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Importance of Federal Programs in Mortgage Finance

Stimulation of the flow of mortgage funds into residential construction has been a principal aim of federal housing policies since the early and middle thirties. With the exception of public housing and the recent program for urban redevelopment, these policies in fact have operated almost exclusively through the use of various devices influencing the flow of private institutional mortgage funds: primarily mortgage insurance or guaranty and improved marketability of loans through the Federal National Mortgage Association.[1] As a result, government aids have had a large and increasing effect upon mortgage lending activity, sources of funds, and the amount and composition of the mortgage debt.

Another major objective of federal housing policies has been to reduce the periodic payments of mortgage borrowers, by lowering interest rates and lengthening contract terms. In fact, an increase in the ease of borrowing has been one of the means through which the federal programs have sought to raise the level of demand for new residential construction.

The precise effects of the FHA and VA programs on the volume of residential mortgage lending are as indeterminable as their impact on residential building activity. By encouraging mortgage lending during the second half of the thirties and under the special circumstances of the war housing program and by stimulating mortgage borrowing through differential terms for various price classes, the FHA has unquestionably contributed to the spectacular increase of the residential mortgage debt which totaled $56.3

[1] The Housing Act of 1948 added a new Title VII to the National Housing Act authorizing "yield insurance" for debt-free investments in rental housing. In this instance, federal aid was designed to stimulate the flow of equity funds. However, no such insurance had been issued by late 1952.

billion in 1950 as against less than $24 billion in 1935; and the VA home loan program with its special terms for veterans has operated in the same direction since 1945. Moreover, public funds used by the Federal National Mortgage Association during the postwar years for purchases of FHA and VA loans have directly supplemented the large private funds that were invested in residential mortgages during this period.

Mortgage Funds for New Housebuilding

From 1935 to 1951 an estimated $22 billion of mortgage loans on new residential construction were insured by the Federal Housing Administration or guaranteed by the Veterans Administration. Of this amount, over $17 billion originated during the six postwar years from 1946 to 1951. Little more than $4 billion of the grand total served to finance the construction of rental and cooperative housing projects, and all but $300 million in this category originated during the postwar period. The annual data reveal a rapid growth in the use of FHA-insured mortgages on new construction from 1935 to 1940, as would be expected in the development of a new program, and during the early years of World War II. The growth was checked by the building limitation of the late war years and the difficulties of postwar reconversion of construction activity. In the postwar period when the VA as well as the FHA program was in operation, the annual amounts of insured or guaranteed mortgages built up rapidly to a peak of $4.7 billion in 1950. A slight decline in 1951 was apparently caused by the credit restrictions on government-insured as well as conventional loans, which were introduced in the fall of 1950, and by the effect in the money market of the "unpegging" of government securities. (Chart B and Table 3).

Over the entire period from 1935 to 1950, government-insured loans on new residential construction averaged about 45 per cent of the total estimated flow of mortgage funds into new construction.[4] FHA-insured loans on new dwellings rose from 5 per cent of the total in 1935 to about 3[illegible] per cent in the immediate prewar period and supplied most of the new construction financing during

[4] See footnote to column 5 of Table 3 for qualifications of the data.

TABLE **3**

FHA-Insured and VA-Guaranteed Loans on New Residential Construction 1935-1951

	MILLIONS OF DOLLARS					COMBINED TOTAL AS A PER CENT OF	
	Loans on New Houses for Owner Occupancy			*FHA Loans on New Rental and Co-op. Housing*	*Combined Total*	*Estimated Loans for New Construction*	*FHA and VA Loans on New and Existing Construction*
	FHA	*VA*	*Total*				
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1935	22	....	22	2	24	5.2	25.0
1936	95	....	95	2	97	11.5	31.2
1937	169	....	169	10	179	17.5	41.2
1938	227	....	227	48	275	24.2	52.8
1939	461	....	461	52	513	32.1	71.2
1940	562	....	562	12	574	30.6	76.6
1941	707	....	707	12	719	31.5	79.5
1942	751	....	751	20	771	65.3	78.8
1943	552	....	552	84	636	96.2	75.1
1944	484	....	484	46	530	97.8	69.5
1945	257	31	288	16	304	47.0	44.3
1946	120	371	491	11	502	19.2	18.3
1947	477	1,357	1,834	359	2,193	50.9	48.3
1948	1,425	944	2,369	606	2,975	48.9	64.7
1949	1,306	842	2,148	1,016	3,164	51.9	68.2
1950	1,633	1,930	3,563	1,152	4,715	48.7	70.2
1951	1,194	2,566	3,760	570	4,330	....	70.7
Total 1935-1951	10,442	8,041	18,483	4,018	22,501	44.3	61.9

SOURCES, BY COLUMN.

(1) *Fifth Annual Report,* Housing and Home Finance Agency, 1951, Table 4, p. 244. Excludes a relatively small amount of loans insured under Title I, Class 3 of the National Housing Act.

(2) Estimates derived from the total amount of VA loans closed (Table 9) and the per cent distribution of the number of loans by purpose of loan (undated mimeographed reports of VA, "Characteristics of Home Loans

SOURCES, TABLE 3, CONTINUED

Reported Closed under the VA Loan Guaranty Program"). To apply the distribution of the *number* of loans for new and existing construction to the total *amount* of loans implies that the average loan per new dwelling was the same as the average loan per existing dwelling. Consequently, the amount of loans on new construction is probably understated. The VA report lists the per cent distribution for the period November 1944 to December 1946 as a whole, and this distribution was applied to the amounts reported for 1945 and 1946. Any resulting error should be small. The amounts of the principal of guaranteed loans are shown rather than the amounts of the guaranty themselves, which are about one-half the principal amounts.

(3) Sum of columns 1 and 2.

(4) *Fifth Annual Report,* Housing and Home Finance Agency, 1951, Table 29, p. 289.

(5) Sum of columns 3 and 4.

(6) These percentages are based on tentative estimates of the flow of mortgage funds into new construction, which are to be included in the forthcoming monograph. The percentage for the total period in column 6 is based on 1935-1950. The percentages are not more than rough approximations, both because of the tenuous basis for the estimates of total mortgage loans on new construction and the differences between the timing pattern of these estimates and that of FHA and VA loan closings. On the whole the percentages conform fairly well with the percentages in Table 1, which is based on the number of dwelling units. The percentages for 1943, 1944, and 1945 in the above table, however, appear high, which is probably due to an understatement of construction expenditures during these years and a resulting understatement of total mortgage loans for new construction.

