December 10, 1935

Governor Eccles

J. M. Daiger

FHA matters for discussion at tomorrow's luncheon.

I think that Mr. McDonald's invitation to you and me to meet him at luncheon tomorrow with Mr. Walsh and Mr. Catherine is due in part to his desire to have Walsh and Catherine hear your views on the FHA and in larger part to his desire to form a sort of working alliance with you on the 1936 program.

In the conversation at last week's luncheon, you hit out pretty hard at the FHA set-up, particularly from the standpoint of the operating personnel in the regional and local offices. At the same time you evidenced a good deal of support for some of the measures that the Freed-Moley group has been pressing, not so much through the FHA as through the Federal Home Loan Bank Board and the Department of Commerce.

Hence I should like to analyze briefly these two aspects of the matter--the FHA set-up and the 1936 program--before we get into the discussion of them at tomorrow's luncheon.

The bulk of the FHA business under Title II has come thus far from the member banks of the Federal Reserve System. The banks generally, member and non-member, account for about 70 per cent of the business, but most of this is from the member banks. The member banks also have among them the largest volume of funds currently available for mortgage investment--considerably more than is held by any other class of institutions.

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Because of these very practical considerations, I have argued that the obvious way to advance the FHA program is for the FHA to have the kind of set-up that, on the one hand, will win the confidence of a much larger number of banks and thus result in a much larger and more widespread number of approved-mortgagee banks, and, on the other hand, will create among prospective borrowers a larger demand among these banks for the FHA type of mortgage loan. It is my opinion that the FHA does not have this type of set-up, and I should therefore like you to press this view tomorrow.as dealing with a situation that definitely needs to be met quite apart from the 1936 program.

Some of the best mortgage men I know have stated without qualification that the FHA has established a sounder system of appraisal practice than any private institution has ever devised. They tell me that they have adopted its standards regardless of whether or not they insure their loans with the FHA. They count the standards as one of the notable contributions of the New Deal to the field of mortgage financing.

In other words, a loan made according to FHA standards <u>is</u> a prime investment. It is such an investment even without the ultimate guaranty afforded by the Federal Government.

But to establish the standards is one thing and to enforce them is another and quite different thing. Too many banks, I am afraid, have the impression that the practices of the FHA are lax and that this

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laxity is due to high-pressure promotion methods which put the emphasis on volume rather than on quality. Instead of regarding the FHA as affording a good business mechanism through which to open up more freely on mortgage loans, the banks are impressed by the fact that the regional and local offices are under great pressure from Washington for volume at any price. The inevitable result, as I see it, is to defeat the very objective that the FHA is preoccupied with--namely, volume.

The point about this that I would call particularly to your attention is that the responsibility for whatever laxity there may be is right here in Washington, not in the regional and local offices. I think that you may tend to overemphasize the shortcomings of the regional and local personnel and to ascribe to these men faults that are largely due to the kind of pressure they are under from headquarters. I know, of course, that the FHA got off to a political start, but it also started with the fallacious notion, in Mr. Moffett's classic phrase, that the FHA is "purely a selling proposition."

In its approach to the banks, the FHA has in my opinion relied altogether too much on the inducement of high interest rates. Manifestly, a low interest rate for a long-term loan was the potent means that the FHA had for creating a demand among borrowers for the FHA type of loan. The groundwork for this demand was laid in the publicity that preceded and accompanied the passage of the Housing Act. But after a year and a half of FHA operation the 5 per cent rate contemplated in the Act as the maximum except under unusual circum-

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stances has not yet materialized, though a lower rate would now be easily possible if the 5 per cent rate had been established at the outset.

