<td>Individuals and others</td>
<td>20.0</td>
<td>15.2</td>
<td>9.6</td>
</tr>
<tr>
<td><strong>Total urban mortgage debt</strong></td>
<td><strong>$105.3</strong></td>
<td><strong>$57.1</strong></td>
<td><strong>$28.9</strong></td>
</tr>
</tbody>
</table>


1Erwin W. Boehmler, op. cit., pp. 451-452.
importance of savings and loan associations, commercial banks, and insurance companies as creditors between 1939 and 1954 reflect growth of these loan agencies. These agencies now supply sixty-four per cent of the total funds, whereas in 1939 they supplied forty per cent. The amount held by individuals and others indicates the extent to which this remains a field in which individual investment is important. Many properties are sold on the basis of downpayment with the seller himself taking a mortgage and a note to cover the balance of the purchase price. A fact which Table 2 does not show is the dominance of the savings and loan associations in residential financing, and of insurance companies in commercial and industrial financing. Savings and loan associations accounted for about 36 per cent of the loans on residential properties, and insurance companies for about one-third of commercial and industrial financing in 1954.

Federal Agencies.—When the depression emphasized a number of fundamental weaknesses in the mortgage field, particularly in the financing of homes and apartments, the federal government initiated a broad program for strengthening and improving the facilities for mortgage lending. We will not mention here all the agencies involved. However, we will speak of those which have a direct bearing upon the purpose of this thesis.

The Federal Housing Administration (FHA) insures payment on homes and rental apartments. In effect, the FHA is an agency placing the credit of the federal government behind the credit of individuals who borrow to buy or build residential property.

The Federal National Mortgage Association (FNMA), sometimes referred to as Fannie Mae, engages in the business of buying or selling first mortgages. The FNMA was of small effect in the mortgage market until 1949 when
low rates on some mortgages encouraged lenders to offer them for sale.

Veteran's Administration Guaranteed Loans are a result of the Service-
man's Readjustment Act of 1944, commonly known as the "GI Bill of Rights."
This act, with subsequent amendments, provided that the Veteran's Adminis-
tration, backed by the United States Treasury, would guarantee real estate
loans to veterans made by private financial institutions.

\[1\text{Ibid., pp. 455-460.}\]
CHAPTER III

THE IMPACT OF MONETARY POLICIES UPON THE VARIOUS SECTORS OF THE MORTGAGE MARKET

As discussed in the preceding chapter, the structure of the real estate mortgage market is composed of many parts - each with its own projecting tentacles. In order to appraise the impact of monetary policy upon the various sectors of the real estate mortgage market it will be necessary to make a distinction between these various sectors. This is because the impact of monetary policies falls somewhat differently upon these sectors.

Distinction Between Conventional Mortgage and FHA and VA Mortgage as to Interest Rates.-- In the non-farm residential mortgage field we should distinguish between Government-insured and guaranteed mortgage on the one hand and conventional mortgage on the other. For the purposes of this paper, the basic distinction is that the interest rate on government-insured and guaranteed mortgages is a regulated rate. Due to the fact that they are set by federal law and are uniform throughout the country FHA and VA mortgage interest rates are much less volatile than the interest rates on conventional mortgages.

The Federal Housing Administration insures home mortgage loans made according to its regulations by approved lenders. For such insurance, the borrowers pay a premium of one-half of one percent per annum on average debt balances outstanding during the year.

1North, Benson, and Ring, op. cit., p. 158.
FHA interest rates (including the insurance premium of 0.5 percent as paid by the mortgagor) were 4.75 percent prior to May 1, 1953. Between 1953 and 1957 these rates rose in three steps as shown in Table 3.

TABLE 3

<table>
<thead>
<tr>
<th>Date</th>
<th>Interest Rate</th>
<th>Insurance Premium</th>
<th>Total Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>May 2, 1953</td>
<td>4.5</td>
<td>0.5</td>
<td>5.0</td>
</tr>
<tr>
<td>December 4, 1956</td>
<td>5.0</td>
<td>.5</td>
<td>5.5</td>
</tr>
<tr>
<td>August 5, 1957</td>
<td>5.25</td>
<td>.5</td>
<td>5.75</td>
</tr>
</tbody>
</table>


Veterans Administration guaranteed mortgage interest rates have been even more stable and have risen only twice between 1944 and the present. These rates were changed from 4 to 4 1/2 percent in May, 1953. On April 4, 1958 they were changed from 4 1/2 percent to 4 3/4 percent.

Whatever yield flexibility exists for investors in this area comes about as the result of discounts or premiums. In a speech at an American Bankers Association meeting, John Adikes (President of the Savings and Mortgage Division of the ABA) noted that VA's were selling in the 80's.


2Ibid.

last November (1957), and "now they've walked up to 91 and 92." FHA's he added, are up from 91 to 92 to 97-98. He said banks should step up their investments in this field before prices go even higher, and yields lower.

Because of the regulated rate, the government-insured and guaranteed mortgage sector of the capital market is unresponsive to changes in overall capital market conditions. On the other hand, the interest rates on conventional residential mortgage loans, although sluggish in movement, are free to respond to capital market changes.

Since conventional mortgage interest rates are free to respond to the changes in market conditions, they not only fluctuate consistently from time to time, but differ in different localities at a particular moment of time. Table 4 shows average conventional first mortgage interest rates for new mortgages for 20 large cities for December, 1952 and January, 1957. In 1952 the city averages ranged from 4.4 percent for Boston to 6.0 percent for Scranton, giving a spread of 1.6 percent points. This compares with a spread of only 1.0 percentage point in 1957, from 5.1 percent for Boston to 6.1 percent for Los Angeles. This points up the fact that if mortgage interest rates are allowed to fluctuate freely there will be a variance of interest rates in different localities due to market conditions -- namely, the supply of and demand for mortgage funds in the particular area. Observation of Table 4 will show that there is a somewhat regional pattern to the variance in the rates. This is more apparent in 1957 than in 1952. In 1957, six of the eight cities with the highest rates were southern and western cities while six of the eight cities with the lowest rates were eastern cities.

TABLE 4

CONVENTIONAL FIRST MORTGAGE INTEREST RATES FOR 20 LARGE CITIES
(DECEMBER, 1952 AND JANUARY, 1957)*

(Percent)

<table>
<thead>
<tr>
<th>City</th>
<th>December, 1952 Rate</th>
<th>City</th>
<th>January, 1957 Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scranton</td>
<td>6.0</td>
<td>Los Angeles</td>
<td>6.1</td>
</tr>
<tr>
<td>Houston</td>
<td>5.7</td>
<td>San Francisco</td>
<td>6.1</td>
</tr>
<tr>
<td>Los Angeles</td>
<td>5.4</td>
<td>Portland (Oregon)</td>
<td>6.0</td>
</tr>
<tr>
<td>Atlanta</td>
<td>5.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>San Francisco</td>
<td>5.2</td>
<td>Cincinnati</td>
<td>5.9</td>
</tr>
<tr>
<td>Chicago</td>
<td>5.1</td>
<td>Scranton</td>
<td>5.9</td>
</tr>
<tr>
<td>Pittsburgh</td>
<td>5.1</td>
<td>Atlanta</td>
<td>5.8</td>
</tr>
<tr>
<td>Portland (Oregon)</td>
<td>5.1</td>
<td>Seattle</td>
<td>5.7</td>
</tr>
<tr>
<td>Detroit</td>
<td>5.0</td>
<td>Cleveland</td>
<td>5.7</td>
</tr>
<tr>
<td>Kansas City (Missouri)</td>
<td>5.0</td>
<td>Detroit</td>
<td>5.7</td>
</tr>
<tr>
<td>Philadelphia</td>
<td>5.0</td>
<td>Chicago</td>
<td>5.6</td>
</tr>
<tr>
<td>Minneapolis</td>
<td>4.9</td>
<td>Minneapolis</td>
<td>5.6</td>
</tr>
<tr>
<td>Seattle</td>
<td>4.9</td>
<td>Pittsburgh</td>
<td>5.6</td>
</tr>
<tr>
<td>Washington, D. C.</td>
<td>4.8</td>
<td>Philadelphia</td>
<td>5.6</td>
</tr>
<tr>
<td>Cleveland</td>
<td>4.8</td>
<td>Kansas City (Mo.)</td>
<td>5.6</td>
</tr>
<tr>
<td>Cincinnati</td>
<td>4.8</td>
<td>New York</td>
<td>5.5</td>
</tr>
<tr>
<td>Baltimore</td>
<td>4.7</td>
<td>Baltimore</td>
<td>5.5</td>
</tr>
<tr>
<td>St. Louis</td>
<td>4.6</td>
<td>St. Louis</td>
<td>5.4</td>
</tr>
<tr>
<td>New York</td>
<td>4.6</td>
<td>Washington, D. C.</td>
<td>5.4</td>
</tr>
<tr>
<td>Boston</td>
<td>4.4</td>
<td></td>
<td>4.4</td>
</tr>
</tbody>
</table>

The attitude of the market toward government-supported mortgage loans has a great deal to do with the rates on conventional mortgage loans. The greater uniformity in rates in 1957, as shown in Table 4, results partly from the decrease in the importance and competitive effect of government-supported loans, particularly VA loans, in many of the cities. It can be noted that generally the rates were higher in 1957. Cincinnati showed the greatest increase over the period, moving from fifth from the bottom with an average of 4.8 percent in 1952 to fifth from the top with an average of 5.9 percent in 1957. The overall rate change in Cincinnati was largely determined by the free market conventional mortgage interest rates, because both FHA and VA loans consistently represented a smaller than average portion of the total.

