

December 4, 1934.

Hon. James A. Moffett, Administrator,
Federal Housing Administration,
Washington, D. C.

Dear Mr. Moffett:

In view of the active part that I took in helping to develop the program that led to the adoption of the National Housing Act, I have naturally followed the progress of the Federal Housing Administration with great interest, and I of course share the desire of yourself and your associates that its operations shall be wholly successful.

It is for these reasons that I am sending to you a memorandum that expresses with great frankness my views on the regulations recently issued to govern the operation of Title II. I am sure you will fully realize that the criticisms and suggestions contained in the memorandum are offered in a spirit of the utmost friendliness, and only with a desire to see the use of the insured amortized mortgage encouraged within the widest practicable limits.

At the same time I want you to know that I myself fully realize the possibility that I may have misread or misunderstood some of the regulations to which exceptions are taken in the memorandum. I know also that there must be matters that have come up in the practical administration of the Housing Act that those of us who worked on the program some months ago could not have foreseen. Nevertheless I shall appreciate it if you will give the matters referred to in this memorandum some consideration, and then let me discuss them with you at your convenience.

With kind personal regards and good wishes, I am

Sincerely yours,

JMD/lem

December 4, 1954.

Hon. Thomas Jefferson Coolidge,
The Under-Secretary,
Treasury Department,
Washington, D. C.

Dear Jeff:

I am sending to you a copy of a memorandum that I have sent today to Mr. Moffett on the regulations recently issued by the Federal Housing Administration, with regard to the insurance of mortgages.

These regulations, it seems to me, are far too restrictive and will severely limit the benefits of Titles II and III.

I will ask you to regard this memorandum as personal and confidential, and I would appreciate an expression of your views on the criticisms and suggestions that it contains.

Yours sincerely,

JMD:gb

December 4, 1934.

Hon. Herman Oliphant, General Counsel,
Treasury Department,
Washington, D. C.

Dear Herman:

I am sending to you a copy of a memorandum that I have sent today to Mr. Moffett on the regulations recently issued by the Federal Housing Administration, with regard to the insurance of mortgages.

These regulations, it seems to me, are far too restrictive and will severely limit the benefits of Titles II and III.

I will ask you to regard this memorandum as personal and confidential, and I would appreciate an expression of your views on the criticisms and suggestions that it contains.

Yours sincerely,

JAL:gb

December 4, 1964.

Dr. Jacob Viner,
Assistant to the Secretary,
Treasury Department,
Washington, D. C.

Dear Dr. Viner:

I am sending to you a copy of a memorandum that I have sent today to Mr. Moffett on the regulations recently issued by the Federal Housing Administration, with regard to the insurance of mortgages.

These regulations, it seems to me, are far too restrictive and will severely limit the benefits of Titles II and III.

I will ask you to regard this memorandum as personal and confidential, and I would appreciate an expression of your views on the criticisms and suggestions that it contains.

Yours sincerely,

JMB:ab

December 4, 1934.

Hon. Preston Delano, General Manager,
Home Owners' Loan Corporation,
New Post Office Building,
Washington, D. C.

Dear Preston:

I am sending to you a copy of a memorandum that I have sent today to Mr. Moffett on the regulations recently issued by the Federal Housing Administration, with regard to the insurance of mortgages.

These regulations, it seems to me, are far too restrictive and will severely limit the benefits of Titles II and III.

I will ask you to regard this memorandum as personal and confidential, and I would appreciate an expression of your views on the criticisms and suggestions that it contains.

Yours sincerely,

JMB:sh

December 4, 1934.

Hon. Rexford G. Tugwell, Under Secretary,
Department of Agriculture,
Washington, D. C.

Dear Rex:

I am sending to you a copy of a memorandum that I have sent today to Mr. Moffett on the regulations recently issued by the Federal Housing Administration, with regard to the insurance of mortgages.

These regulations, it seems to me, are far too restrictive and will severely limit the benefits of Titles II and III.

I will ask you to regard this memorandum as personal and confidential, and I would appreciate an expression of your views on the criticisms and suggestions that it contains.

Yours sincerely,

JMD:sb

December 4, 1934.

Hon. Harry L. Hopkins, Administrator,
Federal Emergency Relief Administration,
1754 New York Avenue,
Washington, D. C.