(7) For FHA: Sources quoted in footnotes for columns 1 and 4. For VA loans, Table 9.

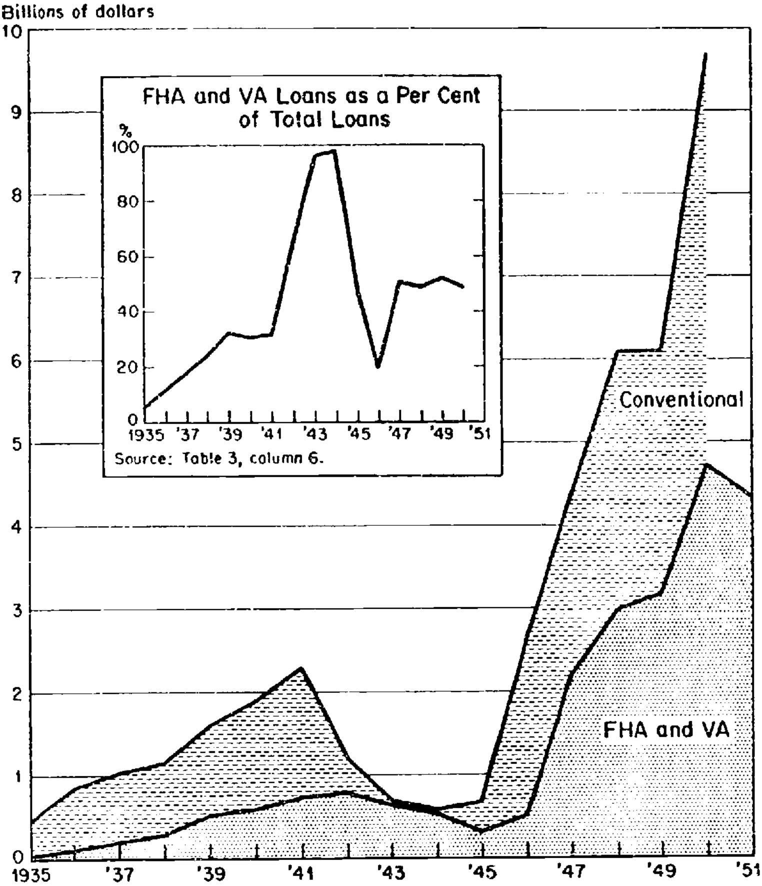
the war. From 1947 through 1950 almost one-half of the flow of mortgage funds into new construction was in the form of FHA and VA loans (column 6 of Table 3).

Still another measure of the relative importance of government-insured loans on new construction is the volume of FHA and VA mortgages on new construction compared to the total volume of FHA and VA loans on both existing and new construction (column 7 of Table 3). For the period as a whole about three-fifths of all FHA and VA residential mortgage loans were on new construction[3] — a higher ratio than that for conventional loans. This proportion also shows a rapid rise during the prewar years, a very

[3] Under the terms of the National Housing Act, FHA-insured loans on rental housing are in effect limited to new construction, except for the refinancing of projects originally financed with FHA loans.

CHART B

Amounts of Conventional and FHA-Insured and VA-Guaranteed Loans on New Residential Construction 1935-1951



Source: For FHA and VA loans, Table 3, Column 5. For conventional loans, estimates in forthcoming monograph.

high level during the war period, and a sharp increase since 1946. From 1948 through 1951 more than two-thirds of the total amount of all FHA and VA loans went into new construction.

The government reached its dominant position in the debt financing of new residential real estate by assuming much of the risk involved in mortgage lending. Whether there are any limits to the use of this potent device, and some of the problems its use creates, will be discussed in the last section.

Influence in Home Mortgage Lending Activity

Because of the emphasis in government programs on the flow of funds into new construction, FHA and VA loans have been somewhat less important in relation to total residential mortgage lending on both existing and new residential real estate. Nevertheless, their share in total lending activity and debt has become substantial, particularly in the home-financing segment.[4]

FHA-insured loans on one- to four-family houses increased from 4 per cent of the estimated amount of all such loans made in 1935 to more than one-fifth in the immediate prewar years (see Chart C). After a decline during the war and immediate postwar period, FHA and VA loans combined rose to more than one-third of aggregate home mortgage lending activity.

Because there are no data on the annual volume of conventional loans on multifamily (rental) housing, no such comparison is possible for this segment of the residential mortgage market.

Government-Insured Loans in the Mortgage Debt

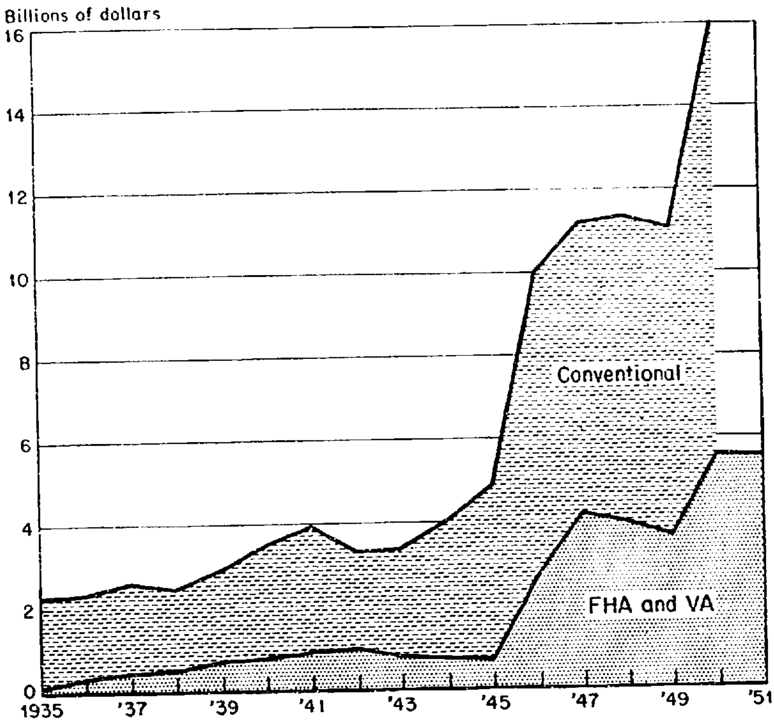
At the end of 1950 the estimated balance outstanding of FHA and VA loans totaled $22 billion and approximated 40 per cent of the aggregate residential mortgage debt.[5] The relative importance of government-insured loans in the total debt increased but slowly before the war. By 1940 less than 10 per cent of the debt was in the form of FHA loans. At the end of the war their share had risen to about 18 per cent. During the five years from 1946 to 1950, how-

[4] The terms "home financing" and "home loans" relate to mortgage loans on 1- to 4-family houses unless noted otherwise.