At the 1958 Savings and Mortgage Conference of the American Bankers Association, James B. Murry, Jr., Director, City Loans, the Prudential Insurance Company of America, cited the following reasons why conventional loans have continued to maintain a dominant position in the home mortgage field, despite certain advantages possessed by FHA's and VA's.

Among the factors that have contributed to conventional loan preference on the part of many lenders, borrowers and builders, Mr. Murry singled out the more flexible interest rate, less complicated procedure for processing and closing loans, better and more flexible servicing arrangement, and lack of discount complications. The advantages are particularly significant in periods of tight money, he explained, which accounts for the fact that in 1957 some 75 percent of the dollar amount of home loans were made on a conventional basis. With easier money, Mr. Murray expects that the proportion of FHA and VA loan volume will rise above the levels experienced during the past two years.

1Except in the case of Scranton which experienced a decrease from 6.0 to 5.9 percent.

In summarizing this analysis, Mr. Murray concluded, it is quite evident that there are strong factors influencing the preference of lenders, borrowers, and builders for both conventional and government underwritten home loans. It is the duty of institutional lenders to obtain the best possible yields consistent with the soundness of the investments. FHA and VA loans do not always meet available market yields due to controlled interest rates and discounts. Consequently,' Mr. Murray asserted, 'it is my firm conviction that the conventional home loans are our most stable financing tool, year after year.'

According to Miles L. Colean, the founder of FHA and of VA loan guaranty plan were wise enough to know that private funds cannot be expected to flow into areas in which yields are not competitive with those in other areas. It is a fact that from FHA's inspection until the early 1950's, the maximum interest rate permitted on FHA mortgages was consistently above the market rate. The several reductions in rate that were made during that period always followed the market's downward trend. There was never even the appearance of leading it, let alone of coercing it. It is also true that the interest rate set for the VA loan guaranty program at its inception was not a privileged rate but one that was well in line with the rates currently being charged on conventional mortgages of good quality.

The following excerpt from an article in the Savings and Loan News exemplifies a Congressional struggle between initiating a tight money policy and VA ceiling rates.

Some of the last words of members of the 84th Congress dealt with the problem of the rise in interest rates.

---

1Ibid., pp. 36, 37.

The lifting of the FHA rate to 5% prompted the announcement that the Housing Administrator would ask Congress to amend the GI Bill of Rights to allow a similar interest change on veteran's loans. But Rep. Teague (D, Texas) said he thought it would be better to expand the direct loan program and keep the interest rate on the guaranteed loans where it is. This was also the implication of testimony by officials of the VA. The guessing leans toward the probability that Congress will end by raising the rate for veterans.

Rep. Patman had two days of hearings to explore the wisdom of the tight money policy of the Federal Reserve System. Federal Reserve Chairman Martin stuck to his guns that the stability of the dollar is a necessary component of the general welfare of the people of the United States, and that the Federal Reserve Board is using its best judgment to keep the flow of credit from feeding inflation.

Distinction Between Conventional Mortgages and FHA and VA Mortgages

as to Down-Payment and Amortization Period. Another important difference is that the government-insured and guaranteed mortgages are low down-payment, long amortization period mortgages, whereas state laws and custom place the conventional loans characteristically on a much higher down-payment and shorter amortization basis.

Down-payment requirements for FHA-insured mortgages have generally been somewhat higher than the requirements for VA-guaranteed mortgages, but still generally below lenders' requirements on conventional mortgages. The lower down-payment requirements for the government-supported mortgages have resulted in lower average downpayments for all mortgages than otherwise would have been the case, especially since conventional mortgages must compete with them when mortgage funds are in plentiful supply. When

1Not including the insurance premium.

down-payments are lower, the amount of the mortgages are necessarily higher and a given amount of mortgage funds will cover fewer loans.

The government controlled long amortization period of the FHA and VA mortgage has a strong effect upon the mortgage market as a whole. Although the amortization period for the conventional mortgage is normally much shorter than the amortization period for the government-supported mortgage, it is necessary for the conventional to come closer in line with the government when they are in strict competition, thus making for over-all longer amortization periods. Under these conditions a given amount of mortgage funds does not cover the financing of as many new mortgages because the turnover of mortgage funds is lower due to the longer mortgage terms. Although average mortgage terms are shortened by prepayments in periods of relatively high real estate activity, in general, funds are repaid more slowly and they cannot be used to finance as many home purchases over a given period of time.

Distinction Between Commercial and Industrial Mortgages and Residential Mortgages.—We must distinguish the sector of the real estate mortgage market dealing in conventional mortgage loans on commercial and industrial properties. Because of the close relation of this sector of the market to financing by means of industrial bonds and notes, the interest on conventional business mortgages are much more sensitive to changes taking place in the bond and in the capital market as a whole. Net yields on these mortgages are closely related to net yields on


2Ibid., p. 3.
industrial and public utility bonds. It should be clear to see that any monetary decisions directed towards the securities market would have an indirect effect upon the commercial and industrial mortgage market.

In his speech at the 1958 Savings and Mortgage Conference of the American Bankers Association, Mr. Adikes pointed out that "With the drop in bond yields following the shift to easier money, the spread between them and mortgages is back to the normal 1^{1/2} points. As a result he predicted that 'in 1958 you will find an abundance of mortgage money.'" ¹

There are, of course, other sectors of the Mortgage Market (such as the farm mortgage sector). However, the ones mentioned above will be sufficient for the intent of this paper.

CHAPTER IV

PECULIARITIES OF MORTGAGE FINANCING

There are certain peculiar characteristics of mortgage financing which have an important bearing upon the impact of monetary policies upon the mortgage market.

The Forward Commitment.-- A significant characteristic of mortgage financing is the forward commitment procedure. This means, for example, that a residential builder, prior to obtaining a construction mortgage, seeks a commitment for permanent financing from some other lender (or refinancing of the mortgage). The terms of the permanent financing are specified in the forward commitment.

Since mortgage loans, as a rule, are made only on improved properties, builders and potential home owners in need for interim construction funds arrange with lenders for "stopgap" financing for a period of 3 to 6 months or until the completion of the proposed structure in accordance with building plans and detailed specifications, the purpose of this type or mortgage, as the name implies is to aid an owner or builder in financing the erection of a building. This arrangement between the lender and the borrower provides in substance that the borrower shall erect a certain building -- as described by plans and specifications -- on the land legally identified and that the lender shall loan, upon the security of such and building, a specified amount to be repaid upon completion.

1Interview with J. B. Blayton (President, Mutual Federal Savings and Loan Association, Atlanta, Georgia, April, 1958).
of the building.

The forward commitment is also an essential part of commercial and industrial mortgage financing.

The forward commitment process is particularly important in the case of new construction because of the time lag involved. For example, a forward commitment made in April on credit terms prevailing in April may finally result in the actual delivery of the mortgage and disbursement of funds in November. The lag usually is related to the period of construction. The length of the lag between commitment and disbursements of funds may vary a few months to as much as two years, depending on whether the construction is residential or commercial or industrial. Furthermore, the lag may be unusually long due to delay in delivery of materials, labor problems, or some other factors.

The Forward Commitment in the Case of a Switch in Direction of Monetary Policy.-- A switch from tight money policies to easier money policies (or vice versa) during the time lag mentioned above will cause conditions at the time for deliverance of the mortgage and the disbursement of the funds to be altogether different from those which existed at the time the forward commitment was made. This situation could cause unusual hardships for lending institutions which have made a large volume of forward commitments on terms appropriate to easy credit conditions but find that they must meet these obligations under tightened credit conditions.


2Interview with J. B. Blayton, op. cit.

3Ibid.
In a period of easy credit and reduced construction activity the supply of mortgage money will greatly exceed the demand for mortgage. Under such conditions lending institutions will tend to enter more readily into a large quantity of forward commitments. Consequently, a large volume of forward commitments may be built up in the mortgage market as a whole, resulting in heavy construction activity at a later time. Due to this effect, the forward commitment process makes it extremely difficult for the monetary authorities to time the effect of their policies upon construction expenditures. In view of this, the monetary authorities have from time to time attempted to bring the mortgage market into line with the overall money market by the use of direct controls (on mortgage market activity) to compliment the general credit controls.

However, it has been found that even these more direct controls do not immediately bring the desired effect upon construction expenditures. For example, the Defense Production Act of 1950 (during the Korean crisis) included a Regulation X designed to hold down inflation in real estate and divert essential materials to the defense production program through a cutback of building activity. This type of control though more direct than general controls was considered less direct and more desirable than even more direct controls such as rationing and the allocation of materials. Nevertheless, it was found that this regulation did not bring the immediate desired effect due to the peculiarity of the forward commitment procedure. This point was brought out

2Ibid.
in a panel discussion on "Home-Building and Home-Financing Opportunities in 1951." During the discussions Mr. Taylor (President of Prudential Federal Savings and Loan Association of Salt Lake City, Utah) said:

So far as the new credit restrictions and increasing downpayments are concerned, the effect of those regulations will not be immediately felt since the FHA and the VA had outstanding at the time they (the regulations) were issued about 500,000 commitments not subject to the regulations. In view of this fact, I dare say that the builders commitments that are not subject to the....requirements will account for almost half of the program of around 800,000 homes for next year.

