

February 5, 1936

TO Mr. McDonald SUBJECT: National Mortgage Associations
FROM J. M. Daiger

You asked me last evening to give you a memorandum on how the program that we have been discussing might be modified, particularly with regard to national mortgage associations, if it were found necessary, in the light of the conference held at the White House yesterday afternoon, to abandon any expectation of using \$100,000,000 of the \$200,000,000 which Congress has appropriated for use under Title I of the Housing Act. You suggested that it might be possible, if sufficient cause were shown, to obtain some part, say \$10,000,000, of the \$100,000,000 that has not yet been turned over to you by the RFC; but I take it from your conversation that you may not be able to depend on this.

In either event, it would seem to me advisable, as a matter of Administration policy, to use whatever funds may remain over from the first \$100,000,000 in such a manner as to give a pull on new construction rather than to meet the demands of various business groups for an extension of Title I. This would mean that Title I would be permitted to expire on April 1.

The argument for making such a choice seems to be fairly clear. Title I was designed solely as an emergency measure to provide a form of installment credit that was not previously available for financing a considerable arrears of repair and maintenance. As a result of this measure, a number of institutions have begun to supply such credit, have had a satisfactory experience with the loans which they have extended, and have indicated their intention of continuing to make loans of this character regardless of whether or not Title I is extended.

Furthermore, the charges for virtually all types of installment credit have been appreciably reduced since Title I was enacted, and there is reason to suppose that this reduction was influenced by the moderate charges authorized by the FHA on repair and improvement loans that it insures. The finance companies that have continued to do business without benefit of Title I, and that in part also operate in fields not covered by Title I, have shown a substantial growth in earnings over the past year and a half or two years notwithstanding the lower rates for installment credit.

For these several reasons, there is no reason to believe that the availability of loans on terms comparable to those under Title I would be diminished if Title I were now permitted to expire.

On the other hand, though private enterprise has taken up a good deal of the arrears of repair and maintenance, it has been extremely slow to take up the arrears of residential construction. The

failure of private enterprise to assert itself amply in this respect, notwithstanding the financial assistance and facilities made available to it by the Government, is still one of the most serious problems by which the Administration is confronted.

If Title I is permitted to expire on April 1, and the un-
thereupon
used part of \$100,000,000 ~~now~~ allocated to you for use in stimulating new construction, you would have available for this purpose only about \$50,000,000. This would not be large enough to provide both a revolving fund to insure construction loans and a capital fund to establish a national mortgage association. It would be large enough, however, to meet one or the other of these purposes.

The practical question, therefore, comes to a choice between these two purposes, or else an alternative proposal that might make such a choice unnecessary and still gain whatever volume of construction would result from having both a construction-loan insurance fund and a national mortgage association.

If I had to make a choice between the two, I should suggest that \$25,000,000 be put at the disposal of the Federal Housing Administrator to establish a national mortgage association. On a 20 to 1 ratio of debentures to capital, this would provide the leverage for \$500,000,000 of new construction, financed in two ways: (1) through approved mortgagees acting under the general provisions of Title II; (2) through direct loans made by the mortgage association on large-scale operations,

say from \$50,000 or \$100,000 upward. The capital of \$25,000,000 should be ample for at least the first year of operation.

You expressed the view last evening, however, that the RFC might now be willing to give substantial assistance in the formation of national mortgage associations if private groups took definite steps to organize them and to subscribe part of the initial capital. You also suggested that you might limit by regulation the number of associations to be established and offer an exclusive franchise to a responsible group of private sponsors in each Federal Reserve District. Your idea, as I understand it, is that subscription books might be opened for a period of 60 days, within which a certain proportion of the initial capital might be privately subscribed. Failing this, a central association would be established by the FHA at the end of the prescribed 60 days.

This idea seems to me to be entirely feasible, provided that assurance of RFC support is first obtained. Furthermore, such a plan has the advantage of providing a broader base of mortgage-association operation, while at the same time leaving you in possession of the money to establish a revolving fund to insure construction loans. The operation of such a fund, in my opinion, is scarcely less important than the operation of a national mortgage association; and the fact that the fund would be only \$30,000,000 does not seem to me to be a serious disadvantage, since it would have a turnover of at least two or three times a year, and

hence would cover, within a year, from \$300,000,000 to \$450,000,000 of construction loans.

In fact, while I realize that the members of your organization attach importance to the mortgage association chiefly from the point of view of stimulating loans up to \$16,000 by institutions which express themselves as being unwilling to make long-term mortgages until a mortgage association has been organized, I myself regard the construction loans on large-scale operations as the chief immediate advantage to be derived from getting a mortgage association into action. If we can obtain both of these advantages, and the construction-loan insurance fund as well, so much the better.

As far as the immediate need of a mortgage association is concerned, I think that it would be adequately met if an association were established in New York with a capital of \$10,000,000 subscribed jointly by a private group and the RFC. An improvement on this would be to have such an association in New York, a second in Chicago, and a third in San Francisco. I do not see any present need to go beyond this, though as a matter of practical policy it would of course be advisable not to restrict the offer of RFC assistance to these three districts.

Your suggestion that the franchises be offered on the basis of an initial private subscription of \$200,000 for any association, to be supplemented by a commitment by the RFC for the balance of the

minimum capital of \$2,000,000 required by law, would meet the immediate situation outside of New York; but, from the standpoint of both the large-scale operations pending in the New York area and the marketing of debentures through the established investment channels, a \$2,000,000 association in New York would not be adequate. To accomplish your purpose, therefore, you would have to keep yourself in a position to establish an association with your own funds if a private group failed to subscribe at least \$1,000,000 toward the capital of an association in the New York district.

I think you are warranted in taking the view, which you expressed last evening, that, once a substantial group establishes an association and gets it into active operation, the opportunity for profit will be apparent, and the call on the RFC for funds may therefore not be made at all, or at least be made only for a short-term advance. In saying this I am necessarily going on the assumption that the essential amendments will have been made to make Title III workable. The amendments that I refer to are the removal of the July 1, 1937, limitation on the governmental guaranty, the increasing of the total authorized volume of insured mortgages on new construction, the increasing of the ratio of mortgage-association debentures to capital, and the authorization of direct loans by mortgage associations on projects involving, say, \$50,000 and upward.