[5] The estimates of balances outstanding of FHA and VA loans are based on the assumption that loans not paid in full or foreclosed are amortized on schedule. In view of prepayments, the balances, and therefore the ratio of these balances to the total residential mortgage debt outstanding, are probably slightly overstated. Also, some double-counting is involved inasmuch as FHA and VA loans held by the Federal National Mortgage Association are included in the mortgage debt totals. A correction to allow for double-counting would be wholly insignificant before 1949 and would change the ratios by not more than two points in 1949 and 1950.

CHART C

Amounts of Conventional and FHA-Insured and VA-Guaranteed Loans Made on One- to Four-Family Houses 1935-1950



Source: For FHA and VA loans: Table 9, sum of columns 1 and 3. For conventional loans, totals as estimated by Home Loan Bank Board minus FHA and VA loans.

ever, in which the VA home loan as well as the FHA program was in operation, the balance outstanding of government-insured loans increased by more than $17 billion, or 360 per cent. Of this amount, roughly $10 billion has been in veterans' home loans (Table 4).

A more significant comparison is that between FHA and VA loan balances and total holdings of private financial institutions which represent the great bulk of portfolio lenders under the FHA and VA programs (Chart D). This comparison omits from the debt the HOLC loans, which were direct government loans, and the loans held by individuals and miscellaneous mortgage lenders who are negligible as portfolio holders though important as loan originators. On this basis, the share of government-insured loans increased from 16 per cent in 1940 to almost 30 per cent in 1945 and 50 per cent in 1950. In other words, roughly one-half of the total amount of residential mortgage loans held by financial institutions were insured or guaranteed by the federal government (column 11 of Table 4).

Over the period as a whole, the share of government-insured mortgages in the *home* mortgage debt has been larger than the share of such mortgages in the debt on multifamily dwellings. The importance of insured loans in the latter was small before and during the war but has shown a phenomenal increase since 1947. By 1950 FHA-insured loans on rental projects represented more than one-quarter of the total mortgage debt on rental housing and 40 per cent of the debt held by institutional lenders. Practically all of the more than $3 billion of FHA loans on rental housing that were outstanding at the end of 1950 was originated during the preceding four years.

Influence on Sources of Funds

Participation of various types of mortgage lenders in the FHA and, to a lesser extent, in the VA program has been at some variance with the historical shares of lenders in mortgage financing activity. The exclusion of individual lenders in the FHA program and their small share in the VA program[6] have accentuated the tendency toward institutionalization of the residential mortgage debt. The government insurance programs, particularly FHA, have stimulated the participation of commercial banks in residential mortgage financing.

The restrictions on loan-to-value ratios and maturity of mortgage loans imposed by the National Banking Act do not apply to loans insured by the Federal Housing Administration or guaranteed by the Veterans Administration. This is also true for the limita-

[6] From 1948 to 1950 "individuals and others" accounted for less than 1 per cent of the amount of VA home loans closed.

TABLE 4

Estimated Outstanding FHA and VA Loans by Type of Property in Million Dollars and as a Per Cent of Residential Mortgage Debt Year-Ends, 1935-1950

	HOME MORTGAGES			RENTAL MORTGAGES	TOTAL FHA AND VA MORTGAGES	FHA AND VA AS A PER CENT OF		FHA AS A PER CENT OF		TOTAL FHA AND VA AS A PER CENT OF	
	FHA (1)	*VA* (2)	*Combined* (3)	*FHA* (4)	(5)	*Total Home Mortgages* (6)	*Institutional Home Mortgages* (7)	*Total Rental Mortgages* (8)	*Institutional Rental Mortgages* (9)	*Total Mortgages* (10)	*Institutional Mortgages* (11)
1935	12	....	12	1	13	*	*	*	*	*	*
1936	203	....	203	2	205	1.2	2.3	*	*	0.9	1.7
1937	594	....	594	6	600	3.5	6.6	*	*	2.6	4.9
1938	967	....	967	36	1,003	5.6	10.3	*	*	4.2	8.0
1939	1,419	....	1,419	98	1,517	8.0	14.4	1.5	3.0	6.3	11.8
1940	2,295	....	2,295	107	2,402	12.1	20.5	1.7	3.1	9.5	16.4
1941	2,962	....	2,962	107	3,069	15.0	24.4	1.6	3.0	11.7	19.6
1942	3,666	....	3,666	126	3,792	18.7	29.7	2.0	3.6	14.6	23.9
1943	3,998	....	3,998	201	4,199	20.9	32.8	3.2	5.8	16.5	26.8
1944	4,146	....	4,146	241	4,387	21.6	33.9	4.0	7.2	17.4	28.1
1945	4,043	500	4,543	237	4,780	23.1	35.9	3.9	7.1	18.6	29.3
1946	3,688	2,600	6,288	214	6,502	25.7	37.8	3.3	6.0	21.1	32.1
1947	3,766	5,800	9,566	549	10,115	32.0	45.0	8.0	13.8	27.5	40.0
1948	5,251	7,200	12,451	1,144	13,595	35.4	47.7	15.1	24.6	31.7	44.2
1949	6,878	8,100	14,978	2,135	17,113	38.3	49.6	25.4	38.7	36.0	47.9
1950	8,533	10,300	18,833	3,220	22,053	40.1	50.1	34.2	46.2	39.1	49.4

*Less than 1 per cent.

SOURCES, TABLE 4, BY COLUMNS:

(1), (4) Estimates in Annual Reports of the Federal Housing Administration. Home loans exclusive of small amount of Title 1, Class 3 loans. Data for 1935 to 1939 are as of June 30, for other years as of December 31. For 1935 to 1939, FHA loans are shown as percentages of the interpolated debt as of June 30 (debt at preceding and at current year-end divided by two).

