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BY

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FOREWORD

In our admiration for technological achievements—giant dams, steel mills, and cyclotrons—we may fail to recognize that residential real estate, though changing but slowly in form and efficiency, has been and is still the largest single component of national wealth, in the postwar decade as well as throughout the nineteenth century and in the United States as well as in foreign countries. At the present time, residential structures account for almost one-third of the total value of all reproducible tangible wealth in this country, and residential real estate (including land) represents practically as high a fraction of total national wealth.[1] Similarly, expenditures on residential structures are the largest single component of capital formation, gross or net. During the 1950's, these expenditures accounted, on the average, for one-fifth to one-fourth of national and for one-fourth to one-third of private capital formation. Residential real estate is also the most important single investment nonfarm consumers own, representing about one-fourth of their total assets. Since the proportion of borrowing to owners' equity investment is higher for residential real estate than for most other forms of capital formation (excluding consumer durables), the extension of residential mortgage credit and the increase in the residential mortgage debt constitute a large proportion of total debt financing and a still larger proportion of external long-term financing. In the decade ending in 1955, the volume of residential mortgage debt outstanding increased by almost $80 billion. This is considerably more than the increase in most other forms of financial assets (disregarding pure valuation changes). The volume of corporate bonds outstanding and of consumer credit, for instance, each increased by only slightly more than $40 billion during the same decade. The debt of state and local governments rose by only $30 billion and total net sales of corporate stock aggregated less than $20 billion, while the volume of federal government debt available to the public remained virtually unchanged. The growth in residential mortgage debt also exceeded the increase in financial assets, such as the premium reserves of life insurance companies ($36 billion), or the time deposits with commercial banks ($20 billion) and mutual savings banks ($10 billion), and share accounts with saving and loan associations ($25 billion).

[1] The figures used in this Foreword, for illustration purposes only, have been rounded. Sources are not specifically cited, nor is attention drawn to the usually well-known limitations of the estimates.

Even if residential mortgage loans did not constitute so large a proportion of the entire capital market, the development and operation of the residential mortgage market during the postwar period would still be of great interest within the framework of a general analysis of the American capital market. For in the market for residential mortgages we can observe, through the detailed discussion of its quantitative and qualitative aspects provided in Saul Klaman's book, several of the basic features and trends that have characterized the American capital market in the postwar period. We can observe them possibly with more clarity, and certainly on the basis of more adequate statistical data and qualitative first-hand information, than in almost any other segment of the American capital market.

The first of the basic tendencies exemplified by developments in the residential mortgage market during the postwar period is its institutionalization. At the end of 1956 nearly 90 per cent of all outstanding residential mortgages were held by financial institutions, 83 per cent of them by the four types of institutions which dominate the market—saving and loan associations, mutual savings banks, commercial banks, and life insurance companies. Financial institutions also absorbed over 90 per cent of the net increase in residential mortgage debt during the postwar period.

The second characteristic which the market for residential mortgages shares with many other segments of the capital market is the delayed fruition during the postwar period of a crop from seeds planted in the mid-thirties—the large-scale adoption of government guaranteed mortgages. This process involved the use of legal and technical forms and of facilitating government agencies which were created as part of the far-reaching reconstruction of American finance under the New Deal—a development that is still often underrated in its long-term significance, possibly because many of the present-day users of these new instruments and organizations would like to forget their origin.

The standardization of mortgage contract terms, with its limitations on length of life, interest rate, and loan-to-value ratios, and the introduction of regular amortization may well be regarded as a separate third characteristic of the postwar market for residential mortgages, even though it is but the outstanding example of the rise to predominance of techniques that were actually introduced during the 1930's. It is only since guaranteed mortgages became standardized and almost fungible instruments that a true secondary market in residential mortgages could develop, a market comparable in essence to that existing for government and corporate securities, even though during the postwar decade it was still limited to a wholesale market among financial institutions.

The market for residential mortgages, fourthly, has provided some very interesting examples of financial innovation, the mechanism of challenge and response operating more clearly here than in most other segments of the capital market. The first of these innovations is the rise of the technique of forward commitments, primarily between large lenders such as the insurance companies and large-scale builders of single-family homes and apartment houses. This technique, described in detail in Chapter 7 of Klaman's book, has had far-reaching influence, not only on the timing of residential building and on the portfolio management of financial institutions (to say nothing of its effect on the interpretation of current mortgage statistics), but also on the behavior of the capital market and beyond that on the timing and width of the business cycle. A second innovation is the development of a new type of financial institution, the mortgage company, which acts as an agent of large-scale institutional investors and is closely tied in its growth and operations to the market in guaranteed home mortgages. This innovation is summarized in Chapter 8, a condensation of the fuller description in his *Postwar Rise of Mortgage Companies.*

