TO: Mr. Eccles

FROM: J. M. Daiger

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May 15, 1937

Dear Mr. Young:

Apropos of the conversation at luncheon on Thursday, I am sending to you herewith a copy of a letter that I wrote to Mr. Allie S. Freed a few months ago. It was in response to a request from him for suggestions as to how the financing of large-scale housing operations might be brought about.

I should appreciate your reading this letter without regard to the fact that it happens to have been written to Mr. Freed, or that it happens to refer to a piece of legislation with which I had a good deal to do. The money-market approach to the problem of housing finance is what I should like you to consider.

Under our form of economy, we get housing only by long-term credit, even though we do not always use long-term credit instruments. The financing mechanisms, therefore, are of primary importance. The financing mechanisms of urban mortgage credit, which broke down completely in 1932, are still, as far as large operations are concerned, in a serious state of disrepair. I think the enclosed letter indicates why this is so and what kind of rehabilitation is called for. There are of course other means than those outlined in the letter by which such a rehabilitation might be accomplished.

As to the question that I first discussed with you--namely, whether the diversion of industrial expansion to lower-cost areas was feasible--I have only recently begun to look into this on the basis of the studies of comparative housing costs lately completed, but not yet published, by the National Bureau of Economic Research. I should like very much to discuss this with you again when I have gone into it further in the light of the obstacles that you pointed out.

With appreciation of your kindness, I am

Yours very truly,

J. M. Daiger
Special Assistant to the Chairman

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Letter to Mr. Allie S. Freed
Committee for Economic Recovery
January 4, 1937

Answering now the question that you raised on your recent visit to Washington, when my engagements were such that I was unable to see you, I would say that the Committee for Economic Recovery might well give some thought, among its housing studies, to the adaptation of Titles II and III of the Housing Act to the requirements of large-scale housing projects on the one hand and the market for high-grade listed bonds on the other.

I myself have never regarded the form in which these titles were originally enacted or subsequently amended as workable from the point of view of large-scale housing operations. The fact that a few such projects have been financed in spite of the hampering restrictions of the Act has in no way altered my view, but on the contrary has further confirmed it; for the methods employed have been extremely cumbersome and necessarily of a makeshift character.

During the 1920's the country had numerous mortgage companies operating for the most part with little or no public regulation or supervision. Many of them were for all practical purposes national associations. They made loans over geographic areas that had no relation to state lines, or even to particular sections of the country. Loans were made on virtually every type of urban property, and distributed throughout the country by means of one or another form of bond issue.

These companies flourished, however, not by resort to the main capital markets, but by a competitive bidding-up of interest rates to satisfy the demand of inexperienced investors for high-yield mortgage bonds. This demand was itself a product of the high-pressure selling and indiscriminate buying that the speculative fever and economic illiteracy of the period naturally generated.

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In other words, much of the large-scale construction of the 1920's had its real origin on the side of financial promotion rather than on the side of industrial development. You have heard me describe this activity, as well as much of the current revival of residential construction, as an effort to carry on an industry without real entrepreneurs--that is, without companies sufficiently capitalized, staffed, and otherwise equipped to assume the risks and management of large-scale housing operations.

Now an essential prerequisite of large-scale industrial operation, of course, is either a huge personal fortune or, what is more to the point, access to the main capital markets through which investment securities are originated and distributed, and subsequently listed for trading on the New York Stock Exchange. This access, however, may be direct or indirect, according to the nature of the transactions involved.

In the case of large-scale housing, the transactions involve mortgages on separate properties; but the mortgages, though themselves too large for most institutions to acquire for their own portfolios, and too large for any one institution to hold in great volume, are nevertheless not large enough individually for economical financing in the form of bond issues. For this reason, access to the main capital markets can be had for such mortgages only indirectly through debentures that would be the obligation of mortgage-financing institutions of sufficient size and standing to command the confidence and support of those markets.

Such an investment instrument as I have here indicated would seem to me to be potentially just such a key to widespread operations by large-scale housing companies as, for illustration, finance-company paper proved to be the key to large-scale production in automobiles and numerous other products which, like houses--from bungalows to skyscraper apartment buildings--are paid for (or leased) on the installment plan.

The mechanism most adaptable to the creation of this kind of instrument for financing large-scale housing is, in my opinion, the combination of the mortgage insurance provided for in Title II of the Housing Act with the debenture financing provided for in Title III. I would emphasize the term "adaptable"

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in the preceding sentence, however, because I regard the present form of the two titles, as I did the form in which they were originally enacted, as mutilated and impracticable, and hence requiring important amendments.

As to Title II, the limitation on both (a) the amount of mortgages insurable and (b) the date by which mortgages must be insured if mortgagees are to have the benefit of the governmental guaranty in event of default, never did make sense from a financial point of view. One or the other might be defended on the ground of prudent experimentation, but the two in combination defy reason in 1937 no less than they did in 1934.

As to Title III, the most to be said for it is that it points the way to the kind of debenture-issuing institution which I have mentioned above. The national mortgage associations contemplated in this title would be hampered not only by the dual limitation just referred to as unduly restricting Title II, but in addition by the lack of legal authority to make any loans whatsoever and by the unpractical limitation on the ratio of debentures to capital. The possibility of prudent investment of private capital under Title III was further reduced about two years ago, when the minimum capital requirement for a mortgage association was reduced from $5,000,000 to $2,000,000.

I do not mean to suggest that amending Titles II and III of the Housing Act will alone accomplish the large-scale housing operations which the Committee for Economic Recovery has been agitating. Far from it. What I do mean to suggest is that, if the Committee wishes to see the financing of such operations made feasible on a sounder and more economical basis than was available in the 1920's, it will have to look toward a method of financing that in the 1920's had not been thought of at all, and that very few persons have thought of realistically even in these latter 1930's.

You will of course understand that this letter is written in response to your request for my personal views. I would therefore ask you to treat it accordingly.

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