Dear Harry:

I am sending to you a copy of a memorandum that I have sent today to Mr. Moffett on the regulations recently issued by the Federal Housing Administration, with regard to the insurance of mortgages.

These regulations, it seems to me, are far too restrictive and will severely limit the benefits of Titles II and III.

I will ask you to regard this memorandum as personal and confidential, and I would appreciate an expression of your views on the criticisms and suggestions that it contains.

Yours sincerely,

JMD:ab

December 4, 1934.

Hon. John H. Fahey, Chairman,
Home Owners' Loan Corporation,
Washington, D. C.

Dear Mr. Fahey:

You told me that you would like to see a copy of the memorandum that I had in mind sending to Mr. Moffett on the regulations governing the insurance of mortgages under the National Housing Act.

I have just prepared this memorandum, and I am sending it to Mr. Moffett today. I am sending a copy of it to you, but with the request that you regard it as strictly personal and confidential.

When you have had an opportunity to read the memorandum, I wish that you would let me have your views on the criticisms and suggestions made therein.

Sincerely yours,

JMD/len

December 5, 1934.

Mr. Winfield W. Riefler, Economic Advisor,
National Emergency Council,
Department of Commerce Building,
Washington, D. C.

Dear Win:

I am sending to you a copy of a memorandum that I sent yesterday to Mr. Moffett on the regulations recently issued by the Federal Housing Administration, with regard to the insurance of mortgages.

These regulations, it seems to me, are far too restrictive and will severely limit the benefits of Titles II and III.

I will ask you to regard this memorandum as personal and confidential, and I would appreciate an expression of your views on the criticisms and suggestions that it contains.

Yours sincerely,

JWD/lea

December 5, 1934.

Hon. Donald R. Richberg, Executive Director,
National Emergency Council,
Commercial National Bank Building,
Washington, D. C.

Dear Mr. Richberg:

I am sending to you a copy of a memorandum that I sent yesterday to Mr. Moffett on the regulations recently issued by the Federal Housing Administration, with regard to the insurance of mortgages.

These regulations, it seems to me, are far too restrictive and will severely limit the benefits of Titles II and III.

I will ask you to regard this memorandum as personal and confidential, and I would appreciate an expression of your views on the criticisms and suggestions that it contains.

Yours sincerely,

JMD/lem

December 5, 1934.

Mr. W. Averell Harriman,
National Recovery Administration,
Department of Commerce Building,
Washington, D. C.

Dear Mr. Harriman:

I am sending to you a copy of a memorandum that I sent yesterday to Mr. Moffett on the regulations recently issued by the Federal Housing Administration, with regard to the insurance of mortgages.

These regulations, it seems to me, are far too restrictive and will severely limit the benefits of Titles II and III.

I will ask you to regard this memorandum as personal and confidential, and I would appreciate an expression of your views on the criticisms and suggestions that it contains.

Yours sincerely,

JMD/len

December 5, 1934.

Mr. Frank C. Walker,
1600 Broadway,
New York, N. Y.

Dear Frank:

I am sending to you a copy of a memorandum that I sent yesterday to Mr. Moffett on the regulations recently issued by the Federal Housing Administration, with regard to the insurance of mortgages.

These regulations, it seems to me, are far too restrictive and will severely limit the benefits of Titles II and III.

I will ask you to regard this memorandum as personal and confidential, and I would appreciate an expression of your views on the criticisms and suggestions that it contains.

Yours sincerely,

JMD/lem

FEDERAL HOUSING ADMINISTRATION

WASHINGTON

December 11, 1934

JAMES A. MOFFETT
ADMINISTRATOR

Honorable Marriner S. Eccles,
Federal Reserve Board,
Washington, D. C.

My dear Mr. Eccles:

Thank you very much for your letter of December fourth enclosing memorandum in which you express your views on the regulations issued to govern the operation of Title II of the National Housing Act. This has just come to my attention on my return to Washington this morning. I have been out of the city for a week.

In due course I will prepare a reply and will endeavor to answer the questions which you have raised in your letter.

Your comment in this regard is greatly appreciated.

Sincerely yours,

A handwritten signature in cursive script, reading "J. A. Moffett". The signature is written in dark ink and is positioned above the typed name of the sender.

Federal Housing Administrator.