This is not the first time that the National Bureau of Economic Research has turned its attention to the market for residential real estate. One of its first publications dealing with it, Wickens' *Residential Real Estate* of 1941, may well be regarded as one of the starting points of serious detailed statistical study in the field. The six volumes reporting the Studies in Urban Mortgage Financing, mostly published from 1950 to 1952, and *Capital Formation in Residential Real Estate,* by Grebler, Blank, and Winnick, published in 1956, represented later substantial contributions to our knowledge of that market. They deal, however, primarily with developments before or immediately after World War II. Klaman's book, in keeping with the program of the Postwar Capital Market Study, concentrates on the financial side of the market for residential real estate, and within that field is limited to the use of credit in financing the construction and sale of dwellings, and deals only peripherally with owners' equity investment and with changes in it that represent realized or unrealized capital gains.

Klaman's study reported here and in two papers previously published by the National Bureau, apart from providing the first reasonably complete, statistically founded study of the market for residential mortgages during the postwar period, makes several contributions to the analysis of this segment of the capital market. It provides the most consistent and detailed analysis of mortgage holdings and flows and—very important for cyclical analysis—puts them on a quarterly basis. It originates a series of interest rates on conventional mortgages which, we hope, will be continued and improved by some of the organizations with practical or research interests in the field. It supplies a detailed description and analysis of institutional arrangements and market techniques and a discussion of the economic problems they raise. It presents for the first time a comprehensive discussion of the mortgage portfolio policies of the main types of financial institutions. Finally, it provides a substantial body of new material on the growth and operation of mortgage companies.

Much, however, still remains to be done before a complete analysis of past and current developments in the residential mortgage market will be possible, and Klaman is careful to point out, particularly in the preface, the gaps in our information and the deficiencies of the material he has been dealing with, most of them entirely beyond remedy in this study.

Even in the narrow field of straightforward statistical information on flows and holdings of residential mortgages the gaps in our knowledge are still wide and serious. We are still unable to present an adequate picture of mortgage flows on a gross rather than a net basis, as we are unable to separate for each of the involved major groups of lenders and borrowers new mortgage loans made, contractual and other repayments. We cannot as yet separate, on either a gross or a net basis, mortgage flows for new and old structures or owner-occupied and rented properties. We also have very little information on current terms of lending. Moreover, virtually all of our market information on mortgage lenders is limited to the administration of and transactions in residential mortgages by financial institutions. To be sure, there is every indication that financial institutions now account for at least four-fifths of all residential mortgages, but the remaining fifth is still large enough compared to many other segments of the capital market to merit more than to be clouded in almost complete statistical obscurity.

Turning to broader aspects of the market for residential mortgages, we know as yet very little about the demand for mortgage loans. Klaman's book, as virtually all the literature in the field, concentrates on the supply side, partly because, as he suggests, it has been supply rather than demand that has determined volume and price in the postwar residential mortgage market. As a result, our knowledge is scant about consumers' decisions to buy or rent housing facilities; about the selection of types of shelter; and—what is more pertinent—the way in which the acquisition of a home, the provision of the initial equity, and the later servicing and repayment of the mortgage loan fit into the consumer's over-all financial picture.

Finally, we are not yet able to integrate what we have learned about the residential mortgage market into the picture of the whole American capital market. This deficiency, which is felt particularly when we try to explain the level and movements of residential mortgage interest rates and the differentials between them and other yield rates, is due, of course, less to deficiencies in our statistics of the residential mortgage market and their analysis than to the still greater gaps in our information and analysis in several other important sectors of the capital market. Outstanding among them is the market for nonresidential nonfarm mortgages. In view of the size and importance of that market the degree of our lack of relevant statistics and the almost complete absence of analysis of what happens in that market is truly astonishing. Not the least to be gained from reading a description and analysis of the market for residential mortgages, which Klaman's book provides, is the realization of how great is the need for a similar study of the market for nonresidential nonfarm mortgages.

RAYMOND W. GOLDSMITH
Director, Postwar Capital Market Study

PREFACE

When this study was undertaken in 1956 it was clear that it would have to deal selectively with the broad and complex subject of postwar real estate finance. Several earlier studies of the National Bureau of Economic Research had already dealt with various aspects of real estate markets,[1] and also the time available for the study was limited essentially to one year.

The selection of areas for investigation was guided, of course, by what had been developed in earlier studies. Attention was centered on fields either previously neglected or for which new or later information had become available. The economic and statistical framework in which the study was cast as part of the National Bureau's Postwar Capital Market Study, moreover, was fundamental in determining its nature and organization. As such, this study is oriented economically towards capital market analysis and statistically towards flow-of-funds accounts. Therefore, it differs basically in subject matter and orientation from earlier National Bureau studies of real estate finance.