(2) Letter of January 15, 1952, from Robert C. Colwell, Chief, Administrative Control Division, Loan Guaranty Service, Veterans Administration. These are rough estimates based upon "certain assumptions that loans not paid in full or extinguished by foreclosure are being amortized on schedule." Because of the general tendency toward accelerated repayment during the postwar years, the balances outstanding are probably somewhat overstated.

(3) Sum of columns 1 and 2.

(5) Sum of columns 3 and 4.

(6), (7) Total home loans outstanding as estimated by the Home Loan Bank Board, "Estimated Home Mortgage Debt and Lending Activity, 1950." Institutional loans as estimated in the forthcoming monograph, exclusive of HOLC loans.

(8), (9) Total and institutional loans on multifamily structures outstanding as estimated in the forthcoming monograph.

(10), (11) Total and institutional loans outstanding on all types of residential dwellings as estimated in the forthcoming monograph. Institutional loans exclusive of HOLC.

tions in many of the state banking laws. While similar exceptions apply to the other mortgage lending institutions, they are more potent in the case of commercial banks because their conventional mortgage lending activity is more severely limited by existing laws. The use of idle bank funds for mortgage loans was one of the prime motives in the development of the FHA insurance plan.[7] The greater assurance of a secondary market for FHA and VA loans (p. 42) made these loans more attractive to banks, by providing a means by which they could be converted into liquid assets if necessary.

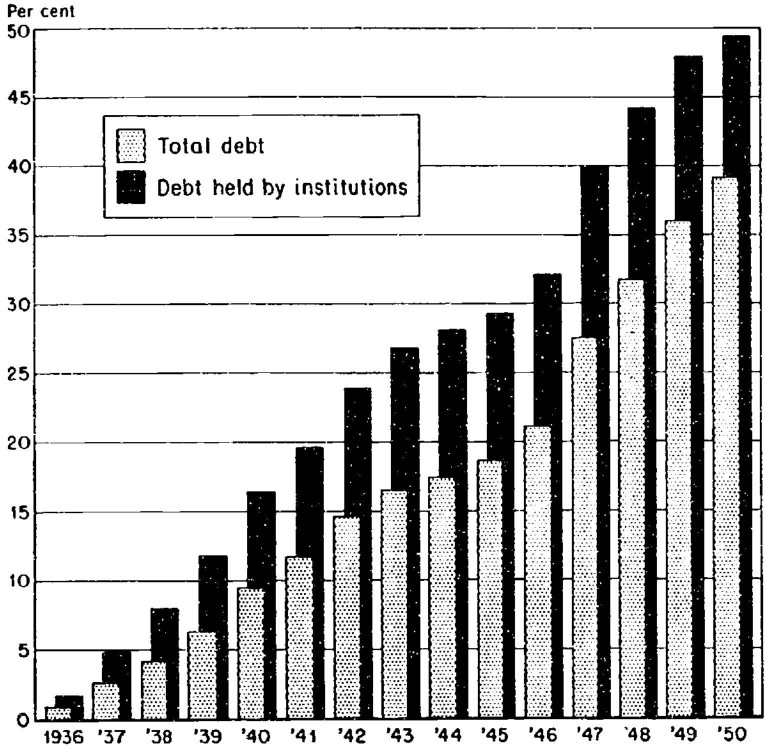
During the period 1935 through 1950 commercial banks originated about one-third of the total amount of FHA-insured home mortgage loans and approximately one-half of the total amount of FHA-insured loans on rental and cooperative housing projects.[8]

[7] For example, see testimony by Marriner S. Eccles before the Senate Banking and Currency Committee (*Hearings on S. 3603*, pp. 153-5, 73 Cong., 2 Sess.).

[8] Consolidated data from Annual Reports of the Federal Housing Administration.

CHART D

Estimated Outstanding FHA-Insured and VA-Guaranteed Loans as a Per Cent of Total Residential Mortgage Debt and of Debt Held by Financial Institutions 1936-1950



Source: Table 4, Column 10 for total and Column 11 for institutional debt.

As shown in Table 5, FHA and VA loans accounted for 38 to 53 per cent of the annual total amounts of home loans made by commercial banks from 1948 to 1950. The impact of government programs on the position of commercial banks in this field is reflected in the increasing share of home loans made by banks in total home mortgage lending activity — 23 per cent in 1946-1950 as against 14 per cent in 1926-1930 — and in the increasing proportion of their residential mortgage holdings to the total residential mortgage debt — 18 per cent in 1950 as against 10 in 1930 and 9 in 1920.[9]

The stimulation of residential mortgage loan investments by commercial banks is probably one of the outstanding recent changes in the history of mortgage finance as well as of banking. Even before 1935, residential mortgage lending was by no means foreign to commercial banks, in spite of legal limitations.[10] But government insurance of loans has been an important factor in the recent emergence of commercial banks as one of the most important types of residential lenders, and the banks are likely to hold this position with the aid of government arrangements that reduce risks and facilitate shiftability of mortgages.

Mortgage companies have played a large role in originating FHA and VA mortgages. Through 1950 they originated almost one-quarter of all home mortgages and almost one-tenth of rental housing loans insured by FHA,[11] and they accounted for a large part of the 30 per cent of all VA loans orginated by "mortgage and real estate companies" in 1948-1950.[12] However, mortgage companies for the most part do not represent primary sources of funds; they usually sell or assign loans to portfolio lenders immediately or shortly after making them.

Life insurance companies have made a large and growing part of their home mortgage investments in FHA and at times also in VA loans. In 1948 and 1949 more than one-half of their estimated total home mortgage lending activity was in the form of FHA and VA loans (Table 5), and this ratio does not reflect their acquisitions of FHA and VA loans from mortgage companies and other loan originators. Mutual savings banks and savings and loan associations have been less active in making government-insured loans, but the investments of savings banks in these loans expanded rapidly from 1948 to 1950.

The principal types of lending institutions show sharp differ-

[9] Based on data in the forthcoming monograph.

[10] Cf. Carl F. Behrens, *Commercial Bank Activities in Urban Mortgage Financing* (National Bureau of Economic Research, New York, 1952).

