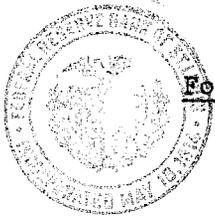


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Statement by

Arthur F. Burns

Chairman, Board of Governors of the Federal Reserve System

before the

Committee on Banking and Currency

House of Representatives

February 7, 1970

I welcome your invitation to present the views of the Board of Governors of the Federal Reserve System on conditions relating to the production, financing, and use of housing.

As a national resource, housing ranks high on both economic and social grounds. The construction of new homes and apartments absorbs the efforts of a major industry. The fortunes of this industry influence the course of production and employment in many other branches of the economy.

Even more importantly, the provision of decent housing for all families is among our most pressing needs, as Congress recognized in laying down a decennial goal for the production of new and rehabilitated housing. Besides the volume of housing production, the price and quality of available shelter are of vital significance. Prices of homes and rents have of late been rising rapidly, reflecting not only higher financing costs but also inflated prices of labor, land, and materials. If these costs are not brought under control, the quality of all housing will be bound to suffer.

I assure you that the Federal Reserve Board is deeply concerned about the recent decline in production of housing and the further rise in costs of buying, financing, and operating new and existing dwellings. Housing starts have been declining for three consecutive calendar quarters now. By last December the seasonally adjusted annual rate of 1,245,000 private housing starts was the lowest in two and one-half years. The downtrend has come at a time

when demand for both new and existing accommodations has generally remained strong. As a result, the vacancy rate for dwellings available for sale or rent has become disconcertingly low.

At the same time, I think it is well to note that the performance of the housing industry over the past year has surpassed the expectations of many experts. Adherence to a policy of monetary restraint, which has been a necessary part of our national effort to bring inflationary pressures under control, has led to very tight credit market conditions and has clearly constrained home-building. Nevertheless, private housing starts in 1969 as a whole came within 3 per cent of the total in 1968. If we include new public housing starts as well as shipments of new mobile homes, last year's combined output of about 1,890,000 units actually exceeded the preceding year's total. Measured in these terms, the gross addition to our total stock of shelter in 1969 was, by a slim margin, the largest in 19 years. The net flow of funds into residential mortgages also reached a new record of nearly \$20 billion, 5 per cent above the 1968 level.

The totals that I have cited for last year conceal, however, the movement within the year. We need to recognize that the month-to-month trend of total housing starts over the past year, even including mobile homes, has been distinctly downward, and I fear that the totals may go still lower in the months immediately ahead. Despite everything that has been done to bolster the flow of funds into housing, reduced credit flows through mortgage lending institutions

and lenders' preferences for other types of investment have sharply curtailed the amount of money available for housing. The environment affecting savings flows to these institutions has been particularly adverse in recent weeks, and many of these institutions are no longer in a position to make large commitments of funds for future deliveries of mortgages. Moreover, reflecting the curtailed availability of funds, the terms of mortgage credit--that is, interest rates, downpayments, and credit standards--have tightened, thereby excluding otherwise willing buyers from the market.

Of course, housing is not the only economic sector in which spending is being restrained by tight credit conditions. As is well known, many State and local government units have had difficulty in selling bonds to finance their capital outlays. Funds for commercial construction have become increasingly hard to come by, and many projects have been delayed because their promoters were unable or unwilling to obtain financing at prevailing terms. Many business firms--small firms in particular--also have been unable to obtain all the credit they desired, especially as the ability of banks to lend has come under increasing constraint. Even some very large corporations have announced cancellations or stretchouts of capital spending programs, at least partly because of the difficulty and cost of financing. It is the very essence of monetary restraint that many economic units find it difficult or impossible to carry through all of their spending plans. This is the way that total spending is curbed and an overheated economy cooled down to a manageable condition.

It should be kept in mind, also, that the problems of the housing industry are not related solely to tight credit. Unusually large wage settlements have been contributing powerfully to a further advance in the total cost of constructing dwellings. New labor contracts negotiated last year called for an average first-year wage increase of as much as 14 per cent, according to Bureau of Labor Statistics figures on settlements affecting 1,000 workers or more, whether employed in residential or other construction. According to one widely-cited privately compiled index, the average cost of constructing a new dwelling rose by more than 8 per cent in 1969, the largest annual increase since 1948. Land values also continued their long-term upward trend as did typical operating costs for both houses and apartments.

Measures taken to aid housing in the past year.

A number of measures have been taken within the past year to bolster the supply of resources available for housing and to shift some of the burden of credit restraint away from this sector. Paramount among these actions has been the Administration's program to bring Federal finances under strict control, as indicated in the austere budget presented to the Congress earlier this week. A budget surplus is essential in achieving a proper mix of fiscal and monetary policies for restoring conditions that favor sustainable economic growth. There can be no doubt whatever that the single most important contribution toward improving housing market conditions would be success in the present struggle to check inflationary trends

and expectations. This, of course, has been the principal objective of the monetary policy of the Federal Reserve System over the past year. Nonetheless, it must be recognized that it takes time to overcome an inflationary momentum that has gathered headway over a span of years dating all the way back to 1964.