It differs in yet another important respect. Compared with the earlier investigations of basic long-run developments over several decades, this study is concerned with the recent relatively short period of postwar economic history from 1945 to 1956. The concern with short-run market changes and their causes results in an analytical approach fundamentally different from that associated with longer-run trend analysis.

Within the basic guideposts established for the selection of subject matter and organization of the study, a wide choice still remained. The final form and content of the report reflects in part personal preferences and interests of the author, and in part the relative feasibility of developing new information about previously uncharted areas. Each of these elements acted to limit the full realization of the other. As a result, several important subdivisions of real estate finance—both statistical

[1] Published by the National Bureau of Economic Research: David L. Wickens, *Residential Real Estate: Its Economic Position as Shown by Values, Rents, Family Incomes, Financing, and Construction, Together with Estimates for All Real Estate* (1941); Raymond J. Saulnier, *Urban Mortgage Lending by Life Insurance Companies* (1950); Miles L. Colean, *The Impact of Government on Real Estate Finance in the United States* (1950); Ernest M. Fisher, *Urban Real Estate Markets: Characteristics and Financing* (1951); and Carl F. Behrens, *Commercial Bank Activities in Urban Mortgage Financing;* also Edward E. Edwards, "Urban Real Estate Financing by Savings and Loan Associations" (1950, unpublished). Published by Princeton University Press for the National Bureau: J. E. Morton, *Urban Mortgage Lending: Comparative Markets and Experience* (1956); Leo Grebler, David M. Blank, and Louis Winnick, *Capital Formation in Residential Real Estate: Trends and Prospects* (1956); and Raymond J. Saulnier, Harold G. Halcrow, and Neil H. Jacoby, *Federal Lending and Loan Insurance* (1958).

and economic—remain yet to be explored. Among these subjects are nonresidential finance, gross mortgage flows, terms of mortgage lending, mortgage borrower analysis, and real estate market transactions. Some were ruled out early in the study, others were discarded only after strong efforts were made to develop new information.

Among these subjects, perhaps the one developed furthest, yet not far enough to yield well-rounded results for inclusion here, was that on gross mortgage flows. Considerable progress was made in achieving a framework for gross mortgage flow analysis, by main types of lender and type of mortgage. The work done indicates the feasibility of maintaining—on an annual basis at least—detailed gross mortgage flow accounts for life insurance companies, mutual savings banks, and savings and loan associations. Only for commercial banks, among the main types of financial institutions, are basic data inadequate to support estimates of gross mortgage lending. For other less important mortgage lenders, not only are estimates of gross mortgage flows impracticable at present, but also data on net flows are inadequate.[2] Notwithstanding the many shortcomings in the data, it is unfortunate that circumstances prevented the completion of even a truncated framework for gross mortgage flow analysis. It is to be hoped that the preliminary unpublished data developed in this study will be amplified by others and incorporated into a useful set of accounts.

The advantage of gross over net financial flows for analysis of market developments is clear. By distinguishing between credit extension and repayment, gross figures permit a more complete analysis and understanding of the response of various market participants to shifting forces at work in capital markets. Moreover, breaking down mortgage debt repayment between contractual obligations and prepayments provides further insight into the nature of real estate market activity. Limiting analysis to net changes in outstanding indebtedness, on the other hand, obscures the distinction between incurrence of debt and its repayment, and between types of debt repayment. Changes in the net flows of mortgage funds from various types of financial institutions reflect not only shifts in response to relative yields and other factors, but also differences in rates of repayment between time periods and types of institutions.

Another basic statistical gap hampering analysis of mortgage markets relates to the inadequacy of comprehensive series on mortgage lending terms—loan-to-value ratios, amortization provisions, maturities, downpayments, and interest rates. A serious attempt was made in the present

[2] See Saul B. Klaman, *The Volume of Mortgage Debt in the Postwar Decade,* Technical Paper 13, New York, National Bureau of Economic Research, 1958.

study to develop current information on this subject, so that the National Bureau's series carried through 1947 could be extended. It proved feasible, however, to obtain data only on conventional mortgage interest rates, and these were not as comprehensive as desired. For a fuller understanding of shifts in mortgage flows and of movements in mortgage interest rates, it is essential that current reporting of data on contract mortgage terms be developed.

