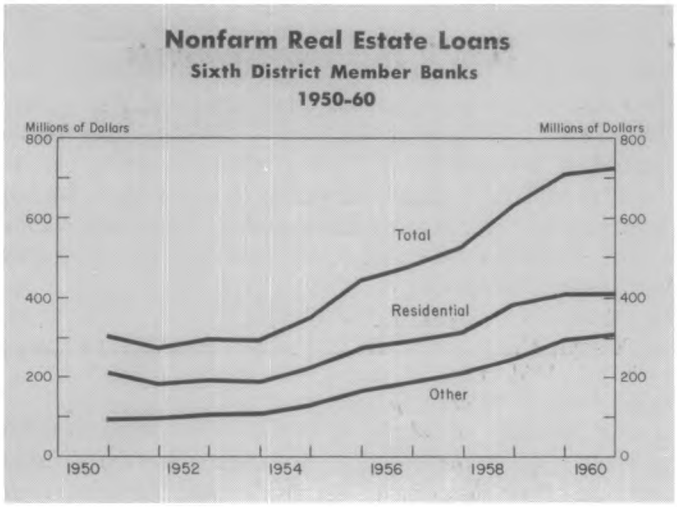
District Banks and Mortgage Financing

The Southeast, like the nation, vastly increased the size and quality of its stock of houses and commercial structures during the postwar period. Accordingly, financing requirements of home buyers, builders, and mortgage lenders increased tremendously. Financial institutions oriented to the mortgage market responded to this basic demand for money and provided funds in large quantities. While the activities of such institutions as savings and loan associations and life insurance companies are well known, the substantial contribution made by commercial banks has been somewhat less publicized.

What have been the trends in real estate lending by banks in this region during the last decade? How do large and small banks compare with regard to their holdings of mortgage loan assets and their ability to increase them? Can southern banks make a greater contribution to mortgage financing within the bounds of safety and liquidity?

All Types of Real Estate Lending Expand

At member banks in the Sixth Federal Reserve District, loans secured by nonfarm real estate amounted to $720 million on December 31, 1960, representing an increase of $420 million since the end of 1950. This gain was about evenly divided between loans on residential properties and those on commercial properties, although the proportion secured by residential structures declined from



68 to 57 percent. Most nonfarm real estate loans represent mortgage holdings, but some construction loans and a small amount of other business loans secured by real estate are included. Loans secured by farm land amounted to $52 million at the end of 1960, or 6.7 percent of total real estate loans.

District member banks also sharply expanded their loans to construction firms and interim mortgage credit to other real estate lenders during the period after World War II. Construction loans more than quadrupled from 1946 to 1957, the latest year for which outstanding loan data are available. Loans to other real estate lenders—mainly mortgage companies, which originate and service loans for permanent investors—increased 250 percent between August 1954 and February 1959 at member banks in leading District cities.

Indeed, member banks in this District are probably more active in making construction loans and loans to other real estate lenders than in buying permanent mortgages. Although a loan survey made in October 1957 showed that construction loans amounted to only $145 million, or 28 percent of nonfarm real estate loans, and that loans to other real estate lenders amounted to $195 million, or 38 percent, these percentages understate the importance of these loans. Both types of credit mature much sooner than the average real estate loan—an average six months for construction loans and less for loans to mortgage companies—and therefore turn over faster.

Judging from national data, the relative importance of commercial banks in the market for nonfarm residential mortgages increased sharply immediately after World War II, reaching an historical peak in 1947 and 1948. Thereafter, as the resources of other institutions specializing in mortgage finance grew rapidly, the share held by banks declined. In District states, it dropped from 15 to 8 percent from the end of 1949 to the end of 1959.

Nevertheless, bank-held mortgages continued to grow more rapidly than total bank resources. The share of nonfarm real estate loans in total District member bank assets increased from 4.5 to 6.0 percent from 1950 to 1960.

What caused real estate loans at District banks to increase as much as they did? First, the heavy postwar demand for mortgage credit made itself felt at banks as well as at other lending institutions. In Florida, where population growth and demand were especially great, growth in real estate loans was strongest. Second, higher interest rates on real estate loans than on some other types of loans and securities made this type of investment comparatively attractive to banks. Third, the near doubling of total resources and a somewhat greater gain in time deposits permitted member banks to invest more in real estate loans without loss of liquidity with respect to deposits.

Lending by Small and Large Banks

As a general rule, the smaller the bank, the more important its real estate lending to total lending activity. For example, at the end of 1960, 31 percent of the total loans at banks with deposits of less than $5 million were real estate loans, compared to 9 percent at banks with deposits of $100 million and over.

