

Form F. R. 511

TO Mr. Wood

FROM Miss Egbert

REMARKS:

6/16/45

Would you please prepare an analysis of the attached for the Chairman; also draft a reply for his signature.

V.E.

CHAIRMAN'S OFFICE

Home Owners' SAFETY Loan Plan

TELEPHONE STATE 4206 ··· SUITE 1611

155 NORTH CLARK STREET ··· CHICAGO 1, ILL.

June 13, 1945

Hon. Marriner S. Eccles
Governor, Federal Reserve System
20th Street & Constitution Ave. N.W.
Washington, D.C.

Dear Sir:

Since February 1944 we have been endeavoring to promote among institutional real estate lenders a more flexible and equitable mortgage practice.

We believe this new home-loaning-mortgage philosophy is the cure for many of the present infirmities in the urban-loan framework, including the downward spiral of interest rates, over loaning, loan shifting and portfolio raiding.

Bankers remain adamant. There exists a laissez faire that is hard to combat. They resist change, even while admitting that the national adoption of this new technique would greatly contribute in stabilizing the real-estate-loan picture, come temporary recessions and lulls.

Members of your Federal Reserve System have many millions of dollars in F.H.A. loans in their investment portfolios. As these loans become seasoned, they are constantly exposed to the overtures of other lenders. I presume the chief reason why some F.H.A. borrowers become fugitive is that they get fed up on paying the extra 1/2 per cent to guarantee their lenders. And when they wake up to the fact their loans are paid down to a safe position, they lend a ready ear to the inducements offered elsewhere. Frankly, why should they do otherwise? There is no particular reason why they should continue in F.H.A. There is no tie or bind between them and their lenders under F.H.A. They lose nothing by going elsewhere - in fact, very often they gain.

Such loan shifting is unhealthy to and has a demoralizing effect on the entire urban-mortgage structure. We believe our Safety Loan Plan - which is the outgrowth of years of experience in treating with thousands of HOLC borrowers - is a vital solution to the problem of loan retention. Knowing of your desire to keep the finances of this country on an even keel, we would be interested in your analysis and reactions to this new Plan.

Would you kindly read the enclosed article and give us the benefit of your views?

Very truly yours,

HOME OWNERS' SAFETY LOAN PLAN

F. M. Murphy
F. M. Murphy

Supplemental Agreement to Original Mortgage Indebtedness Instrument

THIS AGREEMENT entered into between _____ Mortgagors

hereinafter referred to as OWNER, and _____

hereinafter called the MORTGAGEE.

WITNESSETH:

WHEREAS, the MORTGAGEE owns a note (or bond) dated _____, 194____, hereinafter referred to as "obligation" secured by a mortgage (or other security instrument) on the following described Real Estate, situate, lying and being in the County of _____ and State of _____, to wit:

WHEREAS, under the terms of said note (or bond) and mortgage (or other security instrument), there is/was owing as of the _____ day of _____, 194____, the sum of (\$ _____) Dollars,

including principal, interest, and advances, and which amount OWNER has agreed to repay in monthly installments of: \$ _____ including interest and principal on the _____ day of each and every month until fully paid. y. .

AND WHEREAS, OWNER covenants and agrees (1) that he is now the OWNER of the premises upon which the aforesaid mortgage (or other security instrument) is a valid first lien to secure payment of OWNER'S obligation (2) that there are no defenses, offsets or counter-claims to said note (or bond) or said mortgage (or other security instrument); and the OWNER is fully authorized to execute these presents as such.

PART ONE

NOW, THEREFORE, in consideration of the premises and of the covenants herein contained, it is mutually agreed as follows:

(A) That for their mutual benefit, both as a means of providing the OWNER with certain safeguards to better protect his equity in the security property and as a further means of encouraging and inducing the OWNER to maintain his obligation in good standing, resulting in lower collection costs to the MORTGAGEE, the OWNER shall be entitled to earn and accrue rights as set forth in paragraph B, Part One of this agreement, to defer making principal payments on the obligation; (1) that such earned and accrued rights shall be considered cumulative, it being the intent of both parties hereto that such cumulative rights operate as a safety reserve against adverse times and conditions.

