

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. 3801]
[December 27, 1951]

REAL ESTATE LOANS

**Amendment No. 8 to Regulation X, Real Estate Credit, of the Board of Governors
of the Federal Reserve System, Effective December 31, 1951**

**Revised Paragraph 5 of Bulletin No. 4, Loans on Real Estate,
of National Voluntary Credit Restraint Committee**

*To all Persons Engaged in the Business of Extending Real Estate Credit
in the Second Federal Reserve District:*

Amendment No. 8 to Regulation X

The Board of Governors of the Federal Reserve System has adopted Amendment No. 8 to Regulation X, effective December 31, 1951. Following is the text of a statement announcing the amendment, released by the Board for publication December 28, 1951:

The Board of Governors of the Federal Reserve System announced today an amendment to Regulation X, Real Estate Credit, to exempt extensions of credit in connection with the leasing of nonresidential properties from the down payment and maturity requirements of the regulation. Concurrently, the National Voluntary Credit Restraint Committee issued a revision of its Bulletin No. 4 concerning loans on real estate to include a paragraph relating to such leasing arrangements where they are used as substitutes for mortgage financing. Leases on new residential construction are not affected by either the amendment to Regulation X or the revision in the Voluntary Credit Restraint bulletin.

In exempting nonresidential leases on new construction from Regulation X, the Board of Governors gave consideration to the fact that transactions of this particular kind tend to be specialized in character and to represent but a relatively small portion of aggregate financing. It is believed that such leasing arrangements, particularly sale-lease-back arrangements, may be effectively restricted through the Voluntary Credit Restraint Program, which will call for a screening as to the purpose of any such contemplated credit extensions. If subsequently it becomes evident that an excessive increase in new nonresidential construction has occurred through abnormal employment of nonresidential leasing arrangements of the above type, consideration would be given to restoring nonresidential leases to coverage by Regulation X.

Credit extended in connection with certain types of nonresidential leases continues to be affected by the regulation. This is described in a footnote to the nonresidential leasing amendment and includes cases where there is borrowing to finance nonresidential construction on leased land and cases where nonresidential leases are used as collateral for loans.

In connection with new residential construction, lenders and builders should note the statutory provisions regulating certain kinds of leasing arrangements. In this respect, the Defense Production Act, as amended, defines "credit" as including, among other things, "any rental-purchase contract, or any contract for the bailment, leasing, or other use of property under which the bailee, lessee, or user has the option of becoming the owner thereof, obligates himself to pay as compensation a sum substantially equivalent to or in excess of the value thereof, or has the right to have all or part of the payments required by such contract applied to the purchase price of such property or similar property; any option, demand, lien, pledge, or similar claim against, or for the delivery of, property or money; any purchase, discount, or other acquisition of, or any credit under the security of, any obligation or claim

arising out of any of the foregoing; and any transaction or series of transactions having a similar purpose or effect." This definition of credit also has been incorporated in Regulation X.

A copy of Amendment No. 8 to Regulation X is enclosed.

Revised Paragraph 5 of Bulletin No. 4

Following is the text of the revised paragraph (5) of Bulletin No. 4 of the National Voluntary Credit Restraint Committee referred to in the above statement of the Board of Governors:

5. **Leasing arrangements.**—The Committee also urges financing institutions to recognize that leasing arrangements sometimes are used as substitutes for mortgage financing and therefore come within the Program and should be screened as to purpose. This principle should apply to existing construction of all types and should also apply to new construction of commercial or industrial property, since leasing arrangements involving commercial or industrial property are no longer subject to Regulation X. Some examples of leasing arrangements which may be used as substitutes for mortgage credit and where, if this is the case, the above principle (i.e., screening as to purpose) should apply are sale-lease-back arrangements, long-term leases which may be renewed for a nominal rental, and leases in which the lessee has the right to have rental payments applied to the purchase price in a subsequent exercise of an option to buy the leased property.

For your convenience, we have reprinted on the following page the text of Bulletin No. 4, as revised, which includes the new paragraph 5.

Additional copies of this circular and of Amendment No. 8 to Regulation X will be furnished upon request.

ALLAN SPROUL,
President.

BULLETIN NO. 4 (REVISED DECEMBER 31, 1951) OF NATIONAL
VOLUNTARY CREDIT RESTRAINT COMMITTEE

LOANS ON REAL ESTATE

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 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.

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 limit which Regulation X imposes as to new construction or a limit of 66⅔ per cent of the fair value¹ of the property, whichever of such limits is the greater.²

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.

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 transaction³ to exceed 66⅔ per cent of the fair value of the property. 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. **Leasing arrangements.**—The Committee also urges financing institutions to recognize that leasing arrangements sometimes are used as substitutes for mortgage financing and therefore come within the Program and should be screened as to purpose. This principle should apply to existing construction of all types and should also apply to new construction of commercial or industrial property, since leasing arrangements involving commercial or industrial property are no longer subject to Regulation X. Some examples of leasing arrangements which may be used as substitutes for mortgage credit and where, if this is the case, the above principle (i.e., screening as to purpose) should apply are sale-lease-back arrangements, long-term leases which may be renewed for a nominal rental, and leases in which the lessee has the right to have rental payments applied to the purchase price in a subsequent exercise of an option to buy the leased property.

¹ Wherever used in this bulletin, "fair value" 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.

² As a working rule, the above statement may be interpreted as meaning that where the fair value of the property is \$16,700 or less the limits of Regulation X would apply and where such fair value is more than \$16,700 the limit of 66⅔ per cent would apply.

³ 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.

REAL ESTATE CREDIT

AMENDMENT NO. 8 TO REGULATION X

ISSUED BY THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Regulation X is hereby amended as follows, effective December 31, 1951:

1. Add the following new subsection (o) to section 5:

(o) **Nonresidential Leases.**—The prohibitions of section 4 of this regulation, except subsection 4(a)(5), shall not apply to any extension of real estate construction credit which is a contract for the leasing of nonresidential property.^{18a}

^{18a} Leases exempt under this subsection shall be considered "subject to" the regulation for purposes of subsection 4(a)(5). Moreover, even though contracts for the leasing of nonresidential property are exempt to the extent provided in subsection (o) above, in cases where there is borrowing to finance nonresidential construction on leased land, and under the contract for leasing the lessee has the option of becoming the owner of the land, or has the right to have all or part of the payments required by the contract subsequently applied to a purchase of the land, or obligates himself to pay a sum substantially equivalent to or in excess of the value of the land, the amount of credit outstanding by reason of the lease must be taken into account in determining the amount of additional credit which may be extended to the lessee to finance the construction. In such cases, the amount of credit outstanding by reason of the lease shall be considered to be the appraised value of the land less any amounts which have been paid and which are applicable to the purchase of the land.