

## Office Correspondence

FEDERAL RESERVE  
BOARD

Date June 3, 1935

To Governor Eccles

Subject: Letter to Mr. Lewis H. Brown

From J. M. Daiger *J. M. Daiger*on his proposals re urban <sup>mortgage</sup> financing

GPO 16-852

Mr. Lewis H. Brown and his assistant, Mr. Syme, have prepared an extensive survey of urban mortgage financing and have made a number of proposals for changes in the National Housing Act. They asked me if I would go over the survey and recommendations and give them my views thereon; and they later had a conference with Mr. McDonald and Mr. Ardrey to present the survey to them.

In view of the important (I might say dominant) influence that Mr. Brown has had on the FHA program, and also in view of the fact that he is urging further FHA legislation through the Banking Bill or otherwise at this session of Congress, I have thought it advisable to give him more than a brief expression of my views. You may be interested in reading the attached copy of the letter I have written to him.

June 1, 1935

Mr. Lewis H. Brown  
Johns-Manville Corporation  
22 East 40th Street  
New York, N. Y.

Dear Mr. Brown:

From what you and Mr. Syme told me while you and he were here last week, and from the telephone call that I have since received from Mr. Syme, I take it that you would like to have an early answer as to my views on the amendments to the National Housing Act proposed in your study, "Our Mortgage System for Urban Property and Some Proposed Changes."

Knowing that you and Mr. Syme have put a great deal of painstaking effort into this study, I should like to do more than give you my first reaction to the legislative changes that you propose. Unfortunately, however, I cannot at this time, and within the scope of a letter, do more than comment on your principal conclusions and recommendations.

This is the kind of situation that causes me to feel some sympathy with the Supreme Court when it divides five to four. The same informative exposition and argument that leads you to one set of conclusions and recommendations, where this mortgage problem is concerned, would lead me to a different set. But that divergence of opinion does not in any way detract from the worth and usefulness of the exposition and argument.

Of the various changes that you propose in the National Housing Act, only one, it seems to me, relates to the act in its present form. That is the proposal to permit Federal Reserve member banks to invest in the capital stock of national mortgage associations. The other proposed changes (which I am sure would preclude this one) would involve a fundamental departure

from the purposes and the program for which the National Housing Act was conceived.

I seriously doubt, therefore, that such changes as these could be taken up simply as amendments to be incorporated in the Banking Bill.

They are of such a far-reaching character, and so debatable and controversial, as to make it necessary, if they are to be put forward, for them to be made the subject of a separate bill; and I do not believe that such a bill, especially at this stage of the present legislative session, would receive Administration approval.

If I thought that the changes outlined in your survey were an essential prerequisite to the success of the FHA program, I should for my own part be disposed to join you in urging them on Mr. McDonald, notwithstanding the fact that the FHA amendments for 1955 are already under the head of finished business. But, apart from the questionable policy of going back the second time in one session of Congress to ask for extensive legislative changes, I should question the advisability of these particular changes, and I should question also the immediate need for them even if I thought them advisable in the long run.

The essence of the proposed changes is that the FHA, at least in the operation of Title III, should cover all types of urban mortgages rather than home mortgages alone. As I see it, however, there is such an enormous difference, both in kind and degree, between home-mortgage financing as contemplated in the National Housing Act, and commercial-mortgage financing as contemplated in your proposed amendments, as to constitute them two utterly unrelated lines of business. The only resemblance between them is that they both involve a legal instrument called a mortgage.

As to the mixing of mortgages--home mortgages and commercial mortgages, insured mortgages and uninsured mortgages--in the portfolios of the national associations, it seems to me that such an arrangement, even if it were feasible from an operating standpoint, would defeat one of the essential purposes for which these associations were designed. I mean by this that the associations would not then be able to offer to investors a mortgage debenture comparable in its security to a government bond. At the same time the Government

would be assuming the moral obligation for administering a highly specialized and hazardous field of mortgage investment.

This is a matter that I necessarily have to regard in the light of public policy from the governmental point of view; and when I regard it in this light the disadvantages seem to me to outweigh any advantages that might be derived from such an experiment in mortgage practice.