FEDERAL RESERVE BOARD

WASHINGTON

OFFICE OF GOVERNOR

December 5, 1934.

Hon. Donald R. Richberg, Executive Director,
National Emergency Council,
Commercial National Bank Building,
Washington, D. C.

Dear Mr. Richberg:

I am sending to you a copy of a memorandum that I sent yesterday to Mr. Moffett on the regulations recently issued by the Federal Housing Administration, with regard to the insurance of mortgages.

These regulations, it seems to me, are far too restrictive and will severely limit the benefits of Titles II and III.

I will ask you to regard this memorandum as personal and confidential, and I would appreciate an expression of your views on the criticisms and suggestions that it contains.

Yours sincerely,



Office Correspondence

FEDERAL RESERVE
BOARD

Date December 4, 1934.

To Governor Eccles

Subject: The Memorandum on FHA Regula-

From J. M. Daiger

tions for Title II.

... 2-8495

As I understand it, you are planning to use this memorandum, for the time being at least, among only a few persons. My recollection is that you have mentioned particularly Mr. Moffett, Secretary Morgenthau, Secretary Ickes, Mr. Fahey, and Mr. Hopkins.

It occurs to me that it might also be desirable to include Mr. Ardrey and Mr. Riefler in the original list; Mr. Ardrey because he is the deputy in charge of Titles II and III, and Mr. Riefler because he is largely responsible for these Titles and is acting as a consultant to Mr. Moffett and Mr. Ardrey.

no
In view of the interest that the members of the Federal Reserve Board have shown in the particular application of the National Housing Act, they would probably be interested in a memorandum that reflects your views on the mortgage-insurance regulations. I believe that Mr. Morrill and Dr. Goldenweiser, and perhaps also Mr. Paulger and Mr. Smead, would be interested for the same reasons.

If for any reason you decide later to enlarge the official group first mentioned above, the names that occur to me are Secretary Perkins, Mr. Richberg, Under-Secretary Coolidge, and Mr. W. Averell Harriman.

Two persons whose views in this matter would have a strong influence on Mr. Moffett and Mr. Ardrey are Mr. Charles A. Miller and Mr. Lewis H. Brown. I am quite certain that Mr. Miller would concur fully in the objections and suggestions made in the memorandum, though he might be reluctant to press them on Mr. Moffett and Mr. Ardrey unless they consulted him. Mr. Brown, on the other hand, has thus far, I believe, carried more weight with Mr. Moffett than any other person has. I doubt that he would be reluctant to make his views known.



MEMORANDUM ON REGULATIONS GOVERNING

INSURANCE OF HOME MORTGAGES BY FEDERAL HOUSING ADMINISTRATION

The subject of this memorandum is the draft, "Regulations of the Federal Housing Administration Covering Operations under Title II of the National Housing Act," dated November 1, 1934, as issued by the Federal Housing Administrator. The memorandum discusses these regulations primarily from a financial point of view, and, on the basis of objections cited from this point of view, reaches the conclusion that the regulations in their present form seriously jeopardize the success of the program that they are intended to advance.

Twofold Purpose of Housing Act

From the point of view of Administration policy, the National Housing Act is to be regarded as having a twofold purpose:

1. To supplement the home-mortgage relief measure known as the Home Owners' Loan Act with a permanent measure recognizing, as the President has expressed it, "that the broad interests of the Nation require that special safeguards should be thrown around home ownership as a guaranty of social and economic stability."
2. To supplement other emergency measures besides the Home Owners' Loan Act, especially those having to do with unemployment relief and public works, with a permanent measure designed to reorganize and re-open the mortgage market in such a manner as to insure a continuous flow of private capital into residential construction.

Questions Raised by Proposed Regulations

The questions that we now have to consider are the following:

1. Whether the regulations covering Title II are in accord with the twofold purpose of the Housing Act as summarized above.
2. Whether they are in accord with the statutory provisions of Title II.
3. Whether they are calculated to facilitate the operation of the title or are, on the contrary, liable to prove unduly restrictive.

The last of these considerations is the crux of the matter, for it goes directly to a related urgent question--namely, whether Titles II and III can now be relied on to (a) relax the pressure on the Home Owners' Loan Corporation, (b) reopen the mortgage market to a free flow of private capital, and (c) give a vigorous fillip to what is still the most depressed of the country's major industries.

