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A FEDERAL BANK SUPERVISOR LOOKS AT MORTGAGE LENDING

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Before the

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Afternoon Session

Friday, November 6,
1964

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There is one great disadvantage of an assignment near the end of a symposium of distinguished speakers such as we have had here for the last two days. It is simply that everything you had planned to say has already been presented so sagaciously that you feel presumptuous in even reopening a topic. What I would like to do therefore, in the time alloted to me this afternoon, is to raise some questions that might best be related, not so much to technical matters or everyday operations, but rather to a philosophy of mortgage management that recognizes its vital role in our free enterprise system.

We are all, of course, well aware of the great changes that are taking place in our society today. We have the population explosion and the impact upon specific institutions of restructured age groups. We have the continuing migration to the suburbs, notwithstanding the return of some of the disillusioned to the inner city, all within the framework of a dramatic shift from a rural to a metropolitan complex of attitudes and issues. We have the associated problems of urban decay and suburban sprawl, of new choices in housing accommodations, of tangled transportation and overloaded schools and hospitals.

When we stop to think in terms of possible solutions to these problems with which we are all so familiar, we are faced immediately with their magnitude and their complexity. Almost every important problem involves staggering expenditures, architectural and engineering controversies, complicated and time-consuming legal problems, and problems of jurisdiction among governmental bodies and authorities. Such considerations as these loom so large before us and involve such long-range planning and effort that, occupied with our pressing day-to-day affairs, we are tempted to brush them off as being beyond our competence to do anything about them. Those of us who do give serious thought to our civic responsibilities in these areas are likely to think in terms of organized action that government might take or in terms of social welfare projects, rather than in terms of action that we as individuals might take in our own business operations within the framework of our free enterprise system.

What I am trying to say to you is, I suppose, that when we think of our moral responsibilities for the development and well-being of our local communities, these problems should not be viewed as something separate and apart from our profit-motivated system of free enterprise. If it is a good thing for our communities and areas to be kept modern and progressive, then this is also a good thing for our enterprises and business institutions. We all recognize that urban blight, shoddy construction, and inadequate provision for utilities, transportation, or cultural development are a cancer on our society. How many of us, however, recognize that wise and responsible solutions to these chronic problems contribute also to the growth and prosperity of our industry and commerce? In other words, I see nothing inconsistent in our assuming greater responsibility, as businessmen and exponents of free enterprise institutions, in these areas that are too frequently left to government.

What does this broader view of our public responsibilities mean in terms of our own activities? One thing that it means, I believe, is that in mortgage credit negotiations we should not restrict our concern to credit quality, collateral, and terms of lending. We should consider, as well, some larger issues: How does the proposed development or construction fit in with long-range area planning? Will it make a desirable and permanent contribution to the community life? Has corollary construction necessary to overall area development been considered and provided for? Does the timing fit in with the economy's requirements, regarding its impact on prices or employment? I see nothing incompatible in considering and assuming such civic responsibilities as these as an integral part of our evaluation of a loan application. On the contrary, I believe it is in our own selfish interest, and in the interest of the institutions we serve, to take a broad view of our responsibilities.

I am aware that many portfolio managers, particularly those in large metropolitan institutions, have for some time taken into account these broader considerations. They should not be satisfied, however, with what they themselves do. Through their correspondent relationships, they have a unique opportunity to spread the word.

The smaller institutions will be preoccupied with the mechanics of loan terms and credit worthiness, and the bigger institution must from its larger resources develop the research and the thinking from which to develop more useful philosophies, which will include consideration of the impact upon a community and the economy of different lending patterns. These larger institutions should not only be thinkers for their own benefit, but teachers and leaders of the smaller institutions, to insure that no part of the industry loses sight of the highest goals in the press of day-by-day operations.

What are some of those areas that are deserving of greater attention by the mortgage lender?

First of all, in considering the use of funds, I would like to mention the factor of availability. Banks should be wary of granting loans of any type just because they have the money to lend. The continued rapid growth in savings and some dampening in the demand for mortgage credit have put pressure on lenders to seek out loans that frequently represent a greater than normal risk, simply in order to put the money to work. Capitulation to such pressures is usually followed by a season of regrets without compensating benefits in the form of community improvements.

