

Versatility in Serving Real Estate Finance

Remarks of

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at the

Mortgage Bankers Day

Vanderbilt University

Nashville, Tennessee

March 2, 1966

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It is a pleasure and a privilege to be back in Nashville and to be at a gathering whose participants have so much in common and at a university which is contributing so much to our common good.

As I entered this beautiful campus, I saw the statue placed there by Nashville citizens in honor of Cornelius Vanderbilt, its founder and major benefactor. Inscribed on the base is his wish that the university should "...contribute to strengthening the ties which should exist between all sections of our common country." In the 1964-65 academic year, 5,000 students were enrolled in this great university, including almost 200 from other countries. Although the six states included in our Federal Reserve District were fortunate enough to account for some 60 percent of the total, it is clear that, as Vanderbilt approaches its first centennial of service, the wish of Commodore Vanderbilt is being realized in large measure. Your role as host to us today is further evidence of this realization.

I cannot let this opportunity pass, Dr. Heard, to acknowledge the many contributions of Vanderbilt to our own organization. We feel most fortunate to have you on the Board of Directors of our Nashville Branch, and we know that Sam Fleming, our good friend and Federal Advisory Council member, serves you well as a member of your Board of Trust. We also have two very fine alumni of Vanderbilt in our Atlanta office, one in management and one on our professional economic staff. Mr. George Gaffney, of the class of 1959, is continuing his education in the Stonier Graduate School of Banking, and Mr. Richard Long is in the final phase of his doctoral program in economics here at Vanderbilt. In addition,

our Nashville Branch has three of your recent graduates in its family of employees.

A century ago in 1861, when Nashville was suffering growing pains of a young and struggling city, a publication entitled Business Directory enumerated the potentials of the area and stated that millions of dollars would be invested in lots and other property here if the city were better known. The writer stated that if Nashville were to prosper to the extent she should, she must become familiar at a distance. She must assume her responsibility for and participate in the common good. History shows that both she and this great University have done and are doing just this. The ties are strong between Nashville and other sections of the country and indeed the world!

Nashville is one of the growth cities of the Southeast, and as such is not without problems. You have here one problem, however, which is not peculiar to your city or your area. I'm referring to the shortage of regional capital. Nashville, in 1965, supported over \$100 million in new construction undertaken, and in terms of gain over 1964 ranked fourth out of 27 standard metropolitan areas in the Sixth Federal Reserve District. A substantial share of this finance was brought in by the mortgage bankers from other regions.

The Mortgage Bankers who have arranged this meeting today have done so in the true pioneering spirit of their profession, of Nashville, and of Vanderbilt, and I am grateful to be a part of it. We in the Federal Reserve Bank of Atlanta are aware of the magnitude of your efforts and contribution to the advancement of our region, and as you know, we acknowledge and commend it at every opportunity. It is a professional endeavor, which began back in the early, formative days of our

nation, and one which has produced major innovations and adaptations of methods from time to time as our country has changed and grown.

It is to this ever-changing and ever-growing nature of our country and its utilization of an extremely productive population and resource base that I would like to direct my remarks. The nature of this constant change and growth not only explains the past versatility in the field of real estate finance, but indeed requires it now and will require it in the future.

We have already heard from Mr. Goodwin, your national association president, of the significance of mortgage lending in today's economy. Massive financial flows are vital in serving a national economy currently producing goods and services at an annual rate in excess of \$700 billion. These huge flows of funds defy comprehension except in terms of the continuing quest for innovation, flexibility, and versatility of our institutions and methods which handle them. Indeed, it would be attempting too much here merely to examine in detail the full scope of the problem of inter-relationships between the worlds of financial services and of production and distribution of real goods and services. Let us look, instead, at three types of financial flows, and variations within them, as a preliminary to concentrating on real estate financing and its need for versatility.

History tells us that economic growth does not always come about in steady increments. Instead, it moves in long sweeps, with many changes of pace within sweeps: Financial savings vary, sometimes sharply, and real savings ratios are not constant; investment spending, both public and private, is thus subject to wide swings. This type of flow is the principal concern of overall fiscal and monetary policy, and I would

like to come back to it a little later.

Just as total financial flows vary and require flexible response, adjustments are continually being made, between particular sectors of the economy, regardless of the size of overall savings and investment streams. We depend, in our system, upon a set of free-market instruments and service-oriented institutions to channel these flows into and out of specific uses. We thus have a system of rationing, operating within interest rate patterns subject to changing overall supply and demand for financial resources, and within the constraints of general fiscal and monetary policies.