[11] Consolidated data from FHA Annual Reports.

[12] Home Loan Bank Board, *Statistical Summary, 1951*, Table 9.

TABLE 5

FHA-Insured and VA-Guaranteed Home Loans Made by Principal Types of Lenders in Million Dollars and as a Per Cent of Total Home Loans 1948-1950[a]

	Commercial Banks		Insurance Companies		Savings & Loan Associations		Mutual Savings Banks	
	Amount	*Per Cent of Total*	*Amount*	*Per Cent of Total*	*Amount*	*Per Cent of Total*	*Amount*	*Per Cent of Total*
			A FHA-INSURED LOANS[b]					
1948	657	24.9	468	41.3	221	6.1	64	6.5
1949	672	30.1	507	46.4	238	6.5	107	10.8
1950	730	21.3	514	29.5	266	5.1	189	13.5
			B VA-GUARANTEED LOANS[c]					
1948	737	28.0	139	12.3	536	15.0	226	23.1
1949	345	15.4	65	5.9	330	9.1	191	19.3
1950	586	17.1	222	12.7	740	14.1	298	21.3
			C FHA AND VA LOANS COMBINED					
1948	1,394	52.9	607	53.6	757	21.0	290	29.6
1949	1,017	45.5	572	52.3	568	15.6	298	30.1
1950	1,316	38.4	736	42.2	1,006	19.2	487	34.8

[a] Comparable data for years before 1948 are not available. In the case of FHA, available earlier data (through 1945) refer to gross mortgages accepted for insurance rather than premium paying mortgages, or include firm commitments under Title VI as well as net mortgages. This precludes a comparison with the total home loans made by each type of lender. In the case of VA, no classification of the amount of loans closed by type of lender is available before 1948. Since insurance companies and mutual savings banks are net purchasers of FHA and probably of VA loans, the data in the table do not represent their total acquisitions of such loans but rather those written in their own names. Total acquisitions of nonfarm VA loans by life insurance companies were $366 million in 1948, $131 million in 1949, and $930 million in 1950. Total acquisitions of FHA loans (both on homes and multifamily projects) by the companies were $1,202 million in 1948, $1,350 million in 1949, and $1,542 million in 1950 (Institute of Life Insurance, New York).

[b] Amounts from *Annual Reports*, Housing and Home Finance Agency. Percentages based on total estimated amount of home mortgage loans made by each type of lender in *Estimated Home Mortgage Debt and Lending Activity*, 1950, Home Loan Bank Board.

[c] Amounts from *Statistical Summary, 1951*, Home Loan Bank Board, Table 9. Percentages based on total estimated amount of home mortgage loans made by each type of lender, referred to in footnote b.

ences in holdings of government-insured loans, both on homes and multifamily structures (Chart E and Table 10). In the case of life insurance companies the ratio of outstanding FHA mortgages to their total residential mortgage portfolio rose from 23 per cent in 1940 to 37 per cent in 1944, and the ratio of FHA and VA loans combined to total holdings reached almost 60 per cent in 1950 — the highest ratio for any of the four principal types of mortgage lenders. More than one-half of the residential mortgage portfolio of insured commercial banks on June 30, 1950 was in the form of government-insured loans. Mutual savings banks in the short span of four years, from 1947 to 1950, doubled their ratio of government-insured mortgage loans to total residential holdings, but at the end of the period still held less than 43 per cent of the total in these types of loans. The ratio for insured savings and loan associations during this period has hovered around one-third.

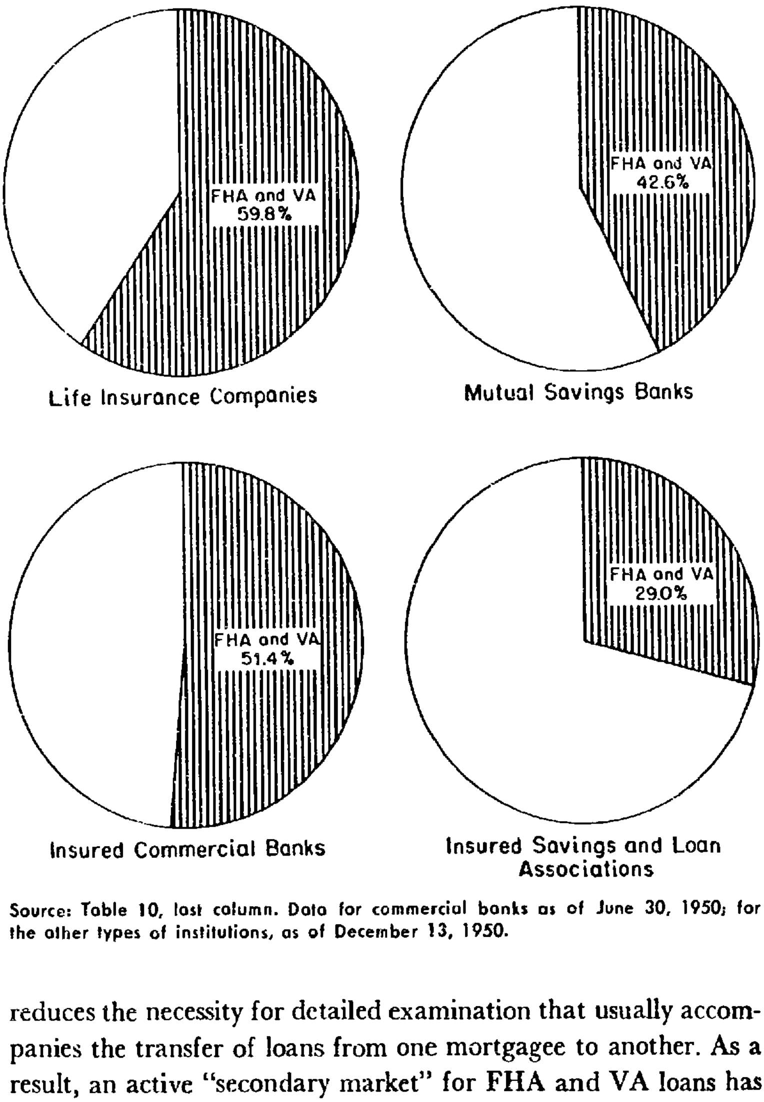
The FHA and VA programs were influential in the growth of total residential holdings of the various types of lenders. While many factors combined to produce the startling growth differentials revealed in Table 6, it must be considered more than a coincidence that the institutions participating most actively in the mortgage insurance and guaranty programs — commercial banks and life insurance companies — show by far the greatest relative increase in residential mortgage holdings. Savings and loan associations rank third, and mutual savings banks experienced a far slower growth of portfolios than any of the other types of institution. The comparatively small increase of noninstitutional holdings probably reflects the historical decline in the importance of noninstitutional lenders, accelerated by the emphasis in FHA and VA programs on institutional sources of funds.