Through the above is in reference to a direct control, it is used as an example since any general credit controls would be effected in a similar manner by the forward commitment process.

The Forward Commitment and Open-Market Operations.— Open market operations have been considered one of the Federal Reserve's key instruments for control of the stock of money. However, as a tool in restraint of inflation it was practically out of use for the several years after World War II. During this period the government, in order to support the local market maintained pegged prices for its long term securities. When the Korean War broke out in 1950, this country was in the early stages of an economic boom, which was spearheaded by a sharp rise in residential construction. At the time the Federal Reserve was still supporting the prices of government securities at par. As the demand for residential mortgage credit (especially government-insured and guaranteed loans) grew, there was open invitation to institutional

---


investors to extend forward commitments to purchase mortgages on the assumption that if necessary the cash required to disburse these loans could be raised by the sale of government securities. The significant point here is that at this time institutional investors had little need to relate their forward commitments to their cash flow. A large portfolio of readily saleable government securities at pegged prices made it certain that cash could be raised to meet commitments almost regardless of how high these commitments became.

In the case of Savings and Loan Associations, it should be understood that it is necessary to hold some government securities in partial fulfillment of the liquidity regulations of the Home Loan Bank Board. In discussion of the liquidity regulation in 1950, William K. Divers (then Chairman of the Home Loan Bank Board) stated:

I cannot stress too much that the statutory liquidity is a minimum. It is the function of your boards of directors to fix the proper liquidity policies for your association.

Whatever liquidity formula is established by management should take into consideration the association's current obligations; in any determination of the availability of funds for savers it is the net liquidity that pays off. Even though liquid assets may represent 15% or even more of total capital, real liquidity is what is left after provision for commitments.

The maintenance of a mere 'gross' liquidity ratio does not necessarily mean that the funds of savers are available to them upon request. For all practical purposes, an association's liquid assets may be regarded as committed to the extent that creditor liabilities and amounts 'due borrowers' have first claim.

---

I do not know of any exact yardstick to measure how far associations may safely commit their resources for construction loans at this time.

In the spring of 1951 the Federal Reserve's restriction of prices and restriction of its purchases of long-term government bonds had far-reaching effects in the control of inflation. Holders of these securities were reluctant to dump them on the market and as a result supplies of funds for mortgages and for other types of credit were greatly reduced.


2Oliver S. Powell, "The Voluntary Credit Restraining Program," Savings and Loan Annals, 1951 (Chicago, 1952), p. 36.
CHAPTER V

FEDERAL CONTROL OF THE MONEY SUPPLY

In the text "Money and Banking" by Steiner and Shapiro it is stated that the policy-making functions of the Federal Reserve System are directed toward regulating the nation's stock of money in the best interest of the general economy. Alterations of the money supply influence the volume of spending done by the public. Money expenditures in turn determine the effective demand for goods and services. In other words, the level of expenditures determines the level of business activity. Ordinarily money expenditures increase and decline with the stock of money. Thus, control of the stock of money is one way to regulate the public's expenditures for the current output of goods and services.\(^1\) In view of this it is a generally accepted principle that the Federal Reserve should exercise a positive influence on the money supply in an attempt to achieve as high a level of business activity as is consistent with price-level stability.

Due to the widely accepted belief that outside the U. S. Treasury, the commercial banking system is the only institution with the power to create money, discussions of control of the money supply are usually concerned only with the commercial banks. Other financial institutions, and other government agencies are said not to influence the quantity of money but merely to influence the direction of money flows.\(^2\) An

---

\(^{1}\) Steiner and Shapiro, op. cit., p. 296.

analysis of the creation of money in the commercial bank and the expansion of credit in other financial institutions will show a great similarity in their respective effects upon the economy as a whole.

**What Constitutes the Money Supply?** — If we are to discuss the money-creating process then we must clearly understand what is meant by money. According to Steiner and Shapiro there are several ways to approach this question. We are most interested in the way in which money influences the operations of the economic system. Therefore, we may define money in broad functional terms as anything which is generally accepted as a medium of exchange and/or as a store of value.¹

There is no sharp line of distinction between what is money and what is not money. There are varying degrees of moneyness, and the extent to which anything is called money depends upon the degree to which people use that thing either as a store of value or a medium of exchange.

A practical definition should include all those assets which people generally regard as being immediately available for spending purposes.² In a discussion of monetary policies, this seems to be a meaningful definition because what people themselves consider immediately available for spending purposes is in fact the sort of thing that will influence their volume of spending and thus the volume of business activity and the level of prices. From this point of view it appears that if the demand deposits of commercial banks are considered as money, then the time deposits of commercial banks should be considered as money although

¹Steiner and Shapiro, *op. cit.*, pp. 9, 10.
money of a lesser degree. The possession of a balance in a time deposit account influences the spending behavior of the owner, whether or not he actually withdraws from that account.

Time deposits are not usually considered money because they are not negotiable. Before a time deposit can be spent it must be converted into another form, while a check on a demand deposit is negotiable in its original form. Though the saver can get his money on demand, the liquidity requirement relegates time deposits to the category of near money. However, it should be recognized that things do not have to be in the process of being spent to be money. A demand deposit is considered as being money even though it is not active.¹ There is no question that owners of savings deposits consider these as money available for spending at will. Nor is there any doubt that their willingness to spend (and thus influence business activity and prices) is affected by their possession of a savings deposit balance. The difference between time and demand deposits is in the quality of the money created. When a commercial bank lends to the public, it does not consider whether the funds used originated in a time or demand deposit. In the case of the savings and loan association, theoretically, their savings accounts are the same as time deposits of the commercial bank. Therefore, the comparison of time deposits and demand deposits will show this difference between savings and loan accounts and demand deposits.

The Creation of Money and the Expansion of Credit.—It should be brought out at this point that no attempt is being made to contradict the fact that the commercial bank is unique in its ability to create

¹Ibid., p. 322.
money through derivative deposits. It is agreed that the commercial banking system is the only institution with the power to create derivative deposits. The point is that the commercial bank can create money through its primary deposits without regard to its derivative deposits. As far as the general economy is concerned any extension of credit by a financial institution increases the stock of money. This point will be explained more clearly later in this chapter.

The commercial bank can and does create credit through its primary deposits. When a deposit of currency is made to a bank, it may lend that amount of money less the amount that must be held in reserve. Theoretically, this money will then be deposited in a bank either by the borrower or his creditor. The second bank may then lend this sum again, less the necessary reserves, which will be deposited in a third bank. The process will continue until the amount that is deposited in the n-th bank is negligible. By this process the amount of money, currency plus credit, will be some multiple of the amount originally deposited depending on the reserve requirement of the Federal Reserve and the amount of leakage from the system.

Since in the lending function time deposits and demand deposits are interchangeable, and since the savings accounts of savings and loan associations are the same as the time deposits of commercial banks, the same process would then take place in the savings and loan system if it were assumed to be closed as is assumed in banking theory. The associations would receive funds which they would lend to the public. These funds would then become income for others who would place them in an association. The process would continue until a limit set by the reserve
requirements of the associations was reached just as in the banking system.

The banking theory of the creation of credit assumes that all capital loaned by the banks will remain within the system. However, it cannot be assumed that all the money lent by the savings and loan associations will return to the savings and loan system. Just as there is leakage from the banking system, there will be leakage from the savings and loan system, except that the rate will be much higher. The power of expansion then depends on the percentage of the funds loaned that return to the system. In our system of varied lending institutions the money will either be deposited in a bank or some other savings depository, but there will be no difference in the total process of credit expansion. The expansion may take the form of real money or near money, but the increase in the total credit supply is just as great.

All commercial banks in the United States are required by law to maintain reserves equal to a certain minimum percentage of their deposit liabilities in order to meet their customers' withdrawals. These reserves act as a limit to the expansion of the money supply. The savings and loan association is also required to maintain a position of liquidity to cover savers desires to redeem their savings. Such liquidity requirement is similar to the reserve requirement of the

---

1 Steiner and Shapiro, op. cit., pp. 124 and 138 and 141-145.
2 Interview with Professor George A. Davis (Atlanta University, Atlanta, Georgia, June 26, 1958).
3 Steiner and Shapiro, op. cit., p. 297.
member banks. Though the basis for the minimum reserve requirements are different the effect is the same since associations are not allowed to lend all of the funds that are placed with them. The savings of the associations are more expansionary than are the commercial banks demand deposits because the associations hold their liquid funds in commercial banks and government bonds, while the banks are required to keep their reserves in the Federal Reserve Banks. This savings and loan system is then almost 100% expansionary as all the funds, except cash on hand, are either lent to the public directly or through the commercial banks or lent to the government.

Much of the preceding discussion is based on an illustration given by Dr. Gordon McKinley in his article titled "The Federal Home Loan Bank System and the Control of Credit." In this article he goes on to say...