Nonresidential real estate finance was recognized in the preliminary phases of investigation as too vast a subject to treat adequately within the framework adopted. The over-all statistics on nonresidential mortgage flows are presented in Chapter 2, but thereafter the report is devoted principally to residential mortgage markets. Postwar institutional lending policies and general market techniques have been significantly different in nonresidential from those in residential transactions. Financing of nonresidential building and transfers by other means than mortgages has become increasingly important in recent years. Equity financing, sale-leaseback arrangements, and directly placed bond issues, among other financing techniques, have for one reason or another been better suited than mortgage financing to some transactions. Thus, the decision to concentrate in this study upon the residential sector resulted partly from its orientation towards real estate mortgages rather than real estate finance generally, and partly from the fact that the bulk of postwar mortgage flows has been associated with residential transactions. In addition, the development of the relevant information on nonresidential market developments was beyond the scope of the work as planned.

A broad aspect of mortgage market analysis given only minor consideration in this monograph concerns the mortgage borrower or demand side of the market. Demand factors are, of course, basic to developments in any market, and in the summary appraisal of major elements influencing the postwar mortgage market those factors have been taken into account. Summary data on mortgage debt by type of borrower are also presented. But in the more detailed appraisal of shifts in mortgage flows and of institutional aspects of mortgage markets, the analysis deals largely with the supply side of the equation. This course was taken mainly because the supply of mortgage funds—its availability and terms—has been a much greater factor than the demand for mortgage funds in influencing postwar changes in the residential mortgage market. Moreover, information bearing on mortgage demand, including borrower characteristics, is fairly limited compared with data on mortgage supply.

This is not to suggest that analysis of the demand side of mortgage markets is unimportant. On the contrary, in view of the paucity of data and of analysis in this area—compared to other sectors of the capital market, for example—it would seem eminently worthwhile for students of real estate finance to devote more attention to it. There is outstanding need for improvement of knowledge and for appraisal of the economic position of mortgage borrowers, and measuring the forces underlying demands for mortgage funds in both residential and nonresidential markets.

In the investigation reported here, I have incurred debts to many individuals and organizations. My indebtedness to some has already been recorded in two previous reports published by the National Bureau.[3] I am happy to acknowledge here the assistance and guidance of others. The staff reading committee, Leo Grebler, Richard Selden, and Raymond W. Goldsmith, carefully reviewed the preliminary manuscript and their suggestions and comments were the basis for improvement and revision of the final draft. Wallace J. Campbell, Harold G. Halcrow, and Gabriel Hauge, all of the National Bureau's Board of Directors, rendered helpful criticism. The influence of Raymond Goldsmith, as director of the Postwar Capital Market Study, upon the report throughout its development and his constant support and interest are gratefully acknowledged.

Grateful acknowledgment is also made to the Advisory Committee on the Postwar Capital Market Study, which assisted in drafting plans for this investigation. Members were: W. A. Clarke, George T. Conklin, Jr., W. Braddock Hickman, Norris O. Johnson, Arnold R. LaForce, Aubrey G. Lanston, Robert P. Mayo, Roger F. Murray, James J. O'Leary, Winfield W. Riefler, Robert V. Roosa, R. J. Saulnier, William H. Steiner, Donald B. Woodward, and Eugene C. Zorn, Jr.

I am indebted to many individuals for sharing with me their time and knowledge, through interview and correspondence, in my search for factual and interpretive information about institutional arrangements, market techniques, and lender policies in the postwar residential mortgage market. Among them are George Bliss, R. Manning Brown, Jr., Norman Carpenter, Thomas P. Coogan, George Conklin, Harry Held, John Jewett, William Keesler, Robert M. Morgan, Raymond T. O'Keefe, John Traynor, King Upton, and William Yoars.

James J. O'Leary, besides paving the way for interviews with officers of several financial institutions, provided valued counsel and encouragement throughout the study. The painstaking job of editing done by Margaret

[3] *Ibid.*, and *The Postwar Rise of Mortgage Companies*, Occasional Paper 60, New York, NBER, 1959.

T. Edgar has greatly improved the readability of the book. The charts were drawn by H. Irving Forman, who did his usual peerless job.

I would not have been able to conduct this investigation without the generosity of the Board of Governors of the Federal Reserve System and of Ralph A. Young, now Advisor to the Board, in permitting me a year's leave of absence from my post as staff economist. To them I am deeply grateful.

These acknowledgments would be incomplete without recognition of the contribution of my former colleagues in the Federal Reserve System who were a constant source of intellectual stimulation and challenge through twelve years of association. In this regard I am especially indebted to Ramsay Wood and Frank Garfield, who instilled in me—not without pain—a respect for high standards, which I hope they will find reflected in this monograph.

It remains only to absolve all who have provided generous assistance from any responsibility for the analyses and conclusions of this study and from the inadequacies which undoubtedly remain. Moreover, the views that I have presented do not necessarily reflect those of the Federal Reserve Board, with which I was associated during most of the study, nor the National Association of Mutual Savings Banks, with which I am now associated.

SAUL B. KLAMAN