Like the high-pressure promotion and the tendency toward laxity that is its counterpart, the high rates of interest maintained by the FHA have in my opinion been a deterrent rather than an inducement where the banks are concerned. The rates of $6\frac{1}{2}$, 6, and $5\frac{1}{2}$ per cent, which the FHA has established from time to time, have been wholly out of line with the prevailing rates on high-grade investments. The result here, I think, has been to cheapen the FHA type of mortgage in the minds of bankers and to raise the question, at least subconsciously, whether there is not after all some doubt as to the quality of the mortgages insured by the FHA.

In other words, I have argued that the banks would place a much higher value on the ultimate guaranty of the Federal Government on the FHA type of mortgage if the return on these mortgages were in line with the return on other prime long-term investments. I have said that the FHA cannot "bribe" banks into making loans by offering a rate a point or half-a-point above the market, but that it could induce them to lend by using a low rate to emphasize high quality.

If you agree with this view from a banking standpoint, I should like you to emphasize it tomorrow as well as the need for

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making the practices of the FHA conform to its much-advertised standards.

The point about the Freed-Moley program to which I would particularly call your attention is that it is directed to the "outs" rather than to the "ins." It looks toward mortgage financing through the building and loan associations and toward housing promotion through the Department of Commerce. Its emphasis on the building and loan associations is due to its drawing a mistaken analogy between them and the British building societies, disregarding the fact that the widespread holding of available funds for mortgage lending in this country is among the banks and that the funds of our building and loan associations are pretty much depleted. Personal differences between McDonald and Freed and personal relationships between Freed and one of Secretary Roper's assistants account in large part, I think, for the proposal to take FHA out of the housing-promotion field and turn that work over to the Department of Commerce.

The points about the Freed-Moley program that I am in accord with are, first, the emphasis on the type of housing for which there is virtually an unlimited market, and, second, the opportunity for larger units to operate profitably in the low-cost housing field. These are the two aspects of the British housing program that have been chiefly responsible for its magnitude and its success.

The Freed-Moley group gives a greatly mistaken impression, in my opinion, in attaching primary importance to the low rate of interest and to the small down-payment, and especially in regarding

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the latter as readily adaptable to the situation in this country. The housing boom in Great Britain began when the interest rate charged by the building societies was close to 6 per cent. The rate fell to $5\frac{1}{2}$ per cent after the boom was well under way and reached $4\frac{1}{2}$ per cent only in the latter part of last year, two and a half years after the boom was started.

As to the 10 per cent down-payment, that is made possible by the size and financial responsibility of the British building-companies. These companies "go on the mortgage" in the same way that our automobile dealers, for example, are parties to automobile sale-contracts with finance companies. The British builders leave part of their investment in the mortgage with the building society until the mortgage is paid down to about 75 per cent. We do not yet have operators who are capable of doing that. Our home-building is carried on by thousands of small developers and contractors operating on a shoe-string, whereas most of the building in Great Britain is done by a handful of big companies.

The best explanations of the British boom that I have seen are those given by the Westminster Bank and by the London Economist. The gist of their explanation is that the housing boom is attributable to great advances in wages, to great reductions in the prices of food and clothing, to the successful operation of unemployment insurance, and to the resultant increased purchasing

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power flowing into the housing field.

Finally, the essential example to be drawn for us is that the housing boom in Great Britain is a boom in low-cost houses. The price range is from $2,500 to $4,000, and the average is about $3,000. My argument, in substance, is that we have an enormous potential market among families that can buy houses on a down-payment of $800 to $1,000 and a monthly payment of $30 to $40 under the FHA set-up. These would be houses in a price range of $4,000 to $5,000. I think that this is the very best that we can do on a large scale under our existing cost structure.

Much as I should like to see a further reduction of the interest rate, and certain as I am that the mortgage market would accept it, I do not see how it can become an important factor except in relation to the type of houses for which there is a large market. It is primarily the total cost of the house, and not a difference of half-a-point or one point in the interest rate, that determines whether or not the borrower can carry the monthly charge.

Which is a way of saying, in short, that governmental propaganda and governmental inducements should be focussed on the price class where the potential volume is.

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