Low-Cost Financing is Essence of Title II

The essence of Title II of the Housing Act, especially when considered in conjunction with Title III, is that it makes a drastic reduction in the cost of urban home-mortgage financing economically justifiable and practicable. A deliberate departure is made from practices hitherto prevalent in such financing, and a new system of home buying and mortgage investing is established. This new system is especially designed to eliminate--

Interest rates substantially higher than those generally prevailing for long-term financing;

Commissions and service charges that only circumvent usury laws;

Second mortgage financing and its exorbitant costs;

Concealment in real estate selling-prices of the prohibitive

3.

costs of financial promotion;

Excessive renewal fees on mortgages fictitiously written for a three-year or five-year term, but without any provision for payment by the borrower, and with the expectation of refinancing at maturity.

To lift this insupportable burden from the home owner, and to free the mortgage market from the consequent hazards, was the main concern of the President's Committee on Housing in formulating the measures now incorporated for the most part in Title II. Title II accomplishes this dual purpose, furthermore, by means that result in a prime investment for private capital—an investment that is still further enhanced by the distributive mechanism provided for in Title III.

Annual Service Charges—An FHA Innovation

In the light of the facts just related, it is difficult to account for the schedule of interest rates, annual service charges, and mortgage insurance premiums set out in paragraph 4 of Article V of the proposed regulations. To begin with, the authorization of an annual service charge for twenty years, applicable to the great majority of mortgages eligible to insurance under Title II, is a distinct innovation on the part of the Federal Housing Administration. No such charge was ever contemplated by the President's committee or its advisers, nor by the witnesses who appeared before the Senate and House committees. Nor is it contemplated in the wording of the statute. Moreover, the making of an annual service charge on mortgage loans has no counterpart in the policies and methods ordinarily pursued by lending agencies.

4.

The annual service charge, therefore, can be regarded only as a device to increase the authorized rate of interest without saying frankly that this is what is being done. Such a subterfuge is bound to provoke popular and political resentment when its implications are generally realized. More particularly, it places the Federal Housing Administration in the untenable position of condoning, and actually imitating, a kind of practice that the National Housing Act was designed especially to discourage and defeat.

High Interest Rates Permitted

In order to arrive at the actual rates of interest that lenders are permitted to charge on mortgages insured by FHA, the annual service charges must be added to the so-called maximum rates of interest authorized in the schedule. These actual rates are thus found to vary, "depending upon the nature of the mortgage indebtedness," as follows:

- Class 1. 5% on mortgages to finance bona fide sale or resale, without change of lender, of property constructed before June 27, 1934.
- Class 2. $5\frac{1}{2}$ % on mortgages to finance purchase of property constructed after June 27, 1934.
- Class 3. $5\frac{1}{2}$ % on refunding of present mortgage, without change of borrower or lender, on property constructed before June 27, 1934.
- Class 4. 6% on refunding of present mortgage, with change of lender, on property constructed before June 27, 1934.

The regulations do not explain these variations in interest rates, nor are the reasons apparent in the classifications themselves. On the contrary, a good deal of unreason is evidenced in the schedule. In the case of

5.

Class 2 and Class 4 loans, for example—and these will be the most numerous classes—the rates include an annual service charge of $\frac{1}{2}$ of 1 per cent; yet the lender is under no annual expense in respect of these that he is not also under in the case of Class 1 and Class 3 loans, which carry no service charges. Class 3 loans involve less work for the lender at the outset, and no more afterward, than Class 1 loans; yet the former carries an additional interest charge of $\frac{1}{2}$ of 1 per cent per annum over the latter.

It is therefore evident that what the President's committee and Congress intended to be the general or uniform rate of interest on all loans under Title II—5 per cent—is now made applicable only to the class of transactions that will be least numerous, namely, Class 1. The great bulk of transactions will be those in which $5\frac{1}{2}$ and 6 per cent respectively will be the actual rate of interest, though the statute plainly looks toward a rate "not to exceed 5 per centum per annum on the amount of the principal obligation outstanding at any time."

