Volume Title: Commercial Bank Activities in Urban Mortgage Financing

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Volume Publisher: NBER

Volume ISBN: 0-870-14143-0

Volume URL: http://www.nber.org/books/behr52-1

Publication Date: 1952

Chapter Title: Introduction to "Commercial Bank Activities in Urban Mortgage Financing"

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Chapter URL: http://www.nber.org/chapters/c1735

Chapter pages in book: (p. 1 - 13)

INTRODUCTION

LENDING by commercial banks on the security of urban real estate has for many years been a rather narrowly circumscribed activity and, as will be seen from the account which this volume gives of the development of the legal framework within which banks finance real estate, they still operate under more severe limitations than those affecting other institutional lenders. Nonetheless, commercial banks play a many-sided and rapidly expanding role in the real estate financing market. It is to the task of describing factually an important aspect of this role—direct mortgage lending by banks for their own account—that the present study is principally devoted. It may be useful, however, in view of the limited scope of the study, to indicate, so far as available information will permit, at least the general nature and dimensions of the other real estate financing functions that banks currently perform.

First, commercial banks play a prominent, possibly a dominant, role in the short-term financing of building operations. In an increasing proportion of cases the permanent mortgage financing is supplied by the bank that extends the "construction loan," but most frequently some other type of lender is looked to for these longer term funds. This specialization of function results, of course, from the predominantly short-term character of the liabilities of commercial banks. Until recently there has been no information as to the amount of this type of lending, but a survey by the Federal Deposit Insurance Corporation of the real estate financing activities of insured commercial banks as of mid-1950 showed that of their $11.4 billion of nonfarm real estate loans about 7.5 percent—$840 million —were of the construction loan type.

Commercial banks also participate in urban real estate financing by extending credit to other financing agencies, such as mortgage loan companies, that occupy an intermediate position between the

mortgagor and the mortgagee supplying long-term, or so-called "permanent," financing. These loans enable the intermediate financing agencies to hold inventories of mortgages for an interval—ordinarily not a long period—between their origination by the borrowing company and their final lodgment with an institution prepared to supply long-term, or so-called "permanent," financing. The FDIC survey of insured commercial banks referred to above revealed that in the $11.4 billion of nonfarm real estate loans held in mid-1950 about $400 million—around 3.5 percent—were of this type. Of these credits to intermediary institutions only around $160 million, however, were actually secured by real estate.

While it might be concluded from these data that banks' holdings of long-term mortgages for their own accounts clearly constitute their most important real estate financing function, this is true only with some qualification. For one thing, construction loans and those extended to intermediate financing institutions have a relatively rapid turnover; consequently, even their quantitative importance relative to the volume of credit extended on a long-term mortgage basis is not properly reflected by an outstandings figure.

Furthermore, construction loans are of crucial importance in the real estate financing process in the sense that they are commonly essential to the undertaking of building projects, especially those of large scope. The end result of these building operations is the creation of long-term mortgage debts which are absorbed by the institutions supplying permanent financing. Thus the strategic role of construction loans is far greater than is indicated merely by their outstanding amounts at any one date.

In appraising the extent of the present study's coverage of bank real estate financing as a whole it should also be noted that a significant amount of the activity of banks in the mortgage market arises from the exercise of their trust functions. Thus, many banks acquire mortgages through their regular loan departments for trust investment, but since these do not appear among the reported assets of banks they are excluded from the $11.4 billion of urban real estate loans reported in the FDIC survey for mid-1950. Unfortunately there are no data available on the amount of such investments, or on their distribution among trust companies.

All of these urban real estate financing activities of commercial banks are supplementary to their role as direct long-term investors.

They are excluded from consideration in the present study in part because of the inadequacy of information concerning them, but also because a full discussion of them would have extended the scope of the investigation beyond manageable limits. One may hope, however, that this monograph will be supplemented, at some not too distant date, by investigations of those aspects of bank real estate financing which it has left untouched.

Direct investment by banks in long-term real estate mortgages is a subject of great importance, nonetheless, in view of the rapid increases in commercial bank urban mortgage holdings which have occurred since the end of World War II. The FDIC survey referred to above showed that the amount of urban real estate loans held by insured commercial banks had increased by more than $6 billion from mid-1946 to mid-1950. Furthermore, the importance of banks in the urban mortgage market relative to other types of lenders has increased markedly. Whereas commercial banks held approximately one-twelfth of the mortgage debt on one- to four-family, nonfarm homes in 1925, this ratio had increased to approximately one-sixth at the end of 1949. The present study, by bringing together much of the existing material pertaining to commercial bank urban mortgage lending, and presenting new primary data acquired through a sampling of the urban mortgage loans held by 170 commercial banks as of mid-1947, makes a considerable contribution to our knowledge of the mortgage market generally, as well as of the direct mortgage lending activities of commercial banks.

