FEDERAL RESERVE BANK
OF NEW YORK

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June 14, 1951]

LOANS ON REAL ESTATE

Bulletin No. 4 of Voluntary Credit Restraint Committee

To all Financing Institutions in the Second Federal Reserve District:

Following is the text of Bulletin No. 4 of the national Voluntary Credit Restraint Committee, which was issued today for publication June 15, 1951:

June 14, 1951

LOANS ON REAL ESTATE

The Voluntary Credit Restraint Committee, at its meeting on June 6, 1951, discussed the application of the principles of the Voluntary Credit Restraint Program in the field of real estate credit and adopted the following statement:

Real estate credit transactions governed by Regulation X, which covers the permanent financing of most new construction and major additions or improvements to existing structures, are not normally within the area of influence of this Voluntary Program. Neither does the Program apply to FHA or VA loans or to other loans guaranteed or insured or authorized as to purpose by an agency of the United States Government. The Program does apply, however, to all other real estate credit transactions. Financing institutions extending such credit are urged to observe the principles and the spirit of the Program.

For the guidance of financing institutions in granting real estate credit encompassed by the Voluntary Program, the national Committee makes the following recommendations:

1. **Loans on residential property (1 to 4 family units).**—The Committee has been informed that most financing institutions are following conservative lending policies on existing residential properties (1 to 4 family units). The Committee urges all financing institutions to follow such policies and in no case to make a loan on existing property in an amount which would cause the *total amount of credit outstanding* (primary and all other credit combined) with respect to the property or with respect to the transaction to exceed the limits which Regulation X imposes as to new construction.

2. **Loans on agricultural property.**—While the Committee recognizes that in some instances a loan on agricultural property may be in effect a loan on residential property, the Committee feels that normally such a loan falls in the category of a loan on commercial property (see section 3 below), and the lender should be guided by the recommendations of that section as to over-all credit limits and purposes.

3. **Loans on residential property (more than 4 family units) and on commercial property.**—Loans on residential property (more than 4 family units) and loans on commercial property, such as office buildings, stores, hotels, motels, motor courts, restaurants, etc., should be screened as to purpose and the loan should not be made unless it is in harmony with the principles of the Program. If the loan is to be made in connection with a sale of commercial or residential property a determination by the financing institution that the sale and the sale price are bona fide may constitute a sufficient screening of the loan. The Committee conceives that it is not the function of the Voluntary Credit Restraint Program to make the transfer of real estate impossible or impracticable, but rather to reduce inflationary pressures by limiting the amount of additional credit created in the process of real estate transfer.

(OVER)

Financing institutions are urged to limit a loan, on any type of property described in this section, whether or not a sale is involved, to an amount which would not cause the *total amount of credit outstanding* with respect to the property or with respect to the transaction[1] to exceed 66⅔ per cent of the fair value of the property.[2] Also, the Committee urges that financing institutions require an appropriate and substantial amortization of principal.

The Committee recognizes that hardship cases may arise where a 66⅔ per cent loan limitation would not be sound or equitable. Such cases would include a loan to finance the sale of property to close an estate or to pay estate taxes, the refinancing of a maturing mortgage, or the sale of property of a bankrupt company. The Committee makes no recommendation in such cases.

4. **Loans on industrial property.**—Loans on industrial property should be screened as to purpose, whether or not the loan is to be made in connection with a sale of real property. In this instance, however, there appears to be no need for a percentage limitation on the amount of the loan, since in the industrial field mortgage security usually is merely one of the factors considered by the lender in determining whether to make the loan and often bears comparatively little relation to the amount of the loan.

5. **Sale-lease back arrangements.**—The Committee also urges financing institutions to recognize that in most instances a "sale-lease back" arrangement, whereby real property is purchased by a financing institution and leased to the vendor or his nominee, is a substitute for a form of financing and therefore comes within the Program and should be screened as to purpose.

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1 If the facts are not already known, the financing institution presumably will want to request the borrower to furnish information as to any other indebtedness or credit existing or contemplated in connection with the transaction.

2 "Fair value" as used here means:

1. If the loan is to be made to finance the purchase of real property: The bona fide sale price, or the appraised value of the property securing the loan, whichever is lower;

2. In all other cases: The appraised value of the property securing the loan. The appraised value should be determined in accordance with sound and established practice in the community. A good definition of "bona fide sale price" is given in section 2(*j*) of Regulation X.

Additional copies of this circular will be furnished upon request.

ALLAN SPROUL,
President.