A third set of flow adjustments is made necessary by regional differences--differences that range widely over the economic map and interact with sociological, political, and institutional variations built up over long periods.

One specific and persistent difference, however, is of primary interest to the mortgage banker. Basic to his business activities is the fact that some geographic regions have accumulated capital and current savings flows that are relatively greater than total demand for them at the "going" interest rate. Other regions are so capital-short that not only can they meet the "going" rate but also they can pay something over and beyond that for imported funds. The mortgage banker's challenge, then, is to develop instruments, channels, and techniques to the point where he can minimize the built-in disadvantages of mortgage lending and make it a fully competitive option for the centralized investor. To meet this challenge, not only must he be versatile himself, but he must have the assistance of other financial institutions. And of course the potential mortgage borrower is entitled

to the most efficient service he can get, as is the mortgage credit supplier, wherever he may be located.

From the earliest day, this country has had an evolving, versatile approach to real estate finance. And banks have had a hand in this evolution--from the Colonial land banks through the early chartered banks of New England and right on up to the present. Today it is commonplace for mortgages to accounts for upwards of \$25 billion annually within a total of some \$70 to \$75 billion of total funds made available to the economy. Also accepted as normal in our versatile system are the closing of almost \$10 billion in mortgages in 1964 and the servicing at year-end of almost \$50 billion by the mortgage banking industry.

By any measure, this is a substantial market for financial services. In view of the sharp changes in commercial bankers' attitudes during the post-1960 period, it would have been remarkable had they not moved toward more direct participation in this market. Bankers have been under the pressures of rising volume of financial flows and higher costs and have sought a greater role as financial intermediaries.

For those of your guests who may not be as close to this field as the mortgage banker, let me just sketch the main private forms of meeting specific real estate finance needs in a particular market area:

1. Financial institutions gather individual savings locally and provide mortgage credit locally. A major share of the needs of many communities is met in this way, and by and large the commercial banks join the local non-banking institutions in this activity. For the most part, mortgages are originated, serviced, and eventually paid off without the necessity of sale or other services.
2. Local financial institutions move funds directly from savers located outside their lending market to the point of local demand. This may be accomplished through direct advertising, by brokers, or

by retention of savings accounts when the owners move to other areas. However done, the banks serve their sister institutions by providing efficient clearing of checks and depositary facilities for working balances. A variation of this form also occurs when local institutions, having originated mortgages, sell an interest or participation in it to another institution outside its savings market area, and then service the mortgage for all co-owners.

3. Local financial institutions, including mortgage bankers, originate mortgages and move them in large lots from point of credit use to some other type intermediary, securing funds in wholesale lots. The major examples here involve primarily government services, such as the facilities of the Home Loan Banks in making advances to member savings and loan associations, and purchase of mortgages by Federal National Mortgage Association. In turn, these institutions have facilities for tapping the national pools of financial resources in competition with all other large bidders.
4. Local financial institutions, primarily mortgage bankers, originate single mortgages, package them, in some cases hold them a considerable length of time, and eventually export them. They may place them directly with investors who gather savings directly from individuals and groups of savers, or they may use the services of brokers and other intermediaries. This is the form which is generally known today as mortgage banking and is the form of inter-regional flows of mortgage credit in which the commercial banks play the largest role in providing versatility.

One way to get at the present role of commercial banks in helping to bridge the funds gap in a capital-short, fast-growth region such as ours, is to follow a mortgage from origin to maturity. The chief steps are origination, warehousing, packaging, sale, and servicing. Let's take the whole package first and look at what has been happening in the last five years as far as commercial banks are concerned.

A number of banks--chiefly large banks--have entered the mortgage banking field or have increased their participation in it: Some have bought mortgage companies outright, others have expanded their own

mortgage lending departments, and still others have formed a working arrangement with a mortgage company under a trust arrangement. In our District, however, this movement has been much more limited than in some other areas. In fact, less than 6 percent of our member banks are members of the National Mortgage Bankers Association and an even smaller percentage have actively expanded into full-scale mortgage banking. As you know, many banks maintain active membership because they are interested in providing you with financial services at the wholesale level.

In the origination function, many commercial banks provide the construction loans for the new output which generates demand for longer-term mortgage credit. Working capital for the builder, the mortgage banker or other permanent lender, and suppliers is also required. In spot-loan origination, the commercial banker may provide the funds for closing and "shelving" the loan. He works closely with the mortgage banker to enable him to use his line of credit to maintain the supply of mortgage funds even when there is no immediate buyer of the finished mortgage.