The Government's Role in the Secondary Market

One of the effects of government insurance of residential mortgage loans has been to create a debt instrument that can be shifted more easily from one lender to another. From the lender's point of view, government insurance endows mortgage loans with greater uniformity of quality than has ever been the case before, and it

CHART E

FHA-Insured and VA-Guaranteed Mortgages
Held by Principal Types of Lenders
as a Per Cent of their Total Residential Mortgage Loans
1950



Source: Table 10, last column. Data for commercial banks as of June 30, 1950; for the other types of institutions, as of December 13, 1950.

reduces the necessity for detailed examination that usually accompanies the transfer of loans from one mortgagee to another. As a result, an active "secondary market" for FHA and VA loans has developed, which in turn has widened the geographic scope of

TABLE 6

Relative Growth of Residential Mortgage Holdings of Principal Types of Lenders

TYPE OF LENDER	PER CENT INCREASE 1950 OVER 1930	1935
Institutional, total	158	193
Noninstitutional, total	3	36
Commercial banks	266	368
Life insurance companies	283	402
Savings and loan associations	112	296
Mutual savings banks	64	84

SOURCE: Based on data in the forthcoming monograph.

the market for mortgage loans and given it some of the characteristics of national capital markets. It has become quite customary, for example, to quote premiums and discounts for FHA and VA loans offered and sought in this market, and the deviations from par are largely determined by general mortgage market conditions rather than by the quality of the underlying security of specific loans.

The Federal National Mortgage Association, a wholly government-owned facility, has played an important role in the development of the secondary market. Its operations at times have had a substantial influence on the volume of construction.

The volume of transfers of FHA home loans among mortgagees is shown in Table 11. Aggregate transfers increased steadily except for the late war and early postwar years, and they exceeded $1 billion each in 1949 and 1950. From 1935 to 1950 the face amount of loans involved in transfers totaled about $7.5 billion. The annual number of home loans transferred from 1946 to 1950 varied between 6 and 13 per cent of the total number of FHA home loans in force. According to preliminary results of the 1950 Survey of Residential Financing by the Bureau of the Census, one-third of the FHA-insured loans and almost one-fourth of the VA-guaranteed loans on owner-occupied houses had been acquired by purchase rather than origination of the mortgage, as against 13 per cent for conventional loans. These figures show a velocity probably unequaled in the history of mortgage finance in this country, except for the refinancing operations of the government-owned Home Owners' Loan Corporation.

In these transfers mortgage companies and savings and loan associations have been consistent net sellers. Insurance companies and mutual savings banks, as well as the Federal National Mortgage Association, have been net purchasers, although the latter's sales exceeded purchases during certain years. Commercial banks as a group have been net purchasers in some years and net sellers in others. Table 12 shows purchases and sales for each of the four principal types of private institutional lenders. While these lenders in the aggregate have been net purchasers of FHA home loans their sales activity has been substantial, the amount of annual sales to annual purchases ranging roughly from 40 to 80 per cent. In other words, there has been an active secondary market among the various types of portfolio lenders, in addition to transfers from loan originators such as mortgage companies to portfolio lenders and federal agencies.[13]

Data on transfers of FHA rental housing mortgages are not available for the entire period, but substantial velocity is indicated for recent years. In 1950 the face amount of loans transferred was more than $518 million, equal to 16 per cent of the face amount of such mortgages outstanding at the end of the year.[14] No transfer figures are published for VA home loans.

The role of the federal agencies in the secondary market for FHA home loans has varied greatly from year to year. During the period 1935-1950 purchases by federal agencies represented almost 12 per cent of all purchases (Table 13).

Federal activity in the "secondary market" increased sharply in the postwar period, primarily in support of the VA home loan program. From 1948 through 1951 the Federal National Mortgage Association (FNMA), now the only agency specifically authorized to buy and sell FHA and VA loans, purchased almost $2.7 billion worth of government-insured loans, about ten times

[13] Although there have been substantial transfers of FHA mortgages among different types of portfolio lenders, individual institutions tend to be either net buyers or net sellers.

[14] *Fourth Annual Report*, Housing and Home Finance Agency, 1950, Tables 35 and 36, pp. 289-90.

as much as during the preceding ten years. Of these, more than $2 billion or 80 per cent were VA loans. Sales from 1948 to 1951 totaled $600 million, and less than half of these were VA loans. The mortgage portfolio of FNMA on December 31, 1951 was almost $1.85 billion, of which about 90 per cent were in VA loans (Table 7). The FNMA holdings of VA loans at the end of 1950 represented more than 11 per cent of the estimated total balance of VA loans outstanding.

The overwhelming proportion of VA loans in recent operations of the FNMA illustrates the government's influence on mortgage lending and on the management of the residential mortgage debt in critical situations. Most of the FNMA purchases of VA loans occurred in 1949 and 1950, on the heels of an increase in government bond yields and mortgage interest rates in 1948. As a result of these changes in the mortgage market, the supply of funds for VA loans at 4 per cent threatened to dry up. In fact, the volume of new VA loans dropped from about $3.3 billion in 1947 to less than $1.9 in 1948 and $1.4 in 1949. The purchases by FNMA in 1949 and 1950 combined with an easing of the money market to overcome these difficulties and were partly responsible for the spectacular increase in VA loans to more than $3 billion in 1950. During 1949 and 1950, FNMA purchases of VA loans equaled approximately one-third of all VA home loans made. These were also years of high and increasing volume of residential construction. The FNMA at that time was an instrument for maintaining a fixed interest rate pattern and for continuing a high level of housing construction in the face of changing conditions in the mortgage market.