Extension of this principle to other financial institutions will show that the ability to create money is limited only by the rather vague line between what is money and what is not money.

As a general principle it is clear that any financial institution (or in fact any individual or non-financial institution) can create money provided that (a) a part of the liabilities of that institution are generally and usually considered by its creditors as money, and (b) the institution maintains less than 100% cash reserves against those liabilities.

The reason popular discussion refers to commercial banks as the only money creating agency is because in practice most people consider commercial bank demand deposit liabilities as having a greater degree of money-ness than the liabilities of other institutions.

...The money creating distinction between commercial banks and other financial institutions is therefore not one of kind, but of degree.

The money created by commercial banks has so much higher velocity that it alone accounts for most of the variation in spending.
The effect of credit controls now exercised by the Federal Reserve System is by no means confined to commercial banks.

This analysis brings out the importance of the savings and loan association and certain other financial institutions in any consideration of monetary policies. Money placed with an association forms the basis for an expansion in the level of credit available to the economy. Though the expansion is not as great as that of the commercial banks, monetary authorities must consider the accumulated effects of policy effecting the savings and loan association and other financial institutions. A reduction of the rate for advances or increases in credit lines which will effect borrowing by the associations will create or contract more than just the credit borrowed. It should also be noted that the associations must be considered when efforts are made to curtail or expand credit generally. A large amount of this credit is extended in the mortgage market. Thus far we have considered the entire credit system as one, it may be concluded that a restriction on one segment of this system will have effects on other areas of the system.

\(^1\)Gordon McKinley, op. cit., p. 330-331.
CHAPTER VI

FEDERAL CONTROL OF THE SUPPLY OF MORTGAGE CREDIT

Control by the Federal Reserve System and the Federal Home Loan Bank—Monetary policy concerning the mortgage market may take the form of either direct or indirect controls. In order to adequately cover this topic it is necessary to discuss both the policies of the Federal Reserve authorities that are directed at the mortgage market as a whole and the policies of the Federal Home Loan Bank Board which are directed at the savings and loan association in particular. In addition, there are policies of other government agencies, such as the Federal Housing Administration and the Federal National Mortgage Association, which affect the activities of real estate financing institutions.

As previously indicated the Federal Reserve has the task of keeping the economy running on an expanding, but not inflationary track. By its actions in the money market, the Federal Reserve can effect the rate of interest which will in turn have effects upon the availability of credit extended for various uses by the nation's financial institutions. The banking system as a whole can create deposits by lending the funds that are deposited with it, but the Federal Reserve actions can limit or expand the volume of this credit. Policies of the Federal Reserve directed at controlling the volume of bank credit take the form of changes in the discount rate, changes in the reserve requirements, and open market

1Steiner and Shapiro, op. cit., p. 347.
operations. However, much of the credit outstanding today is no longer in the banking system. The rise of consumer credit and home mortgage credit outside the banking system have made the Federal Reserve's control of the credit supply more difficult to administer. (See Table 5) Then too, many large corporations turn to financing their expansion programs internally rather than relying upon the open credit market as a source of financing. At year end 1956 the total home mortgage debt (1-to-4 family, non-farm homes) and consumer debt amounted to $141.1 billion. Of this amount the home mortgage debt accounted for $99.2 billion while consumer credit accounted for $41.9 billion. Non-farm mortgage debt on all types of houses amounted to $134.8 billion. The banking system still provides much of this credit, but an increasing portion is coming from sources outside the banking system such as insurance companies, savings and loan associations, pension funds, private investment, and corporations.

The Federal Reserve through its holdings of government bonds may influence the interest rate. If the Federal Reserve sells securities in large numbers on the open market, their prices will fall and their rate will rise. As the purchasers of these securities will have to give up liquid assets in order to buy the securities, the supply of credit will be reduced. These two actions will cause the entire interest structure to shift up. At first the institutional lenders will hold off purchases of any type in anticipation of a further rise in the rate

1Ibid., pp. 296-348.


3Steiner and Shapiro, op. cit., pp. 247, 346.
TABLE 5

SOURCES AND USE OF CAPITAL AND CREDIT, 1954-1956*
Net Increase in Amounts Outstanding
(Billions of Dollars)

<table>
<thead>
<tr>
<th>Major Types</th>
<th>1951</th>
<th>1952</th>
<th>1953</th>
<th>1954</th>
<th>1955</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Cash Borrowing</td>
<td>1.2</td>
<td>3.4</td>
<td>4.6</td>
<td>.09</td>
<td>0.2</td>
</tr>
<tr>
<td>State and Local Government issues (net)</td>
<td>2.2</td>
<td>3.1</td>
<td>4.6</td>
<td>5.4</td>
<td>5.1</td>
</tr>
<tr>
<td>Real Estate Mortgages</td>
<td>9.4</td>
<td>9.0</td>
<td>9.8</td>
<td>12.5</td>
<td>16.7</td>
</tr>
<tr>
<td>Corporate Bond and Stock issues (net)</td>
<td>5.7</td>
<td>7.1</td>
<td>5.4</td>
<td>5.6</td>
<td>4.8</td>
</tr>
<tr>
<td>Consumer Credit</td>
<td>0.7</td>
<td>4.4</td>
<td>3.7</td>
<td>-0.7</td>
<td>6.1</td>
</tr>
<tr>
<td>Bank Loans to Business</td>
<td>3.8</td>
<td>1.5</td>
<td>-0.1</td>
<td>0.6</td>
<td>4.6</td>
</tr>
<tr>
<td>Bank Loans other</td>
<td>0.8</td>
<td>1.6</td>
<td>1.3</td>
<td>2.4</td>
<td>1.7</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Selected Holders</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Reserve Banks</td>
<td>3.0</td>
<td>0.9</td>
<td>1.2</td>
<td>-0.9</td>
<td>-0.3</td>
</tr>
<tr>
<td>Commercial Banks</td>
<td>5.8</td>
<td>8.9</td>
<td>4.0</td>
<td>10.1</td>
<td>4.6</td>
</tr>
<tr>
<td>Non-bank holders</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mutual Savings Banks</td>
<td>0.8</td>
<td>1.7</td>
<td>1.8</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Savings and Loan Associations</td>
<td>2.0</td>
<td>3.0</td>
<td>3.8</td>
<td>4.5</td>
<td>5.3</td>
</tr>
<tr>
<td>Life Insurance Companies</td>
<td>3.4</td>
<td>4.4</td>
<td>4.5</td>
<td>5.1</td>
<td>5.5</td>
</tr>
<tr>
<td>Other Insurance Companies</td>
<td>1.2</td>
<td>1.2</td>
<td>1.2</td>
<td>1.2</td>
<td>1.0</td>
</tr>
<tr>
<td>Corporate Pension Funds</td>
<td>1.4</td>
<td>1.6</td>
<td>1.7</td>
<td>1.9</td>
<td></td>
</tr>
</tbody>
</table>

1Preliminary


of interest. But as the rates solidify at the higher level, the institutions will move into the government bond market in preference to other markets as the yields on these securities will be higher than other yields. Tightening credit will cause interest rates to rise in other areas and soon all available funds will be invested. This type of policy does not directly affect the savings and loan association as it has no choice but to hold real estate mortgages. But the other real estate financing institutions such as insurance companies, commercial banks, pension funds, and individuals will shift their investments to the higher yield areas.

When the Federal Reserve takes action to tighten the supply of money, the cost of money rises. In the case of the savings and loan associations, they will have to raise their dividend rates if they are going to compete for public funds, because the saving public will see safe and higher yield opportunities in other areas and will either withdraw their funds from the association or discontinue adding to their accounts.

The associations will not be able to borrow as easily in a tight money period. The primary source of their borrowing is the Home Loan Bank System. Since the Home Loan Banks have to go to the open market for their funds, in a period of high interest and tight money the Banks may not be able to get the amount of money they need at prices they can afford to pay.\footnote{Report of the Special Committee to Study The Federal Home Loan Bank, United States Savings and Loan League, Chicago, 1956, pp. 14, 15, 21.} The banks will then be forced to curtail their lending to the associations and the expansion of credit will be reduced. Thus in general, though the Federal Reserve does not exercise direct controls...
over the associations, through their activities in the money market, they influence the level of credit extended by the associations.

The indirect controls of the Federal Reserve over the money market may require a prohibitive amount of action. Small sales or purchases of securities may have no effect on the market. It should also be considered that these actions work slowly as they have to work through the monetary structure, parts of which may not react quickly. Consequently, direct controls over certain areas of the economy may be necessary.