Warehousing of mortgages has become a growing service of commercial banks, both in total volume and in number of customers served. For those risk-taking mortgage bankers who originate for inventory and packaging, these services are of course indispensable. The commercial banker also provides the underlying financial services which facilitate the sale of mortgages and transfer of funds from region to region.

On the national scene, many banks now service mortgages owned by investors located in other regions. At the same time, many other banks are buyers of mortgage-servicing from mortgage bankers, both on their own account and in their fiduciary capacity. In our District,

several banks have also built up substantial servicing accounts over the years. And it goes without saying that the banks serving investors and mortgage bankers have benefited from the funds placed in their care in escrow accounts.

One may well ask why banks in this region have not moved as aggressively into the main channel of mortgage banking itself as banks in some other areas have. A prime reason is that the rapid growth and the pressure of financial needs to facilitate this growth in this area has been such that most banks have had their hands full in serving other types of needs.

Among the uses for bank funds which are quite close to mortgage banking, in addition to those which I have already mentioned, are these:

- Financing of land acquisition and development.
- Development of mobile home sites and facilities.
- Promotion of major recreational and sports projects.
- Urban renewal planning and development.
- Acquisition and development of farms and equipment.
- Acquisition and development of forest lands by
timber, lumber, and paper companies.

Beyond this list, which is representative but not exhaustive, is another area of commercial bank participation in our region's growth that is extremely important to you. Housing demand depends upon both demographic and income factors, and income depends predominantly upon the quality and quantity of jobs. In planning and in execution, frequently the community's bankers are among the leaders in acquiring or expanding industry. They are also broadly active in providing the funds needed by state and local governments to keep the level of public services in line with other economic growth. In a region with growth prospects such as ours, I can see no let-up in these heavy demands for financing, neither in the mortgage lending field itself, nor in all the other

activities that reinforce and contribute to the ability of our people to afford better housing.

I would like now to come back to a point I made earlier--that variations in the overall flows of funds occur from time to time and in turn may cause changes in the volume that goes into specific sectors and uses. As you know, we are in the fifth year of the longest expansion period this country has experienced. During most of this period, both fiscal policy and monetary policy were oriented toward two main goals--that of fuller employment of resources and solution of our balance of payments problem. It was a time when increased flows of funds into the private sector of the economy, including extensive increases in the creation of bank credit, were both possible and desirable. At that time, we could use this means to increase employment opportunities and to bring idle resources into use without sharp increases in price levels. Most importantly, this flow of funds could be safely increased during that period because the public sector of the economy, including our defense needs, did not make sharply increasing demands over and above the accelerated revenue flows accompanying economic growth.

During much of this period, we experienced stable or declining long-term interest rates. Funds were available to any sector of the economy that could use them productively. Indeed, one of our concerns was that some credit-using sectors were being served "not wisely but too well," with consequent worries about the declining quality of credit.

This atmosphere began to change at an accelerating pace during 1965. Takings of funds from the capital market by corporations, state and local governments, financial institutions, and government agencies were beginning to step up sharply by mid-year. Declining corporate

liquidity, relative to their expansion plans, and the increasing pressure on state and local government bodies to keep pace in providing public services were two of the underlying causes. In addition, as we all know, the country's defense needs for manpower and other resources began to expand further in the last half of 1965.

By the end of the year, it was apparent that the margin of unused capacity of the economy had become small indeed. Price increases became more frequent and affected a wider range of goods and services. In short, growth in credit demands showed every indication of outstripping available resources, and even if we could have accepted more sharply rising prices, which would have accompanied the expansion of credit to satisfy all demands upon it, real resources would not have increased. Clearly, the flow of financial resources had to be restricted so that resources would be re-directed between uses--in short, some rationing of real resources through financial flows had to occur.

As I am sure the mortgage banker is painfully aware, sharply rising interest rates in the national capital markets reacted rapidly upon the flows of funds available to him and to his sector of economic activity. An example of the value of versatility in real estate finance has been evident during the past few weeks. Since institutional and other factors prevented a rapid and smooth adjustment of yields on the insured mortgages which are your stock in trade, mortgage demand in many local markets shifted to local, conventional lenders as an interim solution. Experience tells us that the adjustment will occur, however, and that the mortgage banker will still have a very important role in our family of versatile institutions serving real estate finance.

Contrary to what you may have heard from a variety of sources,

the Federal Reserve System is not attempting to stop our economic growth or to delay it unnecessarily. We do have a responsibility, however, to help prevent an inflation which would serve nobody and would injure most severely those who can least afford it. If further rationing of financial and real resources is required to meet our national objectives, it may be expected. The problem cannot be solved by over-supply of credit.