(B) That the OWNER, at his option and if he so elects, may defer and postpone payment of that part of monthly installments allotted to reduction of principal obligation, for a period or periods as follows:

- Not to exceed 12 months after _____
- Not to exceed 24 months after _____
- Not to exceed 36 months after _____

provided, however, (1) that such right to defer payment of monies allotted to reduction of principal obligation shall not be exercised for any one period during which less than three monthly installments shall accrue; (2) that the obligation and taxes be not default; (3) that the OWNER shall have paid the monthly installments (including 1/12 of taxes) provided for in the obligation, at the designated place of payment, on or before due date thereof, which accrued in the 12 months immediately preceding the date or dates on which the principal deferment rights, sought to be exercised, shall have accrued; (4) that but one 12 month period of principal deferment shall be granted for each of the above periods, described in paragraph (B) of Part One and in no event shall the total period or periods of deferment of principal payments exceed a maximum of 36 months before maturity of the obligation; (5) that in lieu of monthly installments provided for in the mortgage obligation OWNER covenants and agrees to pay to MORTGAGEE on the date installments become due on the obligation, during any period of deferment of payment of money allotted to principal, (a) a sum equal to 1/12 of the annual interest accrual, computed on the remaining unpaid obligation at the same rate of interest provided for in the note and mortgage, and (b) a sum equal to 1/12 of the estimated taxes.

PART TWO

It is further mutually covenanted and agreed by and between OWNER and MORTGAGEE, (1) that in the exercise, by the OWNER, of all or any part of the accrued principal deferment periods, non-payment of that part of the monthly installment allocated to principal shall not constitute a default under the terms and provisions of the afore-described note and mortgage, nor a violation of any covenant thereof, but shall extend the term of repayment of the obligation for the time required to retire any principal unpaid, by reason of the exercise of the option, by payment of such additional monthly installments as may be necessary to fully pay such obligation. (2) That during the time the OWNER shall exercise his earned and accrued right or rights to make payments on a deferred principal basis, no further earned rights shall accrue in favor of the OWNER, as set forth in Part One until such time as full monthly payments including principal, interest and taxes shall be resumed, and (3) that time is the essence hereof and that the hereinabove described earned periods apply to the deferments of principal payments only and (4) that in event any default of the monthly payments of interest and taxes be made and continue for a period of _____ days, then in such event all sums of money and all indebtedness hereby secured shall be and become immediately due and payable, and the MORTGAGEE may enforce any of the rights which accrue to the MORTGAGEE under the terms of the Mortgage.

PART THREE

It is further mutually covenanted and agreed by and between OWNER and MORTGAGEE, (1) that the OWNER shall notify the MORTGAGEE by written notice, not less than 10 days before an installment date, of his intention to exercise the earned and accrued right or rights to principal deferments, and (2) that such written notice shall indicate the duration the deferred principal payments are to run and (3) that OWNER will pay to the MORTGAGEE, upon demand, any and all costs (including title examination, attorney's fees and recording fees, if any) incurred and incident to the granting and effectuating this Supplemental Agreement.

PART FOUR

It is further mutually covenanted and agreed (1) that none of the provisions of this Supplemental Agreement shall in any way impair any of the MORTGAGEE'S rights under or remedies (on the note (or bond) and/or the mortgage (or other security instrument) except as provided in Parts One and Two hereof, whether such rights or remedies arise thereunder or by operation of law, and (2) that none of the OWNER'S obligations or liabilities under said note (or bond) and/or said mortgage (or other security instrument) except as provided in Part's One and Two hereof, shall be diminished or released by any provision hereof, and (3) that the provisions of this Supplemental Agreement shall bind, and inure to the benefit of the parties hereto, the undersigned, their heirs, executors, administrators, successors, and assigns. Wherever the context hereof so requires, the masculine shall include the feminine and the singular the plural.

