

Preliminary and confidential

January 20, 1936 (JMD)

*Housing
files*

TO Mr. Delano
Mr. Eccles
Mr. Fahey
Mr. Grimm
Mr. McDonald

FROM J. M. Daiger

SUBJECT: 1936 Housing Program.

The purpose of this memorandum is to provide an agendum for this evening's informal discussion of the suggestions assembled in my memorandum of December 30 and summarized in my memorandum of January 6.

Of the persons to whom this present memorandum is addressed, all except Governor Eccles have gone over with me in detail the items in the earlier memoranda. It will therefore simplify and expedite matters this evening if in the present memorandum I confine myself to the high points of the proposed program for 1936.

The conversations that I have had during the past two weeks make it evident that there is virtually complete agreement on the objectives to be aimed at in the 1936 program. On only one important point does there appear to be a marked divergence of views, but even here the divergence relates to the means to be employed rather than to the end sought. I shall presently suggest, in this memorandum, an alternative means that I think may be acceptable as a basis of agreement on the disputed point.

In the introductory pages of my long memorandum of December 30, as well as in the specific proposals assembled therein, emphasis was put on two points with respect to a program for 1936: (1) the need and the opportunity for giving a vigorous impetus to the construction of relatively low-priced houses by both operative builders and prospective owner-occupants; (2) the need and the opportunity for encouraging private capital to undertake large-scale operations in relatively low-priced housing both for rent and for sale. The remarks on housing made by the President at a press conference last week, as extensively reported in the newspapers, would indicate that a concrete program having these two points particularly in view would be welcomed by him and given his prompt approval.

For these reasons I would suggest that it might be well for me to review first the proposals that relate to these two major objectives, and that if time remains after these proposals have been discussed we then proceed to the other points that might also appropriately be covered in a program for 1936. If this suggested procedure meets with your approval, I shall take as a point of departure and definition the figure \$5,000 as the top price, under the existing cost structure in our building economy, of relatively low-priced dwelling units,

The specific proposals relating to such construction are in the main as follows:

(1) That Title II of the National Housing Act be amended to provide (a) that the limitation of insured mortgages on new construction be raised from \$1,000,000,000 to ~~\$5,000,000,000~~ ^{2,500,000,000}, and (b) that debentures issued in exchange for defaulted mortgages shall be fully guaranteed by the Government as to principal and interest, without limiting such guaranty, as at present, to mortgages insured prior to July 1, 1937.

(2) That Title II be amended to permit the insurance of mortgages up to 90 per cent of appraised value of new construction where amount of loan does not exceed ~~\$4,500~~ ⁵⁰⁰⁰. (This is an adaptation of British building-society practice, the principal difference being that insurance by FHA would be substituted for the assumption of part of the mortgage risk by the builder, as is customary in Great Britain.)

(3) That on loans up to 90 per cent of appraised value of new construction, the purchaser be required to make a down payment of 10 per cent in cash or its equivalent, and that criminal penalties be prescribed for fraud, misrepresentation, or collusion in obtaining mortgage insurance where such down payment has not been made.

(4) That national banks and federal savings and loan associations be authorized to make, purchase, and sell mortgages insured up to 90 per cent of appraised value of property, and that national

mortgage associations be authorized to purchase and sell such mortgages.

(5) That \$100,000,000 of the \$200,000,000 now provided for insurance of repair-and-improvement loans under Title I be allocated to the Federal Housing Administrator for use as a revolving fund under Title II, up to July 1, 1937, to insure mortgage-lending institutions against loss up to 20 per cent of any loan, not in excess of \$4,500, made for land acquisition and construction, provided that such loan is supplemented by a commitment for a mortgage loan eligible to insurance under Title II and accepted for insurance by the Federal Housing Administrator.

(6) That Section 207 of the National Housing Act be amended to authorize the insurance of large-scale operations in single-family houses built for sale, provided that the aggregate amount of any large-scale mortgage insured shall not exceed the rate of ^{5,000}~~\$4,500~~ per dwelling unit, and provided further that subsequent insurance of the mortgage on any individual property released from such large-scale mortgage shall not exceed ^{5,000}~~\$4,500~~.

(7) That Section 207 of the Housing Act be amended to provide that insured mortgages on multiple-family dwellings shall not exceed a rate of \$1,250 per room. ^{80%}

(8) That \$10,000,000 of the funds appropriated for FHA administrative purposes be allocated to the Administrator as an insurance fund to provide for complete segregation of risks insured under Section 207. ?