As credit and fiscal measures were adapted last year to our overriding need to cool down the nation's highly inflationary condition, special steps were simultaneously taken to lessen the impact of tight credit on housing. The principal Federal agencies supporting housing provided an unprecedented amount of assistance to the mortgage market. The combined net purchases of home and multi-family mortgages by the Federal National Mortgage Association and the Government National Mortgage Association totaled a record \$4.3 billion. That accounted for more than a fifth of the total net expansion in outstanding residential mortgage debt. In addition, the Federal Home Loan Banks during 1969 extended a record \$4 billion in net advances to savings and loan associations. This assistance was equivalent to 45 per cent of the total expansion in mortgage portfolios at all savings and loan associations.

The capacity of the savings and loan associations to advance funds to the mortgage market was also sustained as the Federal Home Loan Bank Board reduced S&L minimum liquidity requirements. The reductions, of one-half percentage point each in June and November 1969, altogether released approximately \$1.3 billion for additional mortgage investment.

The record amount of funds funneled into the mortgage market by these Federal agencies partly counterbalanced the reduction in net savings inflows to savings and loan associations and mutual savings banks that occurred last year. It should be pointed out, too, that the relationship among maximum ceiling rates on time and savings accounts that could be offered by financial institutions was such that the commercial banks suffered the largest decline in the share of total credit flows. Thus, mutual savings banks and savings and loan associations, which are major sources of funds for housing finance, were protected from inter-institutional competition by the structure of ceiling rates on time and savings accounts--a notable departure from the 1966 experience.

As 1969 progressed, however, and as market interest rates continued to rise further above ceiling rates on time and savings accounts, all types of financial institutions came under increasingly severe pressure. It was no longer a question of one type of institution gaining at the expense of another but of all losing savings funds heavily to the securities markets. Under the circumstances, the Federal Reserve Board felt that a general upward adjustment in ceiling rates could no longer be delayed and, after consultation with the other regulatory agencies, an increase in the ceilings for member banks was announced late last month. The FDIC and the Federal Home Loan Bank Board adopted similar measures. As a result, all institutions now have somewhat higher rate ceilings, including the ability to offer new one- and two-year time instruments at premium rates. Maximum permissible rates on large CD's (\$100,000 and over) were also

raised appreciably, and the savings and loan associations were permitted to offer such instruments at higher rates for the first time. The higher ceilings generally are intended to help preserve, and eventually to enhance, the flow of savings to the private financial institutions, and thereby to give support to the flow of housing credit.

Also in January, contract interest rates on FHA-insured and VA-guaranteed mortgages were raised for the first time in 12 months. The increase brought returns on such investments closer in line with yields available on other types of capital market instruments, and should help to make such mortgages more acceptable to lenders in competition with other investments. Unfortunately, the one percentage point rise in contract rates on these Government-underwritten mortgages failed to match fully the increase that had taken place over the previous year in bond market yields.

There have been a number of other steps taken in recent months to aid housing. Last September, the Administration ordered a reduction of 75 per cent on new contracts for Federal construction projects until conditions ease. This step was followed by a vigorous effort, which has proved moderately successful, to persuade State governments to carry out similar postponements of construction work under their jurisdiction. All this was done with a view to releasing resources, wherever possible, for homebuilding.

Finally, in 1969, nearly a dozen States raised their usury ceilings applicable chiefly to conventional home mortgages. The

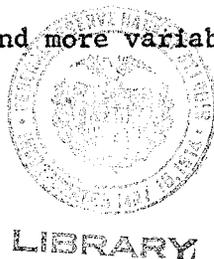
increases brought these limits to more realistic levels that allowed buyers of residential properties who are dependent on this predominant type of mortgage financing to compete on more equal terms with other users for the scarce supply of credit funds.

What more can be done?

These recent measures have contributed significantly to the surprising performance of housing under the very stringent credit conditions of 1969. However, as the continuing problems in the housing market clearly indicate, more remains to be done, particularly if we are to enhance the potential for achieving the long-run housing objectives of the nation.

In the immediate future, it will be vital to preserve the taut fiscal position outlined in the Administration's budget. Keeping a tight rein on Government expenditures will, of course, require discipline on the part of both the Executive and Legislative branches of Government. Such a fiscal policy is an essential element in bringing inflationary pressures under control and in laying a basis for moderation in over-all credit conditions. When this happens, the cost of credit for housing transactions will, obviously, move down.

But as long as credit remains in rather short supply, the financing of new housing is likely to be restricted. Housing is a sector highly sensitive to the cost and availability of credit. In part this is because housing expenditures involve relatively large amounts of long-term credit with fixed interest charges that are large relative to other and more variable costs over the life of the dwelling.



And in part it is because the depository institutions, which accommodate the lion's share of total mortgage demands, are unable to compete for funds on the same high interest terms that borrowers in the open market are prepared to pay.