WITNESS our hands and seals hereto this _____ day of _____, 194____

_____ Mortgagee

By _____

Title

_____ (SEAL)

_____ (SEAL)

_____ (SEAL)

_____ (SEAL)

STATE OF _____ }
COUNTY OF _____ } ss

I, _____, a Notary Public in and for said County in the State aforesaid, do hereby certify that _____

_____ personally known to me to be the same person whose name _____ subscribed to the foregoing Supplemental Agreement, appeared before me this day in person and acknowledged that _____ signed, sealed and delivered the said Supplemental Agreement as _____ free and voluntary act for the uses and purposes therein set forth, including the release and waiver of the right of homestead.

Given under my hand and notarial seal this _____ day of _____, A.D., 194____

Notary Public

My commission expires _____

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The citation for the original is:

Murphy, F. M. "Give a Little and Get Much: Home Owners' Safety Loan Plan." *Savings and Loans*, August 1944, pp. 11-13.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 2, 1945

To Chairman Eccles

Subject: The "Home Owners' Safety Loan

From Ramsay Wood

Plan" of Mr. F.M. Murphy

The "Home Owners' Safety Loan Plan" described by Mr. Murphy would provide grace periods during the life of an amortized mortgage in which the borrower may elect to make no payments of principal although he must continue to pay interest (and taxes and insurance if these are paid through the mortgagee). Three grace periods, each of 12 months, would be provided, to come after the ratio of outstanding debt to original value is approximately 50, 35, and 20 per cent. The term of the mortgage would be extended by the number of months during which the mortgagor exercised his option to defer payment. The mortgagor would be entitled to take advantage of the grace periods only if he had been punctual in making the 12 monthly payments due immediately before the rights of postponement accrued, although one might more logically expect the perfect payment record to be required immediately before the option is exercised.

The advantages claimed by Mr. Murphy for this plan are:

- (1) It would give the borrower a feeling of security and make individuals more willing to take on the obligations of mortgage debt;
- (2) it would prevent portfolio raiding;
- (3) it would stabilize and maintain interest rates;
- (4) it would attract new business and hold old business to institutions which used the plan;
- (5) it would prevent premature foreclosures; and
- (6) it would relieve the mortgagee of the need to review the facts and make a decision when the borrower asked for leniency.

The primary purpose of the plan seems to be to maintain interest rates by offering an incentive to the borrower to keep his mortgage with the original lender rather than refinancing with a lender who offers a lower interest rate or other more favorable terms. In other words, Mr. Murphy believes that the borrower will value so highly his right of deferring principal payment, which will typically come into being only after the mortgage has run for some time, that he will not be easily induced by lower interest rates to refinance; and that the buyer of a house which is encumbered by such a mortgage will be induced to assume the existing mortgage, even though lower rates are available.

In fact, the plan seems to offer very little to the borrower, and might be difficult for the lender to administer. In general, a loan which represents only 50 per cent of the value of the mortgaged property should not be difficult to refinance as a straight loan, and it might well be to the borrower's advantage, if he came on hard times, to refinance and pay only interest. This is even more true of a 35 or 20 per cent loan. Also, the grace periods offered under the plan are not all gain to the mortgagor: as Mr. Murphy himself admits, lenders do make concessions from the strict terms of the mortgage note when borrowers are in difficulties. Under the plan (whose use is licensed under copyright), mortgagees would presumably be prohibited from extending leniency beyond what is written in the contract. This might easily place the borrower in a worse position than he is in now, especially since the early years of a mortgage are generally the most difficult, whereas the grace periods in the plan come fairly late.

The plan could not be used with mortgages insured by the Federal Housing Administration, since the exercise of the option to defer principal payments would extend the original maturity date of the mortgage, which is not permitted for FHA mortgages. Practically the same result can be obtained, however, with more flexibility, under an FHA mortgage: if the mortgagor at any time makes larger payments of principal than are required, he may skip payments of the amount of principal prepaid without being in default.