Regulation "X" was an attempt to bridge the gap between existing direct controls and indirect controls. This was a discriminatory control directed toward the building industry. It is the feeling of the authorities that such controls on one segment of the economy should not be used unless they are absolutely necessary because they are not socially desirable. Regulation "X" attempted to reduce the volume of building by increasing the amount of the equity required of the builder. Need for materials in the defence effort and a desire to reduce building activity as a part of the general measure to control inflation were prime reasons for the issuance of Regulation "X". This regulation apparently accomplished its purpose to some extent as the demand for new residential and commercial construction was substantially reduced during 1950 and 1951. Whether this reduction was entirely due to Regulation "X" or partly due to other factors resulting from indirect controls would be difficult to determine. At other times the administration has considered the use of stand-by controls such as Regulation "X" if they could be deemed necessary. Such regulations have value when only one segment of the

---

economy is inflated while the others are running smoothly. This is a rarely seen condition due to the interdependence of all areas of the economy. However, in the case of Regulation "X" such a measure may have been necessary because the materials that were being used in the construction industry were being bid away from defense needs.¹

The direct controls of the Home Loan Bank System look similar to those of the Federal Reserve over the banking system, but the two do not exert the same influence over the institutions in their charge. Interest is charged on the discounts of the Federal Reserve and the advances of the Home Loan Banks, but the savings and loan associations demand is much less interest elastic than the banks. Changes in the interest rates of the Home Loan Banks' advances will not reduce the level of borrowing in any significant amount unless the change is great. In September, 1955 the banks raised their interest rates both as a reflection of the higher cost of the money to them and to discourage the associations from borrowing, but the rate of borrowing increased until the restrictions of September 15th were enforced. In a boom period, when interest rates are used to restrict the level of credit, the market is not very elastic to interest rates.² As a supervisory body the Home Loan Banks have some powers over the assets of the savings and loan associations, but these powers are not as exact as are the powers which the Federal Reserve has over the commercial banks. The Home Loan Banks can disallow certain types of loans if they are not considered safe holdings, but they have little other power.

¹Ibid., pp. 29-33.

²Hearings before a Subcommittee of the Committee on Banking and Currency, United States Senate, op. cit., p. 57.
In a boom period there will be sufficient opportunity for good loans, so this will not present itself as an obstacle to credit expansion. In a poorer period the Home Loan Banks will encourage loans when the opportunities are not as good so this supervision does not amount to much as long as the associations practices are safe and legal.

Direct efforts of the Federal Home Loan Bank will be effective only when the associations do not have excess funds. This also is true of the banking system. Many of the actions of the Federal Reserve are aimed at making the banks borrow if they are to expand their loans so that the discount rate will have effect. This may be accomplished with changes in the reserve requirements keeping excess reserves at a minimum. The Home Loan Banks can either offer funds or restrict the amount of funds that the association can borrow. Thus, when the associations have sufficient funds to cover the amount of lending they wish to undertake, there is no stimulus that the Banks can exert.¹

The Home Loan Banks have lent more money in time of large mortgage lending by the associations. As the advance is initiated by the associations, when excess funds are available there is no need to borrow and the Banks' control over the associations is reduced. Such borrowing as did occur in other times was due to the uneven demand for credit among the associations. Borrowing is usually heavier at all times in the South and the West even if there is an excess of funds in other areas of the country. The effects of the Home Loan Banks control of credit and, hence, mortgage lending become more important when the associations begin to take advantage of the Banks as a source of funds for relending

¹Ibid.
purposes. Therefore, the Banks can limit the associations lending at
top of the cycle by shutting off a supplementary supply of funds.

The converse is also true as the credit activity of the Home Loan
Banks may be used as a source of funds in a recessed period. First,
the associations must, as stated above, have no excess funds. In such
situations the associations will borrow if they see safe and attractive
opportunities for lending. During the depression the safety of the
mortgage opportunities was so low that the low cost of borrowing was not
a sufficient inducement to the associations. However, in the depression
the associations had some excess funds; so that in a depression which
offers some safe opportunities, some lending may go on if the funds are
offered at a low enough rate. The attractiveness of the opportunities
will be the important factor rather than the availability of Home Loan
Banks credit. The importance of monetary policy is conceded to be
relatively less potent in a depression than it is in a boom period for
these reasons. Credit terms may be eased, but the lender will still
question the safety of investing at this time.

Control By Other Government Agencies—Besides the monetary policies
of the Federal Reserve and the Home Loan Bank System, there are several
government agencies which directly influence the mortgage sector of the
economy.

The Federal Housing Administration (FHA) was created by the National
Housing Act of 1934. The agency was created by Congress at a time when
the residential construction industry was lagging due to the depression,
and the new legislation was designed to stimulate it to greater activity.
It was thought that by providing government insurance on home mortgage
loans, more credit would be made available for the financing of homes with
lower down payments and longer maturities — thus making it possible for more people to buy or build homes. ¹

For the government FHA meant a means to control the mortgage market. In 1956 forty-two percent of the private housing units started were financed by government secured mortgages and the year before the governments represented 51 percent of the total starts.² It can readily be seen that a change in the interest or terms of these mortgages have a strong influence on the building industry. The borrower must find an institution that will lend him the money before he can take advantage of the government security, as the FHA and VA do not make direct loans. FHA and VA terms do not influence the amount of mortgage credit available, but work through the demand for this widely held mortgage. All control that the government exercises over the home credit market comes through the desire to build. If the rates are eased more people will be able to afford the cost of a home. A substantial reduction of interest rates would widen the market for homes — reaching lower income groups. These mortgages are readily saleable on the open market and hence actions concerning the new mortgages to be made will influence their present price. If the FHA was to raise the rate on these mortgages the price of the mortgage outstanding would fall.

The rise in importance of secured mortgages has been a strong factor in mortgage lending on the part of insurance companies, savings banks and commercial banks. In 1956 only 15.7 percent of the dollar volume of total mortgage recordings of saving and loan associations were in

¹Boehmler et al. p. 457.
²United States Savings and Loan League, Savings and Loan Fact Book, 1957, pp. 33, 36.
government secured loans. Whereas the percentage for commercial banks was 33.7, for insurance companies was 31.4, for mutual savings banks was 46.7, and for mortgage companies was 74.6.\(^1\) Such loans do not appeal to the savings and loan associations as they do not return as high a yield as the conventional mortgages. Other institutions like these mortgages because they are readily marketable and insured, but they do not attract the associations because the associations hold only real estate mortgages and necessarily prefer a higher rate.

A change in the terms of FHA and VA loans will have an effect on the climate of the mortgage market. The builder will find it harder to finance his projects if the terms are tightened because he will have to receive more money from the buyer or invest more of his own money. The institution making the loan will find this more attractive as the more equity put into the property, the safer the loan. Consequently, the stimulus or curtailment of mortgage activity due to changes in the rates and/or terms of FHA and VA mortgages will work through the demand for these mortgages.

When the terms of FHA and VA mortgages are tightened demand is cut. The savings and loan associations will then make more conventional mortgages and be relatively unaffected by the change. However, banks and other institutional lenders, who prefer liquidity and safety of government backing, will not move into conventional mortgages as readily so that the total amount of mortgage credit extended may be reduced due to a drop in the demand for government-backed mortgages.

The Federal National Mortgage Association (FNMA) is the nation's

\(^1\)Ibid. p. 33.
principal secondary market in the home mortgage field. It was organized in 1938 by an act of Congress for the purpose of purchasing and selling FHA-insured mortgages, and later VA-guaranteed loans. Funds for the Association's secondary market operations are provided by (1) proceeds of preferred stock issued to the United States Treasury, (2) common stock subscriptions by mortgage sellers, and (3) borrowings through the sale of debentures to investors.\(^1\) When the market is tight FNMA will buy mortgages and hold them until the credit situation eases at which time they will sell their holdings.

The actions of FNMA act as a means of keeping the associations dependent on the monetary authorities as they will saturate excess funds by their sales when the market eases. This is similar to the actions of the Federal Reserve when they increase reserve requirements to keep the commercial banks from having excess reserves. Thus reducing the ability of the banks to expand credit without borrowing from the Federal Reserve.

Due to the fact that FNMA only deals in government backed loans it is not of too much value to savings and loan associations or they do not generally handle many of these loans. In poor times the FHA and VA loans of the association may be the loans that it most wishes to hold because of their safety. In good times the association may desire to sell their FHA and VA loans since their terms would be lower than those offered by the market. FNMA acts within its limited resources as a lender of the last resort to the associations in need of funds.

The government also has several plans in the form of "public works projects", which can be used to stimulate the construction industry in

\(^1\)Ibid., p. 77.
time of depression. These public works projects are used as a means to inject government funds into this private sector of the economy. The savings and loan associations cannot go into these areas as a lender, but would benefit if the construction industry is brought out of a depression due to these measures.

The government plays a large and significant part in the home mortgage market at present. Its actions may be indirect movements of monetary policy or direct regulation by the Home Loan Banks or actions aimed at the savings and loan associations or the building industry in general.
CHAPTER VII

AN ANALYSIS OF THE EFFECT OF MONETARY POLICY ON THE MORTGAGE MARKET IN AN INFLATIONARY PERIOD

With the change in direction of the business cycle after the 1953-1954 recession, a housing boom began to develop in 1954 which reached its peak in 1955. In the first three quarters of 1955 there were 1,046,700 housing starts as compared to 915,500 for the same period of 1954. This represented an increase of 14 percent. In terms of seasonally adjusted annual rates, house building activity declined in the latter part of 1955; but during the earlier months of the year they were running at annual rates in excess of 1.3 million. Total housing starts for 1955 were 1,328,900 as compared with 1,220,400 units started in 1954, and 1,103,800 units started in 1953. Though there was a marked increase in volume over recent years, housing starts in 1955 did not reach the record of 1,396,000 set in 1950 as shown in Table 6.