For this reason, the Federal Reserve Board supports the continued large-scale extension of credit by specialized housing finance agencies, such as FNMA and the Federal Home Loan Banks, under current conditions. The Board also supports the principle of aiding disadvantaged families by subsidizing their mortgage debt burden by means of appropriated funds. We do not favor, however, tapping Federal Reserve credit for the support of a restructuring of credit flows, no matter how worthwhile the immediate objective may be. Special-purpose lending by the Federal Reserve for housing would be likely to lead to demands for other types of special lending as well. Taking such assets into Federal Reserve portfolios would require us to make correspondingly heavy offsetting sales of Treasury securities in order to keep control of the reserve base, and that would lead to a weakened market position for Treasury securities. I assume, of course, that no one is suggesting that the credit needs of housing or other special sectors, however worthy, should be monetized by superimposing them on the money and credit totals that would otherwise be appropriate for the nation as a whole. To compel the Federal Reserve to follow such a policy could lead to a disastrous inflation.

In addition to providing for a continuing substantial flow of Government-assisted funds into housing--while making certain that

it is financed through the housing agencies rather than with newly created Federal Reserve credit--we also believe that everything possible should be done to enhance the attractiveness of mortgages to private investors. In this connection, there is considerable room for improving the characteristics of the mortgage instrument and the institutional practices associated with issuing, holding, and retiring mortgages. For example, greater standardization of laws and customs is needed with respect to the origination of conventional mortgages and with respect to the foreclosure of all types of mortgages. We also support the provision of facilities--such as that envisioned by GNMA guaranteed securities--that would package mortgages in sufficiently large lots to be attractive to pension funds and other institutional investors. It would also be desirable if the States, as well as the Federal Government, would continue to weed out restrictions that unnecessarily limit mortgage lending by size of structure, location of property, or terms of credit.

Of course, nothing will help very much in stimulating private investment in mortgages, unless the yield available on such investments can be as attractive as that on alternative outlets for funds. Some 21 States and the District of Columbia still impose ceilings of 8 per cent or less on home mortgages, particularly on conventional loans which are the principal form of this type of credit. Although these limitations were originally designed to protect borrowers, we should recognize that economic conditions change and that interest rate ceilings that are below the market operate in practice to discriminate against borrowers by denying them access to sources of credit

available at going market rates. We think that artificial barriers to competitive rates on mortgages should be lifted, or at the very least, administered flexibly.

To give an added incentive to member banks in meeting the public's needs for long-term mortgages as well as other types of credit, the Board of Governors again wishes to recommend that the Congress permit member banks of the Federal Reserve System to borrow from the Federal Reserve Banks on the security of mortgages or any other sound asset at the regular discount rate. Mortgages are only an example of the kinds of collateral involved. The adoption of this recommendation would not, of course, solve all the problems of the mortgage market by any means, but we believe that this step--which should be taken in the interests of efficiency in any event--could prove to be of some benefit in stimulating mortgage lending by member banks.

Another helpful step would be to liberalize the authority of national banks to make real estate loans. For conventional mortgage loans, the loan-to-value limit should be raised from 80 to 90 per cent, and the maximum maturity from 25 to 30 years; for loans on large construction projects, the maximum maturity should be extended from three years to five years. You will recall that the Commission on Mortgage Interest Rates recommended these amendments in its report filed last year, and your Committee included provisions to carry out this recommendation in H. R. 15091, as reported to the House. These provisions were retained in the bill passed by the House, but were dropped by the Senate-House conference committee.

Taking a still longer perspective, further measures will be required to release the full potential of private enterprise to respond to our nation's shelter requirements. Substantial additions to the supply of skilled construction labor, for example, will be forthcoming under the expanded and redirected manpower training programs of the Federal Government. Another promising attack on the housing problem is HUD's "Operation Breakthrough," which aims to cut construction costs by relying on mass production and factory technologies as well as by modernizing building codes and labor practices. These and other approaches should help to dampen rising construction costs, which in part have reflected, but also have been a major source of, inflationary pressures.

The Board also recommends that further detailed study be given to establishing a broad secondary market for conventional residential mortgages, recognizing the technical problems involved. Such a market for conventional mortgages would depend in part on the standardization of the instrument, including more uniform procedures involving property inspection and loan origination. In the interim, to gain experience with a two-way market, the Board suggests that the FNMA experiment with operating a trading desk for outstanding Government-underwritten loans. By facilitating portfolio adjustments, FNMA's trading desk could enhance the appeal of this type of mortgage issued under standardized terms and conditions that conform to broad public policy.

In summary, improvements over recent years in Government-sponsored financing of housing and in laws and regulations surrounding

the private financing of housing have contributed to a significantly better maintenance of housing starts in 1969 than in the previous tight money period of 1966. I have no doubt that further improvements in the structure of the mortgage market are possible and practicable, and that these will enhance the performance of the housing industry in the future.

The Board is studying ways and means to lighten the burden of monetary restraint on the mortgage market without impairing the use of monetary policy in achieving national economic objectives. There is great need to focus, as we hope many will, on seeking out ways to increase the attractiveness of mortgage instruments to private investors, to shift the flow of credit towards the housing market, and to lessen the cyclical impact of alternating tight and easy credit conditions on housing production and finance.