As a precaution against contingencies in which mortgage funds might not be attracted to particular localities because of exceptional conditions existing there, separate provision was made whereby the Administrator might establish, "in certain areas or under special circumstances," a rate not to exceed 6 per cent. But no one supposed that this emergency provision would be invoked until the need for it was indicated after the 5 per cent rate had been put to the test of practical experience.

Suggestion in re Interest Rates and Annual Service Charges

To remedy the inequitable arrangement of interest rates and annual service charges authorized in the regulations, the four classifications dis-

6.

cussed above might be abolished and a rate not to exceed 5 per cent be made applicable to all mortgages accepted for insurance. The further suggestion is here offered that the annual service charges not only be dropped from the present schedule, but that FHA add a new regulation strictly prohibiting "service charges" or any other device the purpose of which is to make the true rate of interest exceed 5 per cent.

Another suggestion is that FHA make general or specific provision for mortgage insurance covering two important classes of transactions for which no provision is made in the present schedule. One is the sale or resale, with change of lender, of property constructed before June 27, 1934. The other is the placing of a mortgage on unencumbered property, whether constructed before or after June 27, 1934. There appears to be no reason why these classes of transactions, when otherwise eligible, should not have the full benefits of mortgage insurance.

Insurance Premiums Not Related to Risks

The same schedule that contains the authorized interest rates and annual service charges contains also the premiums to be charged for mortgage insurance. The relevant statutory provisions in this matter are, briefly, these:

1. That the premium charge "be determined in accordance with the risk involved," but in no case be less than $\frac{1}{2}$ of 1 per cent, nor more than 1 per cent, of the original face value of the mortgage.
2. That mortgages accepted for insurance "be so classified into groups that the mortgages in any group shall involve substantially the same risk characteristics and have similar maturity dates."

7.

The premiums prescribed in the regulations, however, are determined, not according to risk characteristics, but according to whether or not there is a "change of borrower." If there is a change of borrower "without change in lender"—that is, if the home owner parts with his home—the premium to be paid by the new owner is only $\frac{1}{2}$ of 1 per cent. But if the home owner holds on to his home, refunding his mortgage either through the present lender or through a new lender, then FHA charges him double the premium that it would charge a new buyer of the same property. Manifestly, there is no way to reconcile this with any accepted principle of insurance or with the statute. Furthermore, the result is again, as in the case of interest and service charges, an arbitrary arrangement that subjects the great bulk of transactions to the highest rates.

Since risk is plainly the criterion prescribed in the statute, the insurance premiums might reasonably be expected to vary among loans within each of the four classifications established by the Administrator. Thus, for example, mortgages maturing 20 years hence might carry an FHA insurance charge of $\frac{1}{2}$ of 1 per cent if the ratio of original principal to valuation were not in excess of 60 per cent, $\frac{3}{4}$ of 1 per cent if the ratio were more than 60 per cent but not in excess of 70 per cent, and 1 per cent if the ratio were in excess of 70 per cent. Such a method of determining the premiums (the figures used here are illustrative only) would be simple and equitable, and would conform fully to the statutory requirements.

Reason for "Initial Service Charge" Not Clear

Besides the annual service charges applicable to Class 2 and Class

8.

4 loans, provision is made in the regulations and in the mortgagor's application form for an "initial service charge" applicable to all loans. This is another dubious item that would be subject to valid criticism, as inconsistent with some of the essential purposes of the Act, unless it were clearly defined as covering only actual out-of-pocket expenditures ordinarily paid by the mortgagor. What expenditures would come under the heading of "initial service charge," however, is not clear. Provision is made elsewhere in the regulation or in the application form for such items as title search, abstract, attorney's opinion, certificate of title or policy of title insurance, appraisal fees, legal costs of preparing papers, recording or filing fees or charges, charge of Federal Housing Administration for appraisal, etc.

Two Appraisals and Two Appraisal Fees Required

The provision for a "charge of Federal Housing Administration for appraisal," in addition to "appraisal fees" charged by the lending agency, carries two important implications:

1. That the borrower is to be subjected to a double cost for appraisal.
2. That the Federal Housing Administrator is not to rely mainly on appraisals made by approved institutions or agencies.