The zoning regulations that govern the type of use that may be made of specific parcels of land comprise one area in which it might be thought that the individual lender has little latitude. Of course, builders and their associates, including lenders, never cease in their efforts to have properties zoned for those uses which they believe to be "best"; and their synonym for best is typically those yielding the "maximum profit." I am naive enough to believe, however, that this definition of "best" is in process of amendment, and that some lenders are coming to recognize that they should not take advantage of zoning regulations that may be obsolete or unduly permissive.

As our burgeoning metropolitan areas push into the surrounding countryside, swallowing satellite towns and precious remnants of unspoiled terrain, some of us have become alarmed. The prospect of losing beyond any retrievement the rambling streams, the magnificent woods and distant vistas that are a part of our heritage has inspired new measures to protect them. One of these measures is the scenic easement, under whose terms property owners are compensated for preserving areas which might otherwise, under local zoning regulations, be used for purposes detrimental to conservation. Is it too much to ask private owners of such land to forego the profits which might come from developing it; or indeed, to disclaim the price of purchasing a scenic easement? Are zoning regulations a sufficient guide to the proper use of land?

If there are moral and community considerations which will deter the conscientious from a permitted but detrimental course, then we should do all in our power to insure that all lenders in the field exercise conscious and deliberate use of moral judgments in these areas. These considerations may seem somewhat alien within the framework of our accustomed points of reference, but are relevant to mortgage lending, and will assume increasing importance as this nation continues to grow.

Somewhat akin to zoning matters, because they too involve government regulations, are building codes. It would appear that the individual lender is closely circumscribed by the maze of complex, conflicting, and often obsolete building codes that have been estimated to add an average of at least $1,000 to the cost of a house. Yet this eminently local matter is the kind of question peculiarly susceptible to assault by local innovators who truly want to rescue the industry from its anachronistic allegiance to the myth that all houses are assembled at the site by skilled craftsmen.

For a generation critics have been jousting with building codes, with no great success, and it would be presumptuous of me to offer a prescription where so many have failed. Perhaps some of you have shared my experience of stepping inside one of the modern mobile homes which dot our road-sides, and of marveling at their up-to-date facilities and efficient arrangement of space. It was a shock to me to learn recently that such mobile homes equaled one-sixth of the one-family houses built last year. These mobile homes seem to be less expensive than houses with comparable facilities, a fact obviously due in part to their dispensing with a permanent site. But I suspect some of the economy is due to freedom from local codes, permitting the industry to standardize its electrical, plumbing and heating, and to move toward a construction technique based on performance standards rather than specifications.

While diverse and inappropriate building codes have been adding to the cost of houses, lack of imagination has been hastening the obsolescence of houses currently being built. Having moved from a condition of housing shortage to one of imminent if not actual surplus, buyers have become more choosy, as well they might. This situation promises, of course, to make a further dent in the 5 million sub-standard houses currently occupied, a fact that is gratifying to all of us. But even the benefits derived from the filtering-down process do not justify the construction of inferior housing that is obsolete before it is completed, and that could be made more nearly adquate at relatively low marginal cost. To add additional storage space or provide adequate wiring at the time of construction costs only one-fifth of what it would cost to do so later, and other seemingly small but highly significant changes in the physical features of a house may help to preserve its desirability in an environment of steady improvement in housing amenities.

How does the mortgage lender fit into this situation? The answer is simple. In today's market of long-term, high percentage loans it is the lender who really buys the house. It is he, rather than the builder, who has to live with it for 20, 30 years, through many unforseeable vicissitudes that threaten his investment. He is, in effect, the nearest thing to a representative of the consumer. How well he exercises his stewardship will determine to a great extent the rate of obsolescence of a given house. He needs to concern himself with plumbing, air conditioning, insulation and underground wiring, along with economic and demographic trends which impair alike the value of the mansion run by servants and the two-bedroom house. More than that, he needs to recognize that rising incomes will make home buyers increasingly dissatisfied with the cheaper housing that comprises the major part of our housing inventory. Both to protect the home buyer and to insure a market for his loans, the lender needs most of all to see that new homes are sufficiently desirable for buyers to want to pay for the kind of house they can afford.