Much of FNMA's effectiveness during this period was due to the issuance of advance commitments to purchase, which was begun on July 1, 1948 and terminated on March 13, 1950. The commitments enabled mortgage lenders to originate FHA and VA loans with the intention of selling them immediately to FNMA which, under the procedure, was commited to buy. "The commitment program made it possible for the lending institution . . . to arrange the needed financing for construction since the commitment assured a market for the permanent mortgage on the completed

TABLE 7

Operations of the Federal National Mortgage Association (millions of dollars)

	1938-47	*1948*	*1949*	*1950*	*1951*	*1938-51*
Purchases of loans						
FHA	272	187	253	49	74	835
VA	0	11	420	995	603	2,029
Total	272	198	673	1,044	677	2,864
Sales of loans						
FHA	167	0	19	261	28	475
VA	0	0	*	208	83	291
Total	167	0	20	469	111	766
Balance of loans held at end of period						
FHA	4	188	403	169	204	....
VA	0	11	425	1,178	1,646	....
Total	4	199	828	1,347	1,850	....

*Less than $1 million.

SOURCE: Housing and Home Finance Agency, *Housing Statistics*, December 1951, and *Annual Reports*. Because of rounding, the components do not necessarily add up to totals.

house. The procedure was of particular significance in facilitating the flow of credit for housing programs involving FHA-insured mortgages and VA-guaranteed mortgages."[15] Advance commitments issued during these 21 months totaled almost $2.5 billion, of which about $1.5 billion was outstanding at the end of the period. Purchases by FNMA declined substantially in 1951 after advance commitments were discontinued and the anti-inflation program necessitated by the Korean war came into operation.[16]

Another significant aspect of FNMA operations is the restriction of purchases, among other things, to loans with an original principal of not more than $10,000 per unit.[17] This limitation is another means of "channeling" new housing construction into predetermined price classes.

[15] Housing and Home Finance Agency, *Fourth Annual Report*, 1950, p. 74.

[16] Advance commitments up to $200 million were again authorized for defense housing in the Defense Housing and Community Facilities and Services Act of 1951, Public Law 139, Chapter 378, (92 Cong., 1 Sess.) and increased by another $52 million by Public Law 309, enacted April 9, 1952.

[17] Public Law 387, approved October 25, 1949.

There is a real question whether the FNMA has been a secondary market facility or a primary supplier of mortgage funds. Its facilities have been widely used by mortgage loan originators who did not intend to hold loans in their portfolios, and the advance commitment procedure for a time sanctioned the role of FNMA as a primary source of funds. The distinction between primary and secondary credit facilities is, of course, largely a matter of definition. In the mortgage market, the distinction has come to be based on the method of originating mortgages, with the originator defined as a primary source and the first portfolio holder, if he is not identical with the originator, considered a secondary lender. The method of originating mortgage loans, however, depends on the organization of the mortgage market and has little significance for an analysis of the real sources of funds. For the latter, the distinction between portfolio lenders who supply funds and other lenders who act as "feeders" to portfolio lenders is more meaningful. On this criterion, the FNMA has at least at times served as a substantial primary source of mortgage funds.

This interpretation is supported by the fact that the agency, originally designed as a stand-by purchaser of FHA loans from portfolio holders or interim portfolio lenders, has more and more developed into an instrument for the support of new lending activity. In this function, the FNMA operates under specific Congressional authorizations, in contrast to the open market purchases of government bonds by the Federal Reserve Banks. The support of new lending activity in some instances performed special services. Thus the FNMA in recent years purchased new types of FHA-insured loans on defense housing projects, which private institutions were initially reluctant to acquire. It usually was able to sell the loans after a period of "seasoning" to private portfolio lenders. On the whole, however, this pioneering activity has accounted for a relatively small portion of FNMA purchases during the postwar period.

The Federal Home Loan Banks, by advances to member institutions secured for the most part by residential mortgage loans, also provide some secondary credit. Advances outstanding did not exceed $200 million in the late thirties, but increased rapidly during the postwar period and reached almost $816 million at the end of 1950.[18]

Influence on Cost and Terms of Financing

Beginning with the then revolutionary terms on which the Home Owners' Loan Corporation from 1933 to 1936 refinanced $3 billion of the outstanding home mortgage debt,[19] federal programs in the residential mortgage field have persistently sought to reduce contract interest rates, lengthen contract terms to maturity, and increase loan-to-value ratios. The interest rate on HOLC loans, originally 5 per cent, was reduced to 4½ per cent in October 1939. The maximum interest rate on all FHA-insured mortgages was established in 1934 at 5 per cent (exclusive of the mortgage insurance premium), but was reduced by regulation in 1939 to 4½ per cent, and maximum permissible service charges were lowered simultaneously. The maximum interest rate on FHA home loans under Title VI was cut down to 4 per cent in 1946 in conjunction with the veterans emergency housing program. In early 1953 the maximum rate was 4¼ per cent for home loans and 4 per cent for loans on rental and cooperative housing projects.

The Servicemen's Readjustment Act in 1944 established a maximum of 4 per cent for home loans guaranteed by the Veterans Administration, and an amendment of 1948 authorizing an increase to 4½ per cent was not used before the spring of 1953 when the maximum interest rate on both VA and FHA home loans was raised to 4½ per cent.

The maximum contract term for FHA home loans, originally 20 years, was extended in 1938 to 25 years for small new houses and now ranges from 25 to 30 years on new home construction, with 40 years allowed on rental and cooperative housing projects. The original maximum term of 20 years for veterans home loans was extended in two steps to 30 years. Similar successive steps

[18] *Fourth Annual Report,* Housing and Home Finance Agency, 1950, Table 1, p. 198.

[19] These terms were 5 per cent interest, maximum contract length of 15 years, and maximum loan-to-value ratio of 80 per cent.

reduced the downpayment requirements for FHA-insured mortgages on new construction, and the Servicemen's Readjustment Act eliminated such requirements for veterans home loans.[20]

The effects of these actions on interest rates and other contract terms for residential mortgages, of course, cannot be dissociated from the effects of changes in the entire market for capital funds, particularly the decline of interest rates from the middle thirties to the late forties. It is reasonable to assume that much of the drop in mortgage interest rates would have occurred without the federal aids, in response to competitive forces in the capital market and the easy money policies of the monetary authorities. As a matter of general observation, however, the federal programs seem to have hastened the reduction of contract interest rates on mortgages and the use of more liberal contract terms.

