

Office Correspondence

FEDERAL RESERVE
BOARD

Date June 30, 1936

To Chairman Eccles

Subject: President's proposal in regard

From J. M. Daiger

to FHA loans on small houses.

... 16-552

Mr. McDonald asked me to attend a meeting in his office yesterday afternoon to discuss with him and his principal assistants a proposed amendment to the mortgage insurance regulations governing eligible mortgagors. The proposal was to eliminate the requirement that a mortgagor must establish that he does not have outstanding any unpaid obligation contracted in connection with the mortgaged property other than the first mortgage.

You will recall my telling you recently that the President had been given to understand that the FHA regulations could be, and would be, amended in such a way as to stimulate the construction of houses selling from \$2,500 to \$3,500. It appears that Mr. Jones advised the President that small-house construction could be stimulated in this manner and that new legislation might therefore better be deferred in view of the differences of opinion that had developed in regard to it. As related to me at second hand, the conversation then proceeded somewhat as follows:

THE PRESIDENT: Very well, then; that will give us plenty of time to work out an entirely new housing program this summer and get it ready for the next Congress. Meanwhile, though, I want to do everything possible under the FHA to help the people who cannot have a new house if they have to pay more than \$2,500 or \$3,000 or \$3,500 for it.

MR. JONES: All right, Mr. President; I am sure that Stewart can take care of them under his present set-up. What is it that you want these people to have?--90 per cent loans?

THE PRESIDENT: No, not 90 per cent--100 per cent. Can that be done under the present FHA set-up?

MR. JONES: Yes, I understand that it can. I am told there is nothing in the law which says that a borrower cannot get more than an 80 per cent loan. It is only the insurance that is limited to 80 per cent.

THE PRESIDENT: Well, I want these little fellows to be able to borrow up to 100 per cent, and I want whatever change is made to apply only to the building of small houses--not over \$3,500.

Up to this point the matter had not been discussed with Mr. McDonald. When Mr. Jones took it up with him, however, he agreed to try to work out a change in regulations that would accomplish what the President had in mind.

Accordingly, the FHA staff worked out a change in the regulations to authorize, in the case of new houses selling up to \$3,500, a second mortgage up to 20 per cent to bear interest at not more than 6 per cent, and to be paid off in monthly installments during the life of the first mortgage. Mr. McDonald then outlined the proposed change to the President, explaining that it would apply only in cases where the credit investigation of the borrower indicated that he was able to take care of the monthly payments on both the first and the second mortgage. The President said that the plan seemed all right, but he did not at that time evidence any eagerness to have it put into effect immediately.

Mr. McDonald thereupon decided to have the proposed change canvassed by the principal field officers of the FHA. Except in California the reaction was wholly unfavorable. The field offices seized upon the proposal, however, to urge, in the interest of volume generally, that the down-payment requirements under the existing regulations be made less rigid. This is a matter that also has a good many advocates in the central office, where there has been a great deal of pressure, as there has also been in the field offices, from speculative builders who want to do business on a 10 per cent down payment, a 10 per cent note, and an 80 per cent insured mortgage.

Yesterday Mr. McDonald asked me if I would not help him to decide the question on the basis of the recommendation made to him by his principal assistants, their recommendation being simply to strike out the regulatory provision that the mortgagor must have no unpaid obligation in connection with the property other than the first mortgage. The effect of this would be to retain the provision that the property be free and clear of all liens other than the first mortgage--in other words, a second mortgage could not be given--but the mortgagor would be permitted to enter into other contractual obligations in connection with the purchase of the property. The recommendation was that this change in the regulations be made applicable to both new construction and existing properties and to all price classes up to the legal limit of \$20,000.

I expressed the view that, while this proposal was within the letter of the law, it was really an effort to get around the intent of the Housing Act, which was that the mortgagee and, what was more important, the mortgage insurance fund should have the protection afforded

by an original equity of not less than 20 per cent actually paid by a borrower whose indebtedness on the property was represented solely by the first mortgage.

I pointed out that a change in the regulations to authorize loans up to 100 per cent, when the mortgages were insurable only up to 80 per cent, could only be construed as an invitation and encouragement to secondary financing without a second mortgage. I said this was a distinction without a difference, and could only result in bringing the second mortgage into use in connection with the mortgage insurance program. I expressed the opinion that this would be, quite definitely, a retrogressive step on the part of the Roosevelt Administration.

Furthermore, I pointed out that the proposal did not go directly to the problem of the small house, which the President had solely in mind, and that any stimulation it might give here and there to new construction would be more than offset by resentment on the part of the more responsible lending institutions against the lowering of FHA standards. I pointed out further that the FHA has now reached the point where some 3,500 banks, not to mention other classes of lending agencies, are actively making mortgages under Title II; that the volume under Title II jumped from \$23,000,000 in March to \$29,000,000 in April, then to more than \$35,000,000 in May, and then to more than \$47,000,000 in June; and that in June for the first time the mortgages insured on new construction exceeded the volume of refinancing.

I said frankly that I thought it was only fair to the President, in these circumstances, to explain to him that the effort to force lending on small houses beyond the 80 per cent that could be insured would in all probability retard the FHA program rather than advance it.

"In other words, then," said Mr. McDonald, "what you advise is: 'Don't rock the boat.' Is that it?"

"Yes," I answered, "that is it."

"Well," he said, "I agree with you one hundred per cent. I think the thing for me to do is to have another talk with Jesse Jones and then for both of us to have a talk with the President."