This acceleration in the building industry was partly attributable to forward commitments made in the second half of 1953 and in 1954. By end of 1954 new commitments to purchase FHA and VA mortgages began to decrease. Many institutional investors took the attitude that, in view of the large buildup of commitments and the prospective acquisition of VA and FHA mortgages, a slowdown in new commitments would be wise in the interest of portfolio balance. Then too, as a result of the housing boom and of good business conditions generally, industry and business began to initiate huge expansion programs.

---

1 United States Savings and Loan League, Savings and Loan Annals, 1955, op. cit., p. 268.
2 Includes non-farm housing, both private and public.
3 See Table 6.
### TABLE 6
NON-FARM HOUSING UNITS STARTED, PRIVATE AND PUBLIC*

<table>
<thead>
<tr>
<th>Year</th>
<th>Private Units</th>
<th>Public Units</th>
<th>Total Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>1940</td>
<td>529,000</td>
<td>73,000</td>
<td>602,000</td>
</tr>
<tr>
<td>1941</td>
<td>619,500</td>
<td>86,000</td>
<td>705,500</td>
</tr>
<tr>
<td>1942</td>
<td>301,200</td>
<td>54,800</td>
<td>356,000</td>
</tr>
<tr>
<td>1943</td>
<td>183,700</td>
<td>7,300</td>
<td>191,000</td>
</tr>
<tr>
<td>1944</td>
<td>138,700</td>
<td>3,100</td>
<td>141,800</td>
</tr>
<tr>
<td>1945</td>
<td>206,100</td>
<td>1,200</td>
<td>209,300</td>
</tr>
<tr>
<td>1946</td>
<td>662,500</td>
<td>8,000</td>
<td>670,500</td>
</tr>
<tr>
<td>1947</td>
<td>845,600</td>
<td>3,400</td>
<td>849,000</td>
</tr>
<tr>
<td>1948</td>
<td>913,500</td>
<td>18,100</td>
<td>931,600</td>
</tr>
<tr>
<td>1949</td>
<td>988,800</td>
<td>36,300</td>
<td>1,025,100</td>
</tr>
<tr>
<td>1950</td>
<td>1,353,200</td>
<td>43,800</td>
<td>1,396,000</td>
</tr>
<tr>
<td>1951</td>
<td>1,020,100</td>
<td>71,200</td>
<td>1,091,300</td>
</tr>
<tr>
<td>1952</td>
<td>1,068,500</td>
<td>58,500</td>
<td>1,127,000</td>
</tr>
<tr>
<td>1953</td>
<td>1,068,300</td>
<td>35,500</td>
<td>1,103,800</td>
</tr>
<tr>
<td>1954</td>
<td>1,301,700</td>
<td>18,700</td>
<td>1,220,400</td>
</tr>
<tr>
<td>1955</td>
<td>1,309,500</td>
<td>19,400</td>
<td>1,328,900</td>
</tr>
<tr>
<td>1956</td>
<td>1,097,200</td>
<td>23,600</td>
<td>1,120,800</td>
</tr>
</tbody>
</table>

(Quarterly, 1956)

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Private Units</th>
<th>Public Units</th>
<th>Total Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>March</td>
<td>244,600</td>
<td>7,300</td>
<td>251,900</td>
</tr>
<tr>
<td>June</td>
<td>325,300</td>
<td>7,100</td>
<td>332,400</td>
</tr>
<tr>
<td>September</td>
<td>292,900</td>
<td>6,000</td>
<td>298,900</td>
</tr>
<tr>
<td>December</td>
<td>234,400</td>
<td>3,200</td>
<td>237,600</td>
</tr>
</tbody>
</table>

It stands to reason that this would cause an increase in demand for capital by business and industry and as a result there would be a rise in the yields on the securities of business and industry. In light of this it is only natural that the investors would tend to switch from mortgages to these securities of business and industry.

In the first three quarters of 1955 general business activity expanded at a rapid rate. The gross national product advanced from a seasonably adjusted annual rate of $367 billion in the fourth quarter of 1954 to $392 billion in the third quarter of 1955. The economy moved to conditions of virtually full employment. Total employment rose to 65.5 million at mid year as compared to 62.3 million at the same point in 1954. Industrial production established new records, moving to 141 percent of the 1946-49 average. Personal incomes advanced to a seasonally adjusted annual rate of $306 billion in the third quarter, a gain of 6% over a year ago. Consumer spending expanded beyond the increase of personal income to the point of reducing the rate of saving. Business firms spent for inventory accumulation at an annual rate approaching $3 billion in contrast to a net liquidation in inventories of a similar amount in 1954. Over-all business firms in general were pursuing aggressive policies.

This increased demand for capital funds by business and industry, and the high levels of mortgage credit caused the Federal Reserve to become alarmed. The Federal Reserve sought to control the boom as a means of softening any recession that might follow and neutralizing the elements which might cause the recession. Consequently, they moved

---

into a policy of credit restraint and this tight money policy acted to accelerate the rise of sensitive interest rates. In addition to the declining rate of new commitments by investors to purchase VA and FHA mortgages the credit terms for these mortgages were tightened.

In July the Federal Housing Administration reduced the length of the mortgages they would back from 30 years to 25 years and increased the minimum down-payment on homes from 5 percent to 7 percent of the purchase price. At the same time the Veterans Administration lifted the minimum down-payment from nothing to 2 percent of purchase price and also lowered the maximum length of mortgages they would guarantee from 30 years to 25 years. The shortened period of the mortgage had the effect of raising the monthly payment, and hence, the monthly carrying charge of the mortgage. Though the increase in minimum down-payments was apparently small, it had the effect of eliminating the marginal borrower who only came into the market on the no cash basis (which even included the loan closing cost in the mortgage). As a result of these actions more and more emphasis was placed on conventional residential and business mortgages since the rates on these were sensitive to capital market changes. Furthermore, early in 1955 many investors began to shift funds to industrial and public utility securities.

The change in FHA and VA regulations was aimed at the construction industry in particular. Inflationary pressures were mounting. The credit market was pressed to meet the demands of the mortgage market which was inflationary in itself, so direct action was taken to reduce

1Ibid.
the demand for mortgage credit. The Economic Report of the President, transmitted to Congress on January 24, 1956 gave the following explanation of the VA and FHA action:

In the spring of 1955 mortgage loans with maturities of 26 to 30 years represented nearly two-thirds of the total veterans' loans on new homes compared with about one-third a year earlier. The like was true of no down-payment mortgages....In addition strains in the mortgage market began to be evident in the spring and summer of 1955. Finding it difficult to handle the large volume of mortgage loans and commitments, mortgage lenders resorted increasingly to short-term credit.\(^1\) The strains on the financial system were paralleled by pressures on the resources available to the construction industry. In view of these developments, the FHA and VA issued regulations in late April.\(^2\)

Immediate criticism was raised from the building industry as these changes made a deep cut into their market. There was a profound effect on the expectations of the builders although the real effects of these actions would not be measurable until many months later due to the lag in the building industry caused by the forward commitment procedure.

Complaints from the building industry and other components of the mortgage market aroused much concern in Washington and as a result there were numerous discussions on the situation. Most noteworthy among these were the Hearings before a Subcommittee of the Committee on Banking and Currency, United States Senate, Eighty-fourth Congress, First Session entitled "A Roundtable Discussion on the Impact of Federal Credit Policies on Residential Construction and Mortgage Financing," held November 28 and 29, 1955.

\(^1\)Refers to "mortgage warehousing" which was a major topic of discussion at the hearings on "Mortgage Market Problems" held before a Subcommittee of the Committee on Banking and Currency, United States Senate on November 28 and 29, 1955.

During these hearings Mr. Levitt, President, William Levitt and Sons, (Builders) Philadelphia, Pennsylvania made the following statement:

One more little thing I would like to add, coming back to the main subject matter of this discussion, and that is the present controls.

The present controls that were put on in August... have no effect on the market today....They will not effect Levitt until some time next May. We have commitments and what we call certificates or reasonable value from the VA... that will cover us until then -- so we are not affected. But for the purpose of this discussion, we analyzed the last 500 applications that we took and applied to those applications the new yardstick....We found that 29.2 percent of those people would go by the wayside....If you can extend that kind of reasoning and thinking throughout the country, ...roughly 30 percent of the housing volume for next year would drop, if we do get that kind of drop, then we are in trouble.

There is one unfortunate thing about your reasoning, Mr. Martin, about turning the brakes on or off again rapidly. You say if we get into trouble, the Federal Reserve will execute an about-face. Unfortunately, that doesn't help us in the industry....

For instance, in about a week or two, we, in my company, will complete our schedule, our plans, buying, and so on, for the next year. If next May it is seen that these present controls hurt us...(all builders) and the Federal Reserve realizes that and executes the about-face, it will accomplish nothing. We are gearing now, based on your present controls, for what we think will be the volume for next year. As you said, very properly, we are all engaged in a profit-and-loss enterprise, and we like profits and not losses. We are being careful as to what we gear for next year....

Once you turn these controls off again in April or May... it will be too late for us. It will be too late for the mass of builders. It will take them another 6 or 8 months to gear up and that goes through 1956.