There is no need to give an accounting in this introduction of the numerous sources from which materials have been drawn for this study. However, in view of the extent to which the study depends on information on a sample of mortgage loans made by 170 banks it may be useful to comment briefly on the adequacy and representativeness of this particular segment of the data. The problem of obtaining an adequate sample of the loans of financial institutions is a formidable one. Cooperation in this study, which was solicited on an entirely voluntary basis, was not easily enlisted, in the main because the necessary records on mortgage loans made in earlier years are either inadequate or inaccessible. Accordingly, a high rate of nonresponse among the sampled banks was inevitable. The materials must be used very carefully, therefore, in drawing inferences concerning the lending practices of commercial banks as a whole.

Apart from the difficulty of obtaining materials from existing financial institutions, there is the further fact that a sampling of institutions undertaken at any time obviously cannot produce information from failed institutions or from those that have terminated operations for any other reason. A study based on the records of surviving institutions—such as the present investigation—is inevitably biased in the direction of relatively favorable investment experience. However, it is unlikely that this fact has substantially affected the results of the study, since most bank failures were attributable to losses on investments other than urban mortgage loans.

Confidence in the representativeness of the sample is strengthened to a considerable extent by the fact that nonresponse was least among banks with the heaviest mortgage holdings: responding banks constituted nearly 75 percent of all those with urban mortgage loan portfolios of $8 million or over as of mid-1945, around 50 percent of all those with mortgage holdings of from $4 to $8 million, though only about 1 percent of the banks with mortgage portfolios of less than $4 million. This heavy nonresponse among the small-portfolio banks probably exerts only a minor influence on the representativeness of the findings since the great bulk of the urban mortgage lending of commercial banks is done by the largest banks—about 35 percent in mid-1946 and 40 percent in mid-1950 by banks with deposits of more than $100 million.

Nonetheless, in view of the questions which a high margin of nonresponse necessarily raises concerning the representativeness of survey results, it may be of interest to compare the results of the bank survey with the results of a companion study of the activities of life insurance companies. Data were compiled for the latter on a high proportion of all life insurance urban mortgage lending activity, and the results are presumably more reliable. Accordingly, confidence may be had in the results of the commercial bank study to the degree that its results conform in general—with such nonconformity as might be expected owing to institutional differences—with the results of the more comprehensive analysis of insurance company activities. Also, at a number of important points the results of the 1947 sample study of commercial banks can be compared with those based on a complete enumeration of the real estate loans of insured commercial banks made by the FDIC in mid-1950.

Survey results show, as indicated in the following tabulation, that

considerably more than half of the amount of urban mortgage loans held by commercial banks were secured by one- to four-family dwellings. A smaller, but still appreciable, proportion of the loans held by insurance companies were in this same category. There is reason to believe, however, that the relatively high proportion of the amount of loans on nonresidential properties held by responding commercial banks is not altogether characteristic of commercial banks as a whole, in view of the results of the mid-1950 FDIC survey. This may well be due to an oversampling of larger banks in the mid-1947 survey but another factor doubtless is a shift toward the financing of larger income-producing properties which became evident in 1950. Nevertheless the broad outlines of portfolio composition revealed by the sample study are confirmed by the mid-1950 enumeration.

TABLE I — PERCENTAGE DISTRIBUTION OF THE AMOUNT OF URBAN MORTGAGE HOLDINGS OF LIFE INSURANCE COMPANIES AND COMMERCIAL BANKS BY TYPE OF PROPERTY SECURING THE LOANS

Type of Property	*24 Leading Life Insurance Companies,* End of 1946	*170 Commercial Banks,* Mid-1947	*All Insured Commercial Banks,* Mid-1950
1- to 4-family dwellings	44.0%	66.5%	71.4%
Other residential property	35.1	5.4	10.8
All other property	20.9	28.1	17.8
Total	*100.0%*	*100.0%*	*100.0%*

As would be expected, close conformity of results is found when comparisons are drawn between the characteristics of insurance company loans secured by one- to four-family dwellings and those made by commercial banks. In both cases the great bulk of loans is of relatively small original amount—under $10,000. This characteristic of the loan portfolios of banks is also revealed when those with large, medium, and small portfolios are considered separately (cf. below, Table 9, p. 42), though there is a somewhat greater concentration of loans of less than $5,000 in the small portfolios. This suggests that the relatively heavy nonresponse among the small-portfolio banks may well have the effect of overstating the average size of home mortgage loans for commercial banks as a whole. However, this effect could not have been very serious since the mid-1950 FDIC survey showed that, for banks as a whole, the average size of outstanding

loan balances secured by one- to four-family properties was approximately $3,600, whereas the mid-1947 commercial bank sample survey showed an average outstanding loan balance of $4,600. In view of the increase that took place between 1947 and 1950 in home prices, and thus in the average size of mortgage loans written, this result appears to bear out the inference that the sample tends somewhat to overstate average loan size, but suggests strongly that the overstatement is not substantial.