This is another questionable departure from the method of operation envisaged by the President's committee and strongly urged by some of its most competent advisers. In fact, one of the two principal reasons for providing in the Act that mortgagees be "approved by the Administrator as responsible" was to avoid the necessity of setting up another large and widespread staff of governmental appraisers. A reasonable reliance was to be placed on

9.

responsible and experienced mortgage-lending institutions rather than a presumption of suspicion and distrust. It was intended and expected, in this connection, that uniform standards of appraisal would be established and enforced. The appraisals would of course be reviewed by the Federal Housing Administration in the light of its prescribed standards, but for this a relatively small staff would suffice, whereas only a very large staff could make a thoroughgoing separate appraisal.

This is a point of fundamental importance if the principle of uniform standards of real estate appraisal is to be widely accepted and the operation of Title II facilitated. The ability of any given institution or agency to make appraisals can be readily determined by a competent staff of appraisal reviewers. Any approved mortgagee that showed a lack of capacity to make appraisals in accordance with the prescribed standards, or that exhibited a persistent tendency to make excessive appraisals, would presumably be subject to the withdrawal of the Administrator's approval, as provided in paragraph 4 of Article III of the regulations. In fact, the making of unreliable appraisals and the failure to service mortgages properly appear to be the only important reasons that the Administrator might have to invoke the penalty here referred to.

Questions Regarding Taxes, Fire Insurance, Etc.

In addition to the items already recited as hampering to the borrower-- initial service charge, excessive interest rates, unwarranted annual service charges, inequitable premiums for mortgage insurance, dual fees for appraisals --still another set of items is questionable from the borrower's point of

10.

view. They are set out in paragraph 7 of Article V of the regulations, which requires that the mortgage provide for equal monthly payments to "amortize the estimated amount of all taxes, special assessments, if any, and fire and other casualty insurance premiums . . . within a period ending one month prior to their final due dates." The mortgagee is required to hold these payments in trust, but the regulations make no provision for the FHA to hold the mortgagor safe against any failure of the trust. Furthermore, the effect of having these payments begin a year in advance is to increase the true rate of interest paid by the mortgagor.

Undue Restrictions as to "Eligible Mortgagors"

A final and extremely serious objection remains to be observed from the point of view of the home-owner borrower, and one that might be irksome to the mortgage lender as well. It is to be found in the interpretation that the FHA has put on the statutory provision requiring "periodic payments by the mortgagor not in excess of his capacity to pay as determined by the Administrator." The purpose of this provision in the Act was to discourage the unamortized short-term mortgage, and to require the mortgagee to look to the character and credit of the mortgagor as well as to the real estate collateral.

The administrative regulations governing "eligible mortgagors" are four in number and may be summarized as follows:

1. That the mortgaged premises be "free and clear of all liens" other than the insured mortgage, and that the mortgagor shall not have "any other unpaid obligation contracted in connection with the mortgaged premises."
2. That the periodic payments shall "bear proper relation to his present and anticipated income and expenses."

11.

3. That the mortgagor "must have a general credit standing satisfactory to the Administration" (should read "Administrator").
4. That the property owned by the mortgagor "may be located in in urban community whose housing standards meet the requirements for insurance under this Title of mortgages on property located therein."

In addition, the regulations are supplemented by the form to be filled out in triplicate by the mortgagor, giving, as Exhibit A, a detailed personal history, and, as Exhibit B, "Personal Financial Statements--Combined statements of both mortgagors, including contributions by other members of the family." The latter exhibit is one of exhaustive and intimate detail, and beyond the capacity of a person of ordinary education and intelligence to supply without extreme personal difficulty or professional assistance.

The regulation requiring that the property be free and clear of all liens other than the insured mortgage is simple and reasonable, and meets in part one of the essential purposes that the President's committee had in view, though to meet this purpose fully the regulation should provide that the mortgage insurance terminate if the mortgagor places any additional lien on the property.

The further requirement, however, that the mortgagor shall not have outstanding "any other unpaid obligation contracted in connection with the mortgaged premises," is unduly restrictive. If literally interpreted it would exclude current accounts for even minor repairs and improvements-- items that any mortgagor otherwise eligible would easily be able to pay, and that would in fact enhance, however slightly, the value of the mortgaged property. A still further effect of this requirement would be to exclude

12.

from the benefits of Title II any home owner who had responded to the appeals of FHA to rehabilitate or modernize his property in the manner provided by Title I. Likewise, of course, lending agencies would be prohibited from re-funding, on the insured, amortized basis of Title II, any mortgages secured by homes improved on the insured, amortized basis of Title I. There seems to be no practical reason why this privilege should be denied to the mortgagor and the mortgagee if the former is fully capable of meeting his obligations under both titles.

