Minutes of actions taken by the Board of Governors of the Federal Reserve System on Tuesday, January 22, 1952.

PRESENT: Mr. Martin, Chairman
Mr. Szymczak
Mr. Powell

Mr. Carpenter, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary

Memorandum dated January 17, 1952, from Mr. Young, Director, Division of Research and Statistics, recommending an increase in the basic salary of Marjorie C. Capps, Clerk-Stenographer in that Division, from $2,950 to $3,175 per annum, effective February 3, 1952.

Approved unanimously.

Letter to Mr. Slade, Vice President, Federal Reserve Bank of San Francisco, reading as follows:

"Reference is made to your letter of January 11, 1952, regarding the application of the Central Valley Bank of California, Richmond, California, for permission to establish a branch in the La Loma District, an unincorporated area in Stanislaus County adjacent to the city of Modesto, California.

"It is noted that prior approval of the State authorities has been obtained and in view of your recommendation the Board of Governors approves the establishment and operation by Central Valley Bank of California of a branch in the above described La Loma District, provided the branch is established within six months after January 8, 1952, the date of approval by the State authorities.

"It is understood that Counsel for the Reserve Bank will satisfy himself as to the legality of all steps taken to establish the branch."

Approved unanimously.

Letter to the Presidents of all Federal Reserve Banks, reading as follows:

"When Regulation X was amended to include nonresidential structures on February 15, 1951, it was recognized that an exemptive provision would be necessary for nonresidential properties essential to the national defense. A need for the exemption did not clearly develop until much later, when several Federal agencies indicated separately that Regulation X might impede certain forms of private nonresidential construction which they had a legislative responsibility to encourage, or which would be necessary to the fulfillment of their administrative programs. In all such cases, the nonresidential structures involved were represented as being essential to the national defense. As a consequence, section 5(m) of Regulation X was issued for the purpose of assisting those agencies and departments of the United States Government which have a legislative or administrative responsibility to further construction essential to the national defense.

"The question has been asked whether a certificate of necessity issued by one of the four processing agencies of the United States Government (Departments of Commerce, Agriculture, Interior, and Defense Transport Administration acting through the Defense Production Administration which issues certificates of necessity) obviates the need for certification by the head or assistant head of an appropriate agency or department of the United States Government that proposed nonresidential construction is essential to the national defense. It is the opinion of the Board that proof that a certificate of necessity is held by the borrower may not be accepted in lieu of the certification required by section 5(m).

"We would appreciate receiving brief information about any exemptions issued under this section, unless you have already informed us of such actions, and we request that you note future exemptions under section 5(m) in your monthly enforcement reports of Regulation X."

Approved unanimously.

Letter to Mr. Heath, Assistant Cashier, Federal Reserve Bank of Chicago, reading as follows:

"Your letter of December 6, 1951, inquires into the possibility that a mortgage loan insured by the Federal Housing Administration might be construed in such a way that, because of existing equity in the property, a major addition or improvement could be financed with no outlay of cash on the part of the borrower. After reviewing their regulations and conferring with representatives of the Federal Housing Administration, we find that the illustration you present is quite possible under present Federal Housing Administration regulations.

"In your illustration the proposed loan is in part refinancing of $3,000, and in part financing of a $7,000 major improvement. Although Federal Housing Administration provides for financing of major additions or improvements with a maximum loan of 90 per cent in Title I of the National Housing Act of 1949, as amended, the use of Title I is not appropriate in this case as the maximum possible loan for major improvements under that Title is $5,000. There are several subsections of Section 203, under Title II, of the National Housing Act which could be used for major additions or improvements, but only in the case of Section 203(b)(2)(A) is the maximum loan sufficient to meet the premises of your illustration. In any event, such a case would have to involve refinancing in order that sufficient equity would be available to warrant a loan without a cash outlay. Under Section 203(b)(2)(A) a $14,000 loan can be insured for a one-family residence, $16,000 for a two-family residence, $20,500 for a three-family residence, and $25,000 for a four-family residence. In all cases the loan-to-value ratio is the statutory 80 per cent limit or as limited by Regulation X, whichever is the lower maximum loan.

"However, it is our understanding that in the application of Section 203(b)(2)(A) of Title II, the Federal Housing Administration makes no distinctions between refinancing, new construction, and/or a major addition or improvement, but when considering the loan application weighs the amount of the entire loan desired against the value of the property. In the illustration you suggest,

"as long as the Federal Housing Administration's valuation of the property was $13,000 or more, no cash down payment on the major improvement would be required. If the valuation was $12,000, only $400 in cash would be required. This agrees with the schedule of maximum loan values for new construction of one- to four-family residences in Regulation X; however, in the case in question, under Regulation X the loan would be treated as a mixed purpose loan and 10 per cent of the major improvement of $7,000, or $700 must be paid in cash by the borrower.

"Although it is not published in their regulations, we understand that the Federal Housing Administration does attempt to screen out those who are attempting to evade credit controls through such devices. If the original loan has been in existence for six months or less, the valuation is the sum of original acquisition cost and the cost of the improvement; if the loan has existed longer than six months, the present value of the property, including improvements, is used. This would have little effect unless the six months covered a period of rapidly rising prices. It does seem, however, that for a situation similar to that postulated the first mortgage would have to have been reduced by a substantial proportion of the original loan in order that sufficient equity exists or the borrower could not be relieved of a cash payment. Federal Housing Administration officials indicate that a major addition or improvement-refinancing proposition such as the one postulated is rare.

"We have not formally requested the Housing and Home Finance Administrator to arrange to have a change made in Federal Housing Administration regulations which would bring them into accord with Regulation X on the above point, but we are considering doing so. Since such a change in Federal Housing Administration regulations is costly, we should appreciate your considering the matter further in the light of the above comments and advising us whether you feel the difference between the regulations is of sufficient practical importance to make it desirable that we urge the Federal Housing Administration to change its regulations."

Approved unanimously.

Secretary.