TABLE II — Percentage Distribution of Urban Mortgage Holdings of Life Insurance Companies and Commercial Banks by Original Amount of Outstanding Loans

Original Loan Amount	*24 Leading Life Insurance Companies,* End of 1946		*170 Commercial Banks,* Mid-1947	
	1- to 4-Family Dwellings	All Other Property	1- to 4-Family Dwellings	All Other Property
Less than $5,000	40.2%	.1%	26.8%	2.6%
5,000 – 9,999	46.4	1.4	53.8	4.9
10,000 – 19,999	11.2	3.8	15.3	9.3
20,000 and over	2.2	94.7	4.1	83.2
Total	*100.0%*	*100.0%*	*100.0%*	*100.0%*

Further evidence of broad similarity in the home financing policies of commercial banks and insurance companies is apparent when the samples for both are compared, as in the following tabulation, with respect to the insured or noninsured status of the loans, their repayment schedules, contract lengths and loan-to-value ratios. Though both types of agencies appear to have about the same proportion of their portfolios in loans made under federally-sponsored programs, commercial banks have been relatively much more active in making GI loans than have life insurance companies. This fact may be due mainly to the essentially local character of bank lending, but the sample, having been taken at a later date, also had a greater chance to include GI loans than the sample for insurance companies.

The reliability of the commercial bank sample is attested again by the results of the mid-1950 FDIC survey, according to which about 57 percent of the outstanding amount of all bank loans on one- to four-family properties were insured or guaranteed—27 percent insured by FHA and 30 percent guaranteed by VA—compared with

TABLE III — PERCENTAGE DISTRIBUTION OF THE AMOUNT OUTSTANDING ON ONE- TO FOUR-FAMILY MORTGAGE LOANS OF LIFE INSURANCE COMPANIES AND COMMERCIAL BANKS BY TYPE OF LOAN AND CONTRACT TERMS [a]

Loan Characteristics	*24 Leading Life Insurance Companies,* End of 1946	*170 Commercial Banks,* Mid-1947	*All Insured Commercial Banks,* Mid-1950
TYPE OF LOAN			
Insured	*53.2%*	*61.5%*	*57.5%*
FHA	47.7	21.0	27.2
VA	5.5	40.5	30.3
Noninsured	*46.6*	*38.4*	*42.5*
Fully amortized	35.6	21.4	38.0
Partially amortized	6.2	13.5	
Nonamortized	4.8	3.5	4.5
REPAYMENT SCHEDULE			
Monthly	89.7	90.1	..
Quarterly	2.2	4.0	..
Semiannually	2.6	1.7	..
Annually	.6	.5	..
No schedule	4.8	3.5	..
CONTRACT LENGTH [b]			
0 – 4 years	9.8	16.1	..
5 – 9	5.7	31.2	..
10 – 14	16.5	46.5	..
15 and over	67.9	6.2	..
LOAN-TO-VALUE RATIO [b]			
Under 40%	3.1	7.8	..
40 – 59	35.4	50.6	..
60 – 79	48.7	34.7	..
80 and over	12.1	6.5	..
Total	*100.0%*	*100.0%*	*100.0%*

[a] Excludes a few loans for which data were not available.
[b] Includes noninsured loans only.

about 62 percent in the sample study. Approximately the same percentage of the conventional, i.e., noninsured and nonguaranteed, loans of commercial banks and insurance companies were made on a full-amortization basis. Around 5 percent of the sample of insurance company conventional loans secured by one- to four-family properties were of the nonamortized type. About 4 percent of the amount of commercial bank loan balances were of this type, according to the 1947 sample and, on the basis of the complete enumeration of mid-

1950, around 5 percent. The materials show, however, a distinct tendency on the part of banks to be relatively conservative in their conventional lending as regards the maturity of loan contracts and the ratios of loan to value. This would be expected, of course, in view of the more restrictive legal framework under which banks operate.

The liberalizing effect on home mortgage credit terms of the federal loan insurance and guarantee programs is brought out sharply in the data which the sample surveys provide on changes since 1920 in the average contract length and average loan-to-value ratios of the loans made by banks and insurance companies. After 1934 the home mortgage loans made by both commercial banks and insurance companies carried considerably longer maturities and higher ratios of original loan amount to value of property. These changes are shown graphically in Chart 2 of the present study (page 51), which may be compared with Chart 4 in the companion study of *Urban Mortgage Lending by Life Insurance Companies* (National Bureau of Economic Research, 1950).

In view of the character of home financing, and of the competitive nature of the home mortgage market, it is not surprising to find that interest rates on urban mortgage loans of commercial banks parallel closely those charged by insurance companies. This would be expected, of course, on loans made under the federal loan insurance and guarantee programs, but there is also a close similarity of rates on conventional loans.