The simple statutory provision, "not in excess of his reasonable ability to pay," relating to periodic payments required of the mortgagor, might easily be complied with by the methods ordinarily used by concerns that extend credit to their customers. The very phraseology of the statute suggests the feasibility of relying in this matter on the judgment and certification of the lending agency; for the agency will already have been approved by the Administrator as responsible, will be obliged to service the mortgage (i. e., collect the required periodic payments), and will suffer whatever inconvenience and diminution of income may result in the event of default, foreclosure, and the necessity of accepting FHA debentures in satisfaction of the mortgage debt.

The clear and simple language of the statute becomes, in the regulations "a proper relation to his present and anticipated income and expenses." This is both vague and variable in meaning, and enormously different in practical application from "not in excess of his reasonable ability to pay." The same objections apply to the regulation requiring that the mortgagor "must have a general credit standing satisfactory to the Administration."

13.

Here again the experience and judgment of an approved mortgagee might well be relied on.

As for the "personal history" and "personal financial statements," they suggest unwarranted meddlesomeness and red tape, and will most certainly provoke resentment and resistance once they are circulated among home owners, lending agencies, the press, and business men interested in the success of the housing program. The practical course in respect of these exhibits, it would seem, is to require them only (a) where the Administrator has become doubtful of the responsibility of the approved mortgagee, or (b) where the Administrator has some doubt of the mortgagor's "reasonable ability to pay" notwithstanding that a responsible approved mortgagee has offered the mortgage for insurance.

The requirement that a property, "if otherwise acceptable to the Administrator, may (sic) be located in an urban community whose housing standards meet the requirements for insurance under this Title of mortgages on property located therein," would only add to the mental confusion and moral bewilderment of borrowers and lenders where Article VI of the regulations is concerned. There is nothing either elsewhere in the regulations or in the text of the Act to suggest what the requirement means or why it was included.

Undue Limitation on Number of Eligible Mortgagees

The only limitation that the Housing Act puts on the Administrator in approving mortgagees is the simple provision that they be "responsible and able to service the mortgage properly." Article III of the Administrator's

14.

regulations, however, denies the benefits of Title II to large numbers of mortgage-lending agencies that are rated by Federal and/or State supervisory authorities as responsible and able to service mortgages properly, but that cannot meet the following additional requirements imposed by the Federal Housing Administrator:

1. That they be located in a town or city with a population of not less than 6,000.
2. That they have a paid-in capital of not less than \$100,000.
3. That their principal activity in the mortgage field consists in lending their own funds.

These limitations are extremely drastic. They rule out perhaps a substantial majority of all mortgage-lending institutions in the country, including a very large proportion of Federal Reserve member banks and non-member state banks, all savings banks and insurance companies of the mutual type (since they have no capital stock), and all concerns that deal in and service mortgages to a larger extent than they lend their own funds. A "note" appended to Article III of the regulations indicates that the Administrator did not intend to rule out as many lending agencies as are in fact ruled out by a strict interpretation of the three regulations referred to above; but this is characteristic of the ambiguities that cause the draft as a whole to be lacking in clarity, simplicity, and precision.

A further objection to be observed with regard to the limitations imposed by Article III of the regulations is that the requirements as to capital and/or population prohibit the refunding of mortgages by thousands of sound and experienced agencies that now hold them, thus subjecting these

15.

agencies to utterly unfair competition as the home mortgages in their portfolios mature. Meanwhile, also, unless mortgagors can obtain a release of mortgages held by the agencies thus discriminated against by the FHA, the mortgagors likewise will be denied the benefits of Title II, at least pending the maturity of their mortgages.

The obvious remedy for all these defects of Article III, it would seem, is to make eligible as approved mortgagees all mortgage-lending agencies that are chartered, that have succession, and that are subject to supervision by the governmental agency, State or Federal, from which their charter powers are derived. For lending agencies that are not subject to governmental supervision, but that otherwise qualify as responsible and able to service mortgages properly, a requirement as to paid-in capital or, in the case of mutual institutions, as to unimpaired surplus, might be established. In this event, a minimum of \$25,000 rather than \$100,000 would seem to be adequate, except in particular instances where the circumstances were exceptional.