That has been the whole history and the whole trouble with this industry and its relationships with the government and the various branches of government that have

1William McChesney Martin, Chairman, Board of Governors of the Federal Reserve System.
anything to do with the housing industry.

You decided how that things were getting out of hand, so you put the brakes on....They don't effect us right now. We slowed down for an altogether different reason, because we have not money. But you put controls on to hit us next May when we hope to have a little money. Then come the new controls, and then we are really in trouble. That is very confusing....

The preceding quotation may appear a little lengthy to be inserted in a paper, however, I felt that it should be included because it brings out rather clearly the far-reaching effects of Federal Reserve policies and how they influence particular segments of the economy. It should be noted here that the building industry is only a component of the Housing segment of the economy; and that Federal Reserve policies have only an indirect effect on the Housing segment. To further sharpen this point I would like to continue with Mr. Martin's comment on Mr. Levitts statements and the brief exchange between Mr. Martin and Mr. Levitt:

Mr. Martin. I would like to make one comment on that. I tried to emphasize that the Federal Reserve is well aware, insofar as its role in the general pool is concerned, that we cannot turn on and off like a faucet. If we have that power we would have exercised it long ago, and we wouldn't have had any trouble in the last 25 to 30 years in the country.

We fully understand the point you are making. But our responsibility is for the general pool of credit, and a private business will have to adjust to that. Our duty is to try to keep the pressures on the overall pool of credit in balance. The free economy has to decide what it wants to do with the supply of credit in the pool.

Mr. Levitt....Why what amounts to a regulation X...and not a regulation W?

Mr. Martin. We are not doing anything on regulation X.

---

Mr. Levitt. I am calling it that...the one we had in 1952, where housing was restricted, but at the same time we had a regulation W, which provided for restrictions of other credit.

Mr. Martin. The housing agencies can discuss any aspect of that they want. I am talking about the overall control of credit. We do nothing that doesn't effect everybody, ... with the exception of stock market regulation....

Mr. Levitt. While I appreciate that the current regulation was put in by the housing agencies, I think that the housing agencies were advised by the Federal Reserve Board.

Mr. Martin. ....The other agencies can discuss all they want the terms of credit for individual areas. I just want to make it clear that my discussion here has been directed to the Federal Reserve's regulation of the money supply. 1

The tight money situation in the savings and loan association was largely due to a fall in the rate of savings at a time when the demand for mortgage credit was expanding. In the first nine months of the year new savings receipts totaled $10.3 billion, an increase of 24% over 1954, while withdrawals rose to $7 billion, or 33% above a year ago. This resulted in a $3.3 billion net savings growth, which was only 9% greater than the three-quarter gain for 1954. The high withdrawal rate was probably due to the increased purchase of automobiles, appliances and other consumer goods. Consumption expenditures for the full year 1955 were $254 billion as compared to $236.5 billion for 1954.

Ordinarily, savings and loan associations have been able to obtain a sufficient volume of funds through growth in savings, repayments on outstanding mortgages, and current earnings to finance their new loan requirements. To the contrary it became apparent in mid-year 1955, that net savings receipts were failing to keep pace with the vigorous

1Ibid., pp. 34, 34.
2United States Savings and Loan League, Savings and Loan Annals, 1955, op. cit., p. 20.
3Ibid., p. 11.
demand for mortgage credit. During the month of July the net savings flow was only $106,641 thousands compared to $742,369 thousands for June and $419,470 thousands in the previous month. The timing of the sharp reduction in July is partially explained by the fact that the associations pay their dividends either in June 30 or July 1, so many people that would have made withdrawals earlier withheld their repurchases until July. The net flow of savings rose in August and again in October as the rate of withdrawals fell.

Though the Federal Reserve initiated the general tight money policy of the period under discussion, the action that effected the savings and loan associations came from the Federal Home Loan Bank Board. Those associations that had relied upon a continued strong savings inflow in making loan commitments, naturally, needed assistance from their respective district banks. This fact is indicated by the rapid rise in bank advances as shown in Table 8. Through the late Spring and Summer the banks were getting into a situation similar to that of the associations. As the level of advances increased, the banks became pressed for funds.

On July 1, the bank floated $200 million of consolidated obligations. This amount was based on the banks expectations of their needs until August 15th. But even before delivery of this issue it became apparent that the Board had underestimated the needs. So they contacted the Treasury and asked if they could have another offering on July 15th. The answer was no, because it interferred with the Treasury's financing plans. This issue would have come right after a large Treasury issue and this was not considered wise since the market was already tight.

---

<table>
<thead>
<tr>
<th>Date</th>
<th>Capital Stock</th>
<th>Reserve and Surplus</th>
<th>Members' Deposit</th>
<th>Consolidated Obligations</th>
<th>Total Liabilities and Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>1954-Oct. 31</td>
<td>430</td>
<td>44</td>
<td>763</td>
<td>179</td>
<td>1,421</td>
</tr>
<tr>
<td>1955-Jun. 30</td>
<td>496</td>
<td>44</td>
<td>855</td>
<td>341</td>
<td>1,743</td>
</tr>
<tr>
<td>July 31</td>
<td>499</td>
<td>46</td>
<td>740</td>
<td>341</td>
<td>1,630</td>
</tr>
<tr>
<td>Aug. 31</td>
<td>501</td>
<td>47</td>
<td>706</td>
<td>460</td>
<td>1,720</td>
</tr>
<tr>
<td>Sept. 30</td>
<td>504</td>
<td>48</td>
<td>668</td>
<td>535</td>
<td>1,762</td>
</tr>
<tr>
<td>Oct. 27</td>
<td>506</td>
<td>49</td>
<td>663</td>
<td>740</td>
<td>1,962&lt;sup&gt;2&lt;/sup&gt;</td>
</tr>
<tr>
<td>Nov. 3</td>
<td>506</td>
<td>49</td>
<td>659</td>
<td>740</td>
<td>1,978&lt;sup&gt;2&lt;/sup&gt;</td>
</tr>
<tr>
<td>Nov. 15</td>
<td>(3)</td>
<td>(3)</td>
<td>(3)</td>
<td>975</td>
<td>2,200&lt;sup&gt;2&lt;/sup&gt;</td>
</tr>
</tbody>
</table>


<sup>2</sup>Includes other liabilities; totals after September 30, 1955, are approximations.

<sup>3</sup>Not available at this time.
TABLE 8
FEDERAL HOME LOAN BANK SYSTEM ASSETS1
(Millions)

<table>
<thead>
<tr>
<th>Date</th>
<th>Cash</th>
<th>Government Securities</th>
<th>Advances to Members</th>
<th>Total Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1943-Oct. 31</td>
<td>43</td>
<td>663</td>
<td>708</td>
<td>1,421</td>
</tr>
<tr>
<td>1955-June 30</td>
<td>51</td>
<td>669</td>
<td>1,017</td>
<td>1,743</td>
</tr>
<tr>
<td>July 31</td>
<td>27</td>
<td>534</td>
<td>1,061</td>
<td>1,630</td>
</tr>
<tr>
<td>Aug. 31</td>
<td>38</td>
<td>486</td>
<td>1,187</td>
<td>1,720</td>
</tr>
<tr>
<td>Sept. 30</td>
<td>35</td>
<td>446</td>
<td>1,275</td>
<td>1,762</td>
</tr>
<tr>
<td>Oct. 27</td>
<td>44</td>
<td>579</td>
<td>1,335</td>
<td>1,9622</td>
</tr>
<tr>
<td>Nov. 3</td>
<td>43</td>
<td>563</td>
<td>1,350</td>
<td>1,9782</td>
</tr>
<tr>
<td>Nov. 15</td>
<td>(3)</td>
<td>(3)</td>
<td>(3)</td>
<td>2,2002</td>
</tr>
</tbody>
</table>


2Includes other assets; totals after September 30, 1955 are approximations.

3Not available at this time.
As a consequence, the banks had no choice but to sell some of the
government securities which they held. Of the $900 million held in
government securities the banks had sold about $400 millions by the
first of September. It was forseen that at the rate at which they
were going the banks would soon be out of securities. Due to the con-
tinuing pressure and demand for credit the Board decided that it would
be necessary to place some very definite curbs on its use. So on
September 8th, the Board issued the following statement to its members:

You cannot borrow from the bank system for forward
commitments -- in other words, for commitments that are
made from this date forward. We will take care of any of
your emergency needs. We will take care of commitments
that have been entered into prior to this time. But we
will not make credit available for commitments that you
enter into from this day forward. You must look to your
own repayment of mortgages and to your increase in savings to
take care of your lending.2

For many associations this action practically curtailed all lending
activity. However, the Federal Home Loan Bank wrote the presidents
of the district banks again stating that they by no means intended or
desired that the savings and loan associations quit making loans. They
indicated that they only desired that the associations work toward an
adjustment of lending activities to the inflow of funds available to them
from repayments on mortgages and net savings.3

This action occurred both because of the effect that continued sales
of government securities would have had on the banks and because further

---

1Statement by McAlliseer at the Hearings before a Subcommittee of the
Committee on Banking and Currency, op. cit., p. 47.
2Ibid., p. 47.
3Ibid., pp. 50, 51.
Credit expansion was not desired. The sale of securities would merely have taken funds from other credit areas and directed them into the home mortgage area. As this area was thought to be inflationary at the time further credit extension was not desired. Also the banks had to consider their position in case of a need for credit to aid the associations if withdrawals became heavier. If the banks had been left without any short term governments than the bank's main function could not be fulfilled.