(9) That Section 207 be amended to provide that mortgages to be eligible for insurance under this section shall be for not less than \$250,000.

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(10) That Section 207 be amended to provide that debentures issued in exchange for defaulted mortgages on large-scale projects shall be issued upon assignment of the mortgage to the Administrator and shall be in full satisfaction of insurance claims.

(11) That Title III be amended to authorize national mortgage associations to make loans on large-scale projects insured under Section 207.

(12) That the provision in Title III limiting the amount of debentures that a national mortgage association may have outstanding to twelve times its capital be repealed, and that there be substituted a provision limiting the amount of loans it may make on large-scale mortgages insured under Section 207 to fifteen times its capital. (Where there is simply a matching of debentures against insured mortgages purchased by an association from other approved mortgagees, the effect of a fixed ratio of debentures to capital is to make the association's working capital a guaranty fund for mortgages that are ultimately guaranteed by the Government in any event.)

(13) That national banks and federal savings and loan associations be authorized to invest in the capital stock of national mortgage associations, provided that no national bank or federal savings

and loan association shall purchase more than 10 per cent of such capital stock of any mortgage association.

(14) That debentures of national mortgage associations be exempted in the same manner as government obligations, government-guaranteed obligations, and municipals from the provisions of the Banking Act of 1933 prohibiting the banks from underwriting or dealing in investment securities.

(15) That the President direct the Reconstruction Finance Corporation to subscribe up to 90 per cent of the capital stock of any national mortgage association chartered within 90 days after the passage of the Housing Act of 1936, provided that not less than \$1,000,000 of the capital stock of such association shall be obtained from private sources, and provided further that not more than one association shall be chartered in any Federal Reserve District or Federal Home Loan Bank District.

This last proposal relates to the point as to which there is a marked divergence of views. The authority for the RFC to subscribe to the capital stock of national mortgage associations, even up to 100 per cent of the total of such capital, appears to be definite enough without further legislation. There is a strong disposition within the administrative staff of the FHA, however, to have \$100,000,000 of the \$200,000,000 appropriated under Title I allocated to the

Administrator for the purpose of setting up within the FHA a mortgage association with a capital of \$100,000,000.

The FHA proposal looks toward 100-per cent government ownership and operation of a single national mortgage association. It is recognized that this would pre-empt the field, and would make virtually impossible the establishment of any privately owned and operated associations as now contemplated under Title III. The advantage seen by the FHA in the course which it proposes is that it would provide construction funds in short order for all large-scale projects now approved under Section 207 and awaiting financing, and that it would satisfy a widespread demand among lending agencies that some substantial evidence be given that insured mortgages will have in fact a ready market through the sale of mortgage-association debentures. It is the very positive conviction of a large part of the FHA organization that headway under Title II is being seriously hampered by the failure of private capital thus far to organize a national mortgage association under Title III.

On the other hand, it is recognized that the failure of any private group to form such an association is to be ascribed mainly to restrictions in the Housing Act that have from the outset made Title III unworkable. The removal of all these restrictions would be accomplished by the adoption of several of the proposals outlined above. Hence it would seem to some of us that resort to governmental ownership

and operation should not be taken until a workable statute has been made available to private capital, and that a statute which is not workable from the standpoint of profitable operation by private capital should not be used by a governmental agency that was established for the express purpose of aiding and encouraging private capital.

But there are other and perhaps more serious objections also to be considered. The mortgage association proposed by the FHA would in reality be a central mortgage-discount bank operated by the Federal Government through the FHA. Since it would necessarily, therefore, stand ready to buy any mortgage which the FHA had insured, it would be making a standing offer tantamount to a guarantee of some 5 per cent interest on demand obligations of the Government. Furthermore, since the proceeds from the sale of its debentures would largely be used to finance new construction, the Government would itself be in the position of offering a 5 per cent demand obligation to finance virtually 100 per cent of the cost of construction under any mortgage which the FHA insured.

My suggestion, therefore, is that the effort be made to establish at least one national mortgage association by the method proposed in paragraph 15 above and that the terms of any advances made by the RFC take full account of the fact that a new financial institution is being established, with private capital taking the initiative and the risks of initiative. I would suggest that the advance be a short-term one, say of one year to five years, and that the charge or dividend

requirement be proportionate according to the current rates for short-term money. The investment of the RFC would be a riskless one, because any advance which it made would be fully secured by insured mortgages.

This completes the review of proposals relating to the two principal objectives where relatively low-priced housing is concerned.