A few data are at hand to illustrate the actual differences in terms between FHA and VA mortgages and conventional loans. The average contract interest rate on a sample of mortgages on 1- to 4-family houses held by 24 leading life insurance companies at the end of 1946 was 4.5 per cent for FHA loans and 4.1 per cent for VA loans, but varied between 4.6 and 4.9 per cent for conventional loans.[21] The comparable figures for a sample of loans held by 170 commercial banks in June 1947 were 4.5 per cent for FHA loans, 4 per cent for VA loans, and 4.8 per cent for conventional mortgages.[22] A sample of similar loans made by 92 savings and loan associations in 1946-1947 showed that practically all of the VA and FHA loans carried contract interest rates of less than 5 per cent, while only 16.3 per cent of the original amount of conven-

[20] Terms for FHA and VA loans were tightened temporarily in the summer of 1950 as part of the anti-inflation policies instituted after the Korean war, and in anticipation of Credit Regulation X for conventional mortgage loans. The restrictions on FHA and VA loans were relaxed in the summer of 1952 when Regulation X was suspended, and the legal maxima were restored in spring 1953.

[21] R. J. Saulnier, *op. cit.*, p. 56. Figures represent averages of current, or last contract, interest rates weighed by amounts outstanding. The maximum interest rate for VA home loans is 4 per cent, and the reported 4.1 per cent is due apparently to erroneous inclusion of service fees or similar charges.

[22] Carl F. Behrens, *op. cit.*, p. 45. Averages are weighted by the outstanding balance of each loan.

tional mortgages fell in this class.[23] A survey of house purchases from October 1950 to March 1951 found that 43 per cent of the loans obtained by veterans had contract interest rates of 4 per cent or less as against 13 per cent of the loans obtained by non-veterans.[24]

Contract interest rates are not, of course, an accurate basis for comparison of cost to borrowers in view of differences in non-interest charges. Nevertheless, it would appear that the average spread between contract rates on FHA and conventional home loans in the postwar period was relatively small. Moreover, from the borrower's point of view, the spread was offset largely by his obligation to pay a mortgage insurance premium of ½ of 1 per cent, even considering the possibility of a rebate of premium payments upon termination of the loan. The average spread between veterans home loans and conventional loans was more substantial, particularly since the borrower on VA guaranteed mortgages was free of any charges comparable to the FHA mortgage insurance premium.

On contract length, the sample of commercial bank loans showed that 58.6 per cent of government-insured mortgages had terms of 15 years or more, as against only 2.4 per cent for noninsured loans.[25] In the sample of mortgages loans made by savings and loan associations, practically all FHA-insured loans and over 60 per cent of the VA-guaranteed loans were for 20 years or more, while only 7 per cent of the conventional loans fell in this group.[26]

While these data are for loans on both new and existing construction, contract terms more favorable to borrowers have been concentrated in the new house field. A sample survey of first mortgages on single-family houses bought October 1950-March 1951 indicates generally lower interest rates and longer maturities for

[23] Edward E. Edwards, "Urban Real Estate Financing by Savings and Loan Associations" (National Bureau of Economic Research, Manuscript, 1950), p. III-16. Based on original amounts of loans.

[24] "House Purchases in the Five Months Following the Introduction of Real Estate Credit Regulation," *Federal Reserve Bulletin,* July 1951, Table 13.

[25] Carl F. Behrens, *op. cit.,* p. 44. Percentages refer to amounts outstanding.

[26] Edward E. Edwards, *op. cit.,* p. III-13. Percentages refer to original amounts of loans.

loans on new dwellings than for loans on existing dwellings. About 78 per cent of the mortgages on new houses bought during this period carried interest rates of less than 5 per cent as against 51 per cent of the mortgages on old houses. More than two-thirds of the loans on new houses had maturities of 20 years or more, as against one-third of the loans on old houses.[27] Differences in terms for mortgages on new and existing dwellings would be expected on the basis of risk considerations alone, but some of these differentials are probably due to the greater emphasis in the government programs on new construction (Table 3, column 7).

Much of this information covers only short periods and in some cases is based on small samples. In the absence of more comprehensive data, however, the findings may be accepted as reflecting broadly the contract terms prevailing during recent years.

The information on contract interest rates and contract lengths in combination suggests considerable differences between periodic charges on government-insured and conventional loans per $1,000 of loan. But to the extent that FHA and VA loans usually are for larger percentages of appraised value,[28] the differences per $1,000 of purchase price would be smaller. Moreover, the factors discussed in the section "Widening the Market" need to be considered at this point. The easier financing terms may have served to induce purchasers to buy more expensive houses, particularly in the sellers' market of the early postwar years, as well as to facilitate purchase by families who otherwise could not have afforded to buy.

The nationwide terms for FHA and VA loans have probably made a great contribution toward the narrowing of geographic differentials in residential mortgage interest rates and other contract provisions. By and large, the maximum interest rates have become standard rates under the programs; that is, even in areas of relatively abundant supply of funds few FHA and VA mortgages have been made at rates below the maxima. The uniformity of rates has given added impetus to the long-term forces operating toward a reduction of geographic differentials in interest rates and

[27] "House Purchases in the Five Months Following the Introduction of Real Estate Credit Regulation," *Federal Reserve Bulletin*, July 1951, Table 21.

[28] The aforementioned sources confirm this observation; see also p. 25.

other loan terms.[29] On the other hand, it appears at times to have diminished the flow of funds into new residential construction in certain areas with prevailing higher interest rates, and geographic differentials have taken the form of premiums and discounts on FHA and VA loans.

In summary, the federal credit aids since the middle thirties have probably accelerated the decline in residential mortgage interest rates and the liberalization of other contract terms. Lower interest rates and particularly longer contract terms on FHA and VA loans, compared to conventional mortgages, represent advantages to borrowers under these programs so far as periodic outlays are concerned. Because of the indirect influence of easy credit on prices paid for new as well as existing construction during the war and postwar periods, however, these advantages were at least partially canceled by price effects.

[29] Data on this effect of federal programs in many credit fields will be given in the forthcoming volume by R. J. Saulnier and others on federal lending, loan insurance, and guarantees (National Bureau of Economic Research).