There seems to be little reason for national banks to adopt the "Home Owners' Safety Loan Plan," since they may not make uninsured amortized loans for more than 60 per cent of appraised value or running for more than ten years. Under the plan, national banks would be allowed to make 60 per cent loans with an original maturity of not more than seven years if three grace periods of twelve months each were to be allowed, but they can make FHA-insured loans for as much as 90 per cent of value and running for as long as 25 years.

It is desirable that mortgage contracts be as flexible as possible so that temporary misfortune will not jeopardize the position of the borrower, but Mr. Murphy's plan, at best, does not increase appreciably the safeguards to the borrower, and at worst, might substantially reduce them. If borrowers could be induced to believe that the plan offers them advantages, however, competition among lenders might be reduced to some extent thus maintaining interest rates when they would otherwise decline, and discouraging lenders from offering lower interest rates on smaller risks.

RW

July 11, 1945.

Mr. F. M. Murphy
Home Owners' Safety Loan Plan
155 North Clark Street
Chicago 1, Illinois

Dear Mr. Murphy:

This is in reply to your letter of June 13, 1945 in which you asked for my reactions to your "Home Owners' Safety Loan Plan".

The idea of giving a borrower the right to defer payments of principal from time to time is certainly an interesting one and is worthy of study, but I think you offer the borrower too little and expect too much in return. By the time the borrower earns his first right of deferment, his loan balance is down to about 50 per cent of the original appraised value of the security, and in most markets he would be able to refinance, perhaps with a straight loan, and probably on advantageous terms. The lender is not doing the borrower much of a favor in being lenient at that point, yet for this leniency you expect the borrower to resist any temptation to refinance his loan at a lower rate of interest. The second and third rights of deferment are still less valuable.

If you were to exercise your power to license users of the plan so as to prohibit the lender from extending leniency beyond what is provided for in the contract (and this seems to be implied in your statement of the plan) the borrower would be in a worse position than he is in now, and lenders themselves might suffer by being forced to foreclose when good management might dictate forbearance.

Your plan reflects a realization of the fact that, when the risk of loss to the lender is small, the interest charged should be less than when the risk is great. The plan, however, is directed at preventing lenders from having to act on this fact by inducing borrowers to pay high-risk rates on low-risk loans. This, I think, is undesirable. You say, "I presume that the chief reason why some F.H.A. borrowers become fugitive is that they get fed up on paying the extra 1/2 per cent to guarantee their lenders." Does it make much difference to the borrower whether he pays $4\frac{1}{2}$ per cent interest

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To: Mr. F. M. Murphy, page 2

and 1/2 per cent mortgage insurance premium on an F.H.A. mortgage or pays 5 per cent interest on a 20 per cent loan because of the operation of your plan?

There are several courses of action which a lender can take to hold his loans and protect his security: the lender can provide an amortized loan in which the interest rate declines as the risk of loss declines; he can provide generous prepayment privileges so that the borrower, when his income is high, may lessen his interest burden and at the same time reduce the lender's risk; and he can refrain from lending the maximum amount which the borrower's present income will support, so that changes in income will not be as serious as they often are. And all of these courses of action can be taken by lenders who lend on F.H.A.-insured mortgages.

A mortgage loan which incorporated your supplemental agreement could not be insured by the Federal Housing Administration, since the actual term of the loan would be longer than the term of the loan insured. National banks would therefore have little reason to use your plan, since the maximum loan which they would be able to make under the plan would be a 60 per cent loan for seven years which would be extended to ten years if the deferment options were exercised.

The idea underlying the "Home Owners' Safety Loan Plan" deserves further study. I do not think that the plan, in its present form, is a cure for the ills of mortgage lending which you are concerned about.

Very truly yours,

Marriner S. Eccles
Chairman

KW
HW:PRO:rj

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