Effect of Regulations on Capital Market

The financial community has been encouraged to look to the operation of Titles II and III of the Housing Act to rescue the mortgage market from its demoralized and deflationary state of the past several years, and to give it a new impetus and direction. This accomplished, the stabilizing of real estate values and the revival of residential construction might logically be expected to follow, with a further substantial improvement in business generally as activity and employment in construction brought a corresponding increase in the national income.

Already, however, a delay of several months has occurred in getting

16.

the operation of Titles II and III under way, and even now they are only nominally operative under regulations that are expressly stated to be incomplete. The effect on many mortgage-lending agencies is necessarily one of disappointment and discouragement. It is scarcely an occasion for surprise, therefore, if they are found to be impatient and critical. Nor is it to be supposed that they will be greatly reassured if they find Titles II and III to be encompassed in complicated administrative machinery and hampering restrictions.

But the effect of the delay and uncertainty on lending agencies is, unfortunately, more than subjective. There is still a pressure for liquidation in the mortgage market, as is evidenced, to cite only one example, by the volume of applications for HOLC loans that might well be directed to private agencies, and accepted by them, if the advantages of Titles II and III of the Housing Act were now actually available. Because of the continued apprehensive attitude of mortgage investors, many home owners who might qualify for mortgage insurance under Title II, and thus offer their mortgagees a prime investment, are still under severe pressure for full payment or substantial curtailment of matured or maturing mortgages, with foreclosure and loss of their homes, and in numerous instances a deficiency judgment in addition, as the sole alternative. The politico-economic danger of permitting such a condition to run on until Congress and a majority of the state legislatures are in session next year is all too obvious. Even more serious are the demoralizing social and financial risks meanwhile to the families concerned.

What the Situation Now Calls For

The urgent need, then, is for the prompt operation and vigorous

17.

promotion of Titles II and III, under such regulations for Title II as will--

- (a) induce the largest practicable number of home owners to seek a refunding of their mortgages by this new means, and--
- (b) induce state legislatures to repeal mortgage-moratorium laws wherever they now exist and to refrain from enacting such laws where they do not now exist;--

and under such regulations for both Title II and Title III as will

- (c) induce the largest practicable number of lending agencies to give an immediate preference to the new type of insured amortized mortgage, and--
- (d) induce banking and investment leaders in the larger financial centers to take immediate steps to organize national mortgage associations and/or mortgage-trust companies, utilizing the combined facilities of the Federal Housing Administration and the Reconstruction Finance Corporation.

A Concluding Observation on Mortgage Interest Rates

In conclusion, it is to be emphasized that an interest rate in excess of 5 per cent, on either home mortgages or mortgages on low-cost housing projects--insured, amortized, and otherwise safeguarded from the outset under the terms of Title II, and with the Federal Government guaranteeing full recovery of principal and 3 per cent interest on any part of such mortgage as may default--is unwarranted and unnecessary in the present and prospective state of the capital market. As a matter of fact, 5 per cent is the rate generally prevailing on mortgages already held or being currently made by many institutional lenders; and this notwithstanding that the loans made by them at 5 per cent or less lack the special safeguards provided under Titles II and III of the Housing Act.

The higher rates actually or nominally prevailing in many communities,

18.

sometimes running to 8 or 9 per cent, or even more, have not been due to any correspondingly larger cost of servicing mortgages, or even to any greater risk of loss through default. They have been due in the main to a deficiency of local savings for mortgage investment, in contrast to the lower rates in communities where a great abundance of such funds was seeking an outlet. In the latter connection, it is to be remarked that the congestion of mortgage money has often resulted in acceptance of both a low rate of interest and inferior security--notably in the case of mortgages on slum dwellings and other obsolete property.

Title II eliminates any need, real or imaginary, for high rates of interest to compensate for potential depletion of principal. As for high rates occasioned by an insufficiency of local savings, Title III is expressly designed to syphon mortgage money from communities where there is a surplus to communities where there is a deficiency. This is in fact the fundamental principle underlying the provision for national mortgage associations, and also the means by which they will give the home-mortgage market a liquidity that it has never before possessed.

December 4, 1934.