Most small banks, of course, are in small cities. Demands for private short-term credit from commercial and industrial borrowers are generally less strong there than in the large cities, and competition from other real estate lenders may also be weaker. Moreover, time deposits, which may influence the amount of real estate lending banks can do, are greater in relation to total deposits at small banks than at large ones. Because of legal limitations, a national bank must hold its outstanding loans secured by real estate (excluding Government insured or guaranteed loans and construction loans) within an

amount no greater than 60 percent of its total time deposits or 100 percent of unimpaired capital and surplus, whichever is higher. Most member banks are operating well within these limits, but many relate their long-term real estate lending to the inflow of time deposits.

Real Estate Loans
Sixth District Member Banks
1950 and 1960

Deposit Size of Bank ($ Millions)	Number of Banks Dec. 30 1950	Number of Banks Dec. 31 1960	Dollar Volume of Loans Dec. 30 1950	Dollar Volume of Loans Dec. 31 1960	Real Estate as a Percent of Total Loans Dec. 30 1950	Real Estate as a Percent of Total Loans Dec. 31 1960
	Percent of Total					
0 - 5	50	28	15	6	32	31
5 - 10	21	26	13	12	28	29
10 - 25	15	26	17	20	22	22
25 - 50	6	9	14	16	19	20
50 - 100	4	5	11	13	13	18
100 and over	4	6	30	33	10	9
All Banks	100	100	100	100	16	15

Although real estate lending accounts for a smaller share of total lending at large banks than at small ones, large banks control a greater proportion of total resources, thus accounting for a major share of the real estate lending at all District banks. Between 1950 and 1960, large banks accounted for a more than proportionate share of the increase in this lending. As a result, large banks held more of the total real estate loans outstanding at District member banks in 1960 than in 1950.

The greater demands for real estate financing in large cities resulting from the greater population growth and building activity there may partly explain the greater growth in real estate lending at large banks. Since small banks were already heavily committed to real estate lending in 1950, they may have been less inclined to commit additional funds to real estate lending in subsequent years.

Can Banks Do More?

Will District banks contribute more to real estate financing in the 1960's than in the last ten years? Broadly speaking, the answer depends on four factors: (1) overall demand for mortgage credit, (2) growth of bank resources, (3) demands for other kinds of bank credit, and (4) bank decisions on lending policies.

About the demand for mortgage and construction credit we can be quite sure. Continued population growth in parts of this region will generate demand for more houses and funds to finance them. On the other hand, other short-term credit demands may also press heavily on bank resources, even as resources grow.

In such an environment of competing demands, the fourth factor influencing banks' volume of real estate loans—possible changes in bank policies—could be crucial. The recent easing of legal restrictions on national banks may lead to some policy changes. Since late 1959, national banks have been authorized by law to make conventional loans of up to 75 percent of the appraised value of the real estate if the loan is to be amortized within twenty years. Previously, national banks could make a conventional loan of no more than two-thirds of the appraised value of the property if the loan were to be amortized completely within fifteen years.

Past experience with Government guaranteed and insured mortgages, however, suggests that bankers consider liquidity more important than legal restrictions. Bank holdings of Government insured or guaranteed mortgage loans are not subject to the restrictions on conventional mortgage financing. A national bank could, therefore, legally have made loans on residential property at much more liberal terms than at those imposed on conventional mortgage lending even before the recent liberalization of restrictions. Many banks have made such FHA and VA loans in large volume. Yet, in 1960 such insured or guaranteed loans made up only about one-fourth of the total dollar volume of mortgage loans on residential properties held by District banks. Apparently, the banks preferred to make loans with shorter maturities than those typical of FHA and VA. Such liquidity considerations are likely to continue to influence lending policy in the future.

Some banks are exploring a possible way to keep active in the mortgage lending field and at the same time avoid undesirable liquidity aspects. By originating a substantial volume of mortgages in their own communities, they hope to build up a staff competent not only to grant or originate loans efficiently but to service a large volume for other holders as well. At the same time, by developing channels for the sale of mortgages in the secondary market, they believe they can keep the mortgages they hold themselves within the limits of their banks' liquidity standards.

During the 1960's, the pattern of residential construction may differ considerably from that of the 1950's, as the article on the southern housing market states. Also, uneven rates of income growth and migration may cause residential construction to be heavier in certain cities and localities than in others. Consequently, some banks may find heavier demands for real estate financing than others. In addition, changes in financing techniques may be required. If the past record is any guide, however, District bankers will undoubtedly continue to adapt their lending practices to the changing times and to contribute significantly to short-term construction financing and long-term mortgage lending.

ALBERT A. HIRSCH

Continued from Page 6

and a lowering of mortgage rates, by reducing monthly payments, could also help to overcome the income obstacle that may have deterred some families from buying a new or more expensive home.

The availability of mortgage funds on favorable terms to the borrower does, no doubt, tend to broaden the base of potential home buyers. It should be remembered, however, that families *demand* the satisfaction that comes from living in a home. They demand mortgage credit simply to obtain this satisfaction. As we have noted in the first article in this issue, the nature of the housing market has changed markedly during the past decade. Families in the District are now better housed than they were ten years ago. Thus, the task of stimulating home building through easy credit may now be more formidable than in the past.

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