The Federal Home Loan Bank Board sent a letter to the President of the Federal Home Loan Banks part of which read as follows:

...the Board is of the opinion that the current credit restraints should be applied in a manner which will permit the members to continue to make some new loans. Therefore, it is suggested that as a general rule, not more than half of a member's receipts from net savings and loan amortizations should be applied to the reduction of prior commitments as of September 8 before the member is eligible to receive an advance....

This letter was meant to take some of the paralyzing effect out of the policy restraining bank advances. It was especially meant to ease the situation for those associations which had had to just about curtail all lending activity. Toward the end of 1955 there was further easing of restrictions.

About this time the Federal National Mortgage Association suspended sales of more than 2,500 million of mortgages it held. There were to be no further sales pending the conclusion of a study of the general secondary mortgage market. An official said, "an anticipated practical effect of taking these off the market would make it easier for builders

\[1\text{ibid., p. 53.}\]
to get mortgage money for new construction since FNMA sales would not be in competition with them. The FNMA suspensions did not ease the situation, but kept new demand from entering the market at this time. Soon after FNMA reversed the direction of their activity and bought mortgages in the open market. By December FNMA was buying at a rate of $350 million per year. Until this time FNMA had been a last resort as a source of funds as the association selling the mortgages had to subscribe to stock in the corporation equal to 3 percent of the mortgages sold. In 1956 this requirement was reduced to 2 percent and later to 1 percent.

In January 1956, the July restriction of terms of VA and FHA mortgages was reversed. A little later FNMA announced a repurchase plan which would enable the associations to temporarily sell mortgages and then buy them back nine months later at the same price. This enabled the association to make commitments to builders at a time when 1956 construction schedules were being prepared.

The credit curbs caused a decline from the high level of lending earlier in the year. Lending in the fourth quarter of 1955 was down 4 percent from the previous year. However, lending for the year was up 27 percent over 1954. After the action of the Home Loan Bank Board, many associations took stock of their ability to lend and decided no further lending was possible. They were no doubt afraid that a recurrence of the

---

3 Savings and Loan Annals, 1956, op. cit., p. 143.
July drop in net savings would leave them with no source of credit to meet demand. They consequently held a more liquid position to the extreme of some associations curtailing all lending. Seemingly, many associations became over cautious, a psychological effect which was not expected or desired by the Home Loan Bank Board and led to the easing of the restrictions in October and December. The authorities found it hard to evaluate the real effect of the restrictions. Lending was reduced, but it was difficult to determine what part of the reduction came from forced liquidity and what part from over-caution.

This analysis of a tight money period shows the complex relationship between monetary policy and the construction industry. When inflationary pressures were feared, the quantity of credit was reduced and government backed loans made more difficult to obtain. The construction industry under boom influences would plan new construction as long as expectations looked good. However, as soon as his source of credit was curtailed, the situation changed for the builder. He was forced to curtail his construction, even though he still saw a high level of demand. It should be considered that the psychological effects of restrictions may be more responsible for results than the real effects. It may be noted that when the level of construction began to fall below the desired amount the credit situation was eased so that more construction was planned.

From this analysis we can draw the conclusion that the level of home mortgage credit extended by the savings and loan associations depends on the level of savings and credit extended by the Home Loan Banks. In this period we saw both net savings and credit fall at a time of increasing demand for mortgage credit. In a boom period when
the associations are loaned up, the Home Loan Banks can effect the level of loans which are made on borrowed funds. This will have adverse effects on the construction industry unless the absolute level of net savings can affect the demand for mortgage credit. Thus by manipulating the level of credit extended the administration can control the level of construction. Changes in the terms of government backed mortgages can be used to supplement the monetary action. Of course the question still remain as to whether the necessary control can be achieved without the use of direct regulations upon a particular segment of the economy.

In the years following the tight money period covered in this analysis many of the points brought out here came into sharp focus. In 1956 and 1957 business and industrial spending for plant and equipment continued to rise. This caused rising interest rates in the sensitive areas of the capital market which made the rigid rates of VA and FHA mortgages less and less attractive. Consequently, new commitments in this area declined to very low levels. Even though increasingly large discounts were quoted on VA and FHA mortgages, funds were still not made available for those mortgages because most institutional investors were not willing to purchase on a heavy discount basis. This situation was partially due to the restrictive credit policy on the Federal Reserve which added to the ordinary market forces causing a rise in interest rates in the industrial and public utility financing field.

All this resulted in a reduced volume of housing starts in the years in question, with a larger proportion being financed on a conventional basis. FHA interest rates have been raised from time to time in an effort to attract more funds. These increases could do little toward making more funds available because of the highly attractive rates on business and industrial securities and conventional mortgages.
Although the Federal Reserve Board is not concerned specifically with the mortgage market the monetary policies which they initiate have had a highly significant impact upon the mortgage market as a whole and a differential impact upon the various sectors of the market. Sometimes monetary policies stimulate the activities of Real Estate Financing Institutions and at other times they exert a drag on activity. It should be clear, however, that basic changes in the supply of and demand for capital funds are the controlling influence in the mortgage market and that monetary policies have a marginal effect.

With regard to the impact of general credit controls on the mortgage market, the following should have been observed. Because of the fixed rate on government-insured and guaranteed mortgages, and the ineffectiveness of discounts or premiums as a device for providing yield flexibility, a restrictive credit policy will usually hamper government-insured and guaranteed credit, and an easy credit policy will usually aid this sector of the mortgage market. This might be considered to be in the public good because residential construction automatically becomes reduced in a period of industrial expansion and is stimulated in a period of declining capital spending by business and industry. However, it should also be considered that the effect of monetary policy upon the government-insured and guaranteed mortgage market is somewhat haphazard.

It should also be understood that general credit controls will not have a direct effect upon the residential mortgage sector as long
as the interest rate on government-insured and guaranteed mortgages is not allowed to move freely and flexibly in response to general capital market forces.

It appears that general credit policies will have a difficult time coping with mortgage credit and housing expenditures because of the forward commitment process and the long lag between commitment and disbursement of funds. Monetary authorities often speak of the difficulties of timing monetary policies. Because of the forward commitment process, these difficulties seem to be greater in the case of residential mortgage credit than anywhere else. As expressed in this paper the forward commitment process is essential to the building industry. Therefore, it appears that more consideration should be given to these facts in the initiating of monetary policies.

The activities of savings and loan associations can be summarized as lending all the money that is placed with them (except reserves necessary for liquidity). Usually, the level of mortgage activity will follow the level of savings which are the major source of the associations' assets. Hence the associations cannot be kept out of the mortgage market as long as they receive savings, except by direct restrictions. Likewise, the associations cannot be forced to enter the market if the available opportunities are not considered safe or attractive. The policy which the government may advance is, then, restricted to the regulation of the volume of funds. The Home Loan Banks, FHA, FNMA, and like agencies may alter the amount of funds extended to the association but they have little control over the use of these funds.

The assets and lending of the savings and loan associations will
follow the general business cycle due to fluctuations in the level of savings. These fluctuations will not be as great as the fall in the level of business. However, a gain or loss in savings will have a multiple effect through the credit multiplier. The extent of the expansion or contraction will depend upon the extent to which the funds loaned revert to savings and loan associations.

The associations will not be primarily influenced by interest rates or activity of other lenders, but will withdraw from the market if foreclosures or other signs of poor credit are evidenced. If the climate of the market is bad, raising of FHA and VA rates will not have much effect on the investment policies of the associations, though such action may strengthen the market.

The author sincerely hopes that this thesis has been instrumental in pointing out the close and important relationship between monetary policy and the activities of the institutions involved in real estate financing. It should be clear that real estate mortgage financing and the institutions connected therewith are taking a position of increasing importance in the credit and capital markets of our nation. Further, it should be clear that, with the administrative authorities becoming more and more concerned with keeping the American economy on the thin line of balance between recession and inflation, there will be increasing and continuing importance attached to monetary, credit, and fiscal policies. In light of the above observations, it seems that in the future real estate financing, residential construction, the savings and loan business and the Federal Home Loan Bank will necessarily be deeply involved in the formulation of extension of national monetary and credit policies.
There are indications that monetary authorities such as the Federal Reserve, the Treasury, and the Council of Economic Advisers, are giving increasing attention to home mortgage financing. In our present economy there can be neither credit restraint nor credit stimulus without significant impact on the mortgage market.

That there is an ever increasing relationship between home mortgage financing and money market considerations is evidenced by the many congressional hearings that have been held on the topic and the concern of the Federal Reserve authorities with the relationship between acquisition of mortgages and the level of the government bond market. The impact of money market conditions on the note issue of the Federal Home Loan Banks and, hence, on their advances to savings and loan associations is very much to be considered. More and more, mortgage debt and residential construction are tied inseparably to the credit and capital markets and condition of the economy as a whole.
BIBLIOGRAPHY

Books


Articles


Public Documents


Reports