Since a house is tied to a particular piece of land, location is an integral, and often an overriding part, of it. We have all seen desirable homes deserted because of change in the character of a neighborhood, and have, contrariwise, seen people move into unattractive houses in order to obtain the presumed benefits of a better location. What comprises a good location is, of course, a highly individual matter. Some persons will suffer peeling plaster and companionable cockroaches in order to be near their work, or the theatre, or the excitement of a metropolitan area. Others choose the murmur of brooks even if it means a daily two-hour travail of creeping cars and a sacrifice of urban amenities. That many of us have been obliged to choose between these types of alternatives is itself an indictment of the forces that have shaped our communities.

These problems are being attacked vigorously on all fronts; new problems are being created in the wake of our successes. The transformation which has come to many of our inner cities through urban renewal has inevitably meant the displacement of familes and the sacrifice of businesses. Aside from the hardships and difficulties attending relocation, some people believe that urban renewal has contributed to crime and delinquency and has destroyed neighborhoods which, whatever their inadequacies, were treasured by their residents as pleasant places to live.

It is trite to observe that the movement to suburbia has also created problems. The primacy of the purpose to provide bare shelter in the earlier stages of the boom has laid the basis for the slums of tomorrow. Neither zoning regulations nor building codes have provided an effective barrier against that eventuality. I would like to think that more imaginative lending policies and a greater sense of responsibility among mortgage lenders would have saved us many of the headaches that are just over the horizon.

One of the great strengths of the free enterprise system is its flexibility. I would hope that, in the realm of attitudes toward their role and responsibility, mortgage lenders would show the flexibility they have recently exhibited in their response to changes in the housing market. If anyone ever doubted the ability of the construction and the mortgage lending industries to adjust to changing situations, developments of the past five years have provided dramatic reassurance of their flexibility. Only a free enterprise system, I sincerely believe, could have engineered the recent turn toward construction of multi-family housing. In the last five years apartment units constructed have more than doubled as a proportion of total dwelling units built. During this period multi-family construction increased 140 percent, while the building of single-family houses went down 25 percent.

Accommodation to this change in the market rests not alone on the emergence, but also the recognition, of new elements in the housing picture. Lenders have to be abreast of these changes in order to satisfy and, to the extent possible, influence the market along progressive lines. Among the forces effecting the current surge of apartment construction are the well-known change in the age group structure of the population, featuring a bulge at either end of the age scale and the preference of this group for apartments; the economy of using increasingly expensive space; and possibly a growing antipathy to the commuting, gardening, and do-it-yourself maintenance that are the cost of suburban living. Some of the elements in the focus on apartments appear less soundly grounded; among these are certain tax advantages, easier mortgage credit, and the need to put idle men and money to work as sales of houses slowed down.

You are much more familiar than I am with the forces likely to dominate the housing market during the next year. From what I hear about the rise in vacancies, coupled with the apartment units now under construction and destined soon to hit a weakening market, there may be difficulty in absorbing the added units to our housing supply. This may be temporary, however, as signs point to a steady rise in the normal demand, from new households particularly, which should support the current level of housing starts.

My discussion of mortgage lending has focused on the physical evidences of this type of credit. There is nothing more important to the welfare of our people than the creation of the best homes they can afford. The process of providing these homes is unequalled as a sustainer of our economy, providing jobs and income to millions of our people. Mortgage lending itself is the largest type of credit, accounting as it does for nearly one-half of all private debt. It is also one of the fastest growing types of credit, new mortgage debt having increased an average of about 12 percent a year since 1960.

It is a sobering responsibility to be entrusted with the allocation of funds so heavily charged with potential for good -- and for ill. The substantial successes that have been ours in this operation, represented by a level of housing adequacy unrivaled elsewhere in the world, have been eclipsed in this recital by a plea for still better housing. Private builders and private mortgage lenders have brought us to this high eminence; imbued with an even deeper understanding of the dimensions of our housing concerns, they can take us further still.