Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date March 24, 1936

To Chairman Eccles

Subject: Mr. Fahey's memorandum on FHA amendments.

From J. M. Daiger

This is a copy of the memorandum filed by Mr. Fahey with Mr. Bell following the confidential hearing arranged by Mr. Grimm at Mr. Fahey's request. Mr. Grimm and Mr. Preston Delano were with Mr. Fahey when he made his verbal protest to Mr. Bell against the proposed FHA amendments.

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MEMORANDUM

RE: AMENDMENTS TO NATIONAL HOUSING ACT

The eighth draft, dated February 25, 1936, of a bill to amend Titles II and III of the National Housing Act raises certain new questions concerning the responsibility of the Government in connection with the mortgage problem which are entitled to the most serious consideration. Some of these questions are:

(1) Titles II and III of the National Housing Act originally contemplated a mutual mortgage insurance system which would be self-supporting after it was once started with Government assistance and which would provide cheaper mortgage money on better terms.

To assist in initiating the system, the Government provided in Section 202 a ten million dollar fund, and in Section 4 such expense funds as the Administrator deems necessary through Reconstruction Finance Corporation for carrying out the law. On mortgages which defaulted, the plan provided for the issue of debentures guaranteed by the Government as to both principal and interest on insured contracts made prior to July 1, 1937. The Government was not responsible on debentures or in connection with the insurance fund itself after July 1, 1937. In other words, the original theory was that the insurance fund would become self-supporting in a year or so, but in any event the Government would be free of responsibility after July 1, 1937 on debentures issued.

(2) The present suggested bill involves the following proposals

which reverse completely the original theory of the mutual mortgage insurance plan:

(a) The Government guarantee of the debentures without charge is made permanent by removing the original July 1, 1937, limitation;

(b) Continued provision by the Government of expense funds;

(c) Government credit to support this system on a permanent basis <u>is increased $1,500,000,000</u>. This brings the total Government credit behind debentures up to three and one-half billion dollars. The premiums paid to the mutual mortgage insurance fund to December 31st indicate that to that date only about $100,000,000 of insurance had actually been issued of the present two billion dollars provided for;

(d) Very substantial reduction in the insurance premiums on home mortgage loans, although expenses to date have been many times more than premium receipts. It is obvious that the <u>present</u> premium, much less a <u>reduced</u> premium, cannot even support the expense of the system without providing any reserve for losses or any fund for "mutual" return of premium;

(e) No specific statutory premium is fixed for large-scale housing insurance;

(f) Insurance on large-scale housing is made to mature by mere assignment of the mortgage for which the Government guarantee bond must be issued immediately. This change removes entirely the original idea that the mortgagee must face the necessity of some loss in the event of default. This provision was relied upon to insure caution on the part of the mortgagee in making the loan and thus protect the interests in the insurance fund;

(g) Insurance on loans up to 90% of value and up to $4,500 in amount for a limited time on new houses built;

(h) Provision for interest on debentures from the date foreclosure starts. This provision has the effect of further shifting the burden for making bad loans from the mortgagee and upon the Government. The proposal aggravates the difficulties in States where foreclosure is long drawn out.

(3) It is agreed that the mutual mortgage insurance plan is influencing the investment of a substantial amount of mortgage money. It may represent possibly 10% of the home mortgage lending. As an emergency measure it should be continued on substantially the original theory for the ensuing year to bring out what money it will and give the system a more

thorough test. It should be recognized, however, that in following this course the Government is assuming a large comparative expense and a serious responsibility.

It is to be remembered that the Government is becoming responsible for the entire loan on a 90% basis on mortgages up to $4500.

Many of the best students of the mortgage problem believe:

(a) That provision of a <u>permanent</u> Government credit as a guarantee for the support of the debentures of such a system cannot be justified;

(b) That experience with the system does not warrant the increase of Government credit for its support from $2,000,000,000 to $3,000,000,000.;

(c) That the provision of expense by the Government cannot be justified except through the emergency period;

(d) That while it is clear the present premium will not cover expenses or provide for losses, it cannot be reduced without making the discrepancy even greater. The present premium rate makes the cost of the insured loan unduly high to the mortgagor. The possibilities of reducing the total cost by lowering the rate of return on the mortgage should be examined;

(e) The system of large-scale mortgage insurance providing a Government guaranteed 3% bond for apartment house mortgages in exchange for their troubles without foreclosure, cannot be justified. If this advantage is extended to apartment houses and large developments, it will be demanded by other mortgagees making insured loans;

(f) Lending 90% on an insured basis cannot be made broadly effective by the method proposed because under present laws few mortgagees are able to lend 90%;

(g) That increasing the proportion of debentures which may be issed by a national mortgage association to a twenty-to-one basis is clearly dangerous in view of recent experiences and the Federal Government should not approve such a plan. Congress declined to accept it a year ago;

(h) There is serious doubt of the wisdom of the Reconstruction Finance Corporation purchasing insured mortgages. If this plan is taken advantage of it may result in Reconstruction Finance Corporation being asked to buy mortgages already insured by the Government up to 90% on a basis to yield 4½% to Reconstruction Finance Corporation. The Government would then be placed in the position where one of its agencies is ready to accept 90% mortgages at 4½% while another, Home Owners'

Loan Corporation, has been by law limited to 80% and contends that any reduction of its 5% rate would cause great losses;

(i) If 90% insurance is the only plan offered to the country to meet present needs, much will be expected of it. It cannot meet these expectations because of present legal limitations and much disappointment will result. To meet successfully the needs of the ensuing year it is necessary to stimulate lending for new construction by all classes of mortgage lending institutions.