If the arrangement that you propose for national mortgage associations would in fact be attractive to private capital, there is no reason why a company could not be organized now to do business precisely on the lines that you have indicated. All the safeguards that you suggest could be adopted by the company as matters of operating policy. It would of course lack whatever psychological advantage might be derived from a national charter and from supervision by the Federal Housing Administration, but this advantage would be slight anyhow if the mortgage portfolios were only partially insured. On the other hand, the company could be incorporated under the laws of the State of New York and would in that event, I believe, be under the supervision of the State Banking Department, or some other state agency; and it would also have to comply with the rules of the Securities and Exchange Commission.

I point these facts out simply to show that neither Title III nor new legislation by Congress is essential to the formation of a mortgage discount bank under private auspices, though my own view is that private capital would more likely be attracted to such an enterprise if it dealt exclusively in mortgages insured by the Federal Government.

Now as to what I regard as the third major point made in your survey--namely, that "the system which has been created will not operate as it was intended and has not provided a satisfactory flow of mortgage money." It seems to me that this conclusion is only partially accurate, and is in any event premature. I think it is much too soon for you to speak of "the failure of these new measures" as if their failure were a self-evident fact.

You will recall that you and I have differed in our ideas as to when Title II and Title III should begin to function. I have never regarded Title III as indispensable to the early functioning

of Title II. On the contrary, I have always felt that there could be a widespread operation under Title II without Title III, and I have often expressed the view that the widespread acceptance of the insured mortgage would be necessary before any national mortgage association was organized. I also recognized the fact that there were serious statutory impediments to the successful operation of Title III. These impediments, which are the result of political compromises to which I was to some extent a party, still remain.

As you know, I was not in a position to put my views forward once the Federal Housing Administration was established. The opinion that prevailed (to my astonishment and regret) was that the organization of both Title II and Title III was a long-time undertaking, and that it should be deferred for six months, mortgage market or no mortgage market, in order that the FHA might concentrate all its efforts on Title I. It was not until some time in the autumn of last year that a deputy administrator for Title II and Title III was appointed, and the view that prevailed then and subsequently was that Title II and Title III were like the reciprocal parts of an engine and must be set up simultaneously. On that basis the mortgage program was presented to the financial community.

The adoption of this last-mentioned policy, it seems to me, is accountable for the expectation having been created that one or more national mortgage associations would be promptly organized as an inducement to lending agencies to insure mortgages; and the disappointment of this expectation would seem to account in large part for some of the slowness in getting Title II under way during the past six months. Even so, I do not regard this disappointment as a primary factor in retarding new construction.

Although I think the FHA policy to which I have referred above was a mistaken one, and not carefully thought out as to its practical implications, I am very definitely of the opinion that Title II is now well on the way to success in spite of that policy-- a policy that the pressure of events has forced into the discard. It is my understanding that the volume of mortgages offered for insurance is approaching \$8,000,000 a week. This seems to me to show that real progress is being made. It is also my understanding that some important steps to accelerate this rate of progress are now under consideration by Mr. McDonald and his associates.

If this information as to the pick-up under Title II is correct, and if further changes to facilitate its operation are in

prospect, I should think there is reason to feel reassured as to the steady improvement of the home-mortgage market.

I should not want you to infer from all this that I am not receptive to any statutory amendments that experience may show to be necessary, or that I am any the less willing than I was a year ago to help in any way that I can to make the housing program a success. The fact that I am now on the outside looking in, rather than on the inside looking out, does not mean that I have lost any of my interest in the housing program. Nor am I by any means unmindful of the large contribution that you have made to that program through your personal efforts and thoughtful interest.

It may be that a full discussion with others, who are closer to the program than I have been, would materially alter my views as to the changes that you propose. I talked with Win Riefler for a little while on Wednesday afternoon, but he had just returned home from a trip and had not yet had an opportunity to read the copy of your survey that I sent to his house. In any event, since the initiative in a legislative matter of this kind would have to come from Mr. McDonald, I would suggest that you undertake to bring a small group together here after you have heard from him. You can count on my open-minded cooperation.

With kind regards to you and Mr. Syme, I am

Yours sincerely,

J. M. Daiger  
Special Assistant to the Board