TABLE IV — AVERAGE CURRENT INTEREST RATES FOR URBAN MORTGAGE LOANS ON ONE- TO FOUR-FAMILY DWELLINGS HELD BY LIFE INSURANCE COMPANIES AND COMMERCIAL BANKS, CLASSIFIED BY TYPE OF LOAN

Type of Loan	*24 Leading Life Insurance Companies,* End of 1946	*170 Commercial Banks,* Mid-1947
Insured		
VA	4.1%	4.0%
FHA	4.5	4.5
Noninsured		
Fully amortized	4.6	4.9
Partially amortized	4.9	4.6
Nonamortized	4.9	4.7
Total	*4.5%*	*4.4%*

Perhaps the most striking influence of the loan insurance programs on the home mortgage market has been the virtual elimination of regional differences in interest rates. In effect, the federal programs have created a national pattern of mortgage rates, from which there can be only relatively minor deviations, though regional differences in the proportion of insured and guaranteed loans to total home loans outstanding may result in some variation in average interest rates for portfolios as a whole. This variation is somewhat greater for banks than for insurance companies, which might be expected in view of the nationwide range of the lending operations of the latter and the essentially local markets of most banks.

While it is instructive to compare similarities in the investment experiences of commercial banks and insurance companies with respect to urban mortgage loans, there are a number of reasons why one would expect to find differences in the two records. In the first place, the limitation of the commercial bank study to surviving institutions would tend, as indicated above, to produce a bias in the direction of relatively favorable experience. Furthermore, it is likely

TABLE V — AVERAGE CURRENT INTEREST RATES FOR URBAN MORTGAGE LOANS ON ONE- TO FOUR-FAMILY DWELLINGS HELD BY LIFE INSURANCE COMPANIES AND COMMERCIAL BANKS, CLASSIFIED BY CENSUS REGION

Census Region [a]	*24 Leading Life Insurance Companies,* End of 1946		*170 Commercial Banks,* Mid-1947	
	All Loans	Noninsured Loans	All Loans	Noninsured Loans
New England	4.6%	4.5%	4.4%	4.5%
Middle Atlantic	4.6	4.7	4.4	4.5
East North Central	4.5	4.6	4.4	4.6
South Atlantic	4.5	4.7	4.4	4.7
East South Central	4.5	4.5	4.5	4.5
West North Central	4.5	4.5	4.3	4.3
West South Central	4.5	4.7	4.4	4.7 [b]
Mountain	4.6	4.9	4.5	5.7 [b]
Pacific	4.5	4.6	4.4	5.1
United States	*4.5%*	*4.6%*	*4.4%*	*4.8%*

[a] For the states included in each census region, see footnote [b] of Table 6, Chapter 3.
[b] Based on twelve loans for the West South Central region and twenty for the Mountain region.

that the banking institutions able to provide information on samples of loans, that is, the responding banks, would be the better organized and better managed institutions and thus the institutions with the better investment records. Finally, until the end of the twenties the laws affecting commercial bank investment in mortgage loans were so much more restrictive than those affecting insurance companies that one would expect banks as a whole to have a more favorable investment experience. On the other hand, all life insurance companies survived the thirties, so that there is no survival bias and there seems to be no basis for believing that the few noncooperating insurance companies would have had a loss experience differing significantly from that of the cooperating companies.

The expectation that insurance company experience would be less favorable than that shown by the sampled commercial banks is borne out by a comparison of their foreclosure rates. When the loans made by insurance companies and commercial banks on one- to four-family dwellings over the period 1920–46 are classified according to the year in which they were originated and the percentage of the loans in each year which eventually went to foreclosure, the commercial bank experience—except for 1933 and 1937—is found to have been consistently better than that of the life insurance companies. For all types of properties combined, only 3.2 percent of the mortgage loans made by commercial banks over this period eventually went to foreclosure while 8.2 percent of the loans made by insurance companies were so terminated.

However, the relative severity of the foreclosure experience of the two types of institutions in different periods was markedly similar. Thus, the percentage of loans going to foreclosure of those made in the years 1925–29 was, in both cases, about four times as great as the percentage going to foreclosure of those made in the period 1920–24. On the other hand, while the experience of commercial banks on loans made in the period 1930–34 was considerably better than their experience on loans made in the years 1920–29, this was not true of the life insurance companies.

Despite the fact that the commercial banks for which loan experience information was available had a better foreclosure experience record over the years 1920–46 than the reporting insurance companies, they seemed to do less well in the disposal of foreclosed properties. Thus, the losses which commercial banks sustained on

foreclosed one- to four-family properties arising out of loans originated in the period 1920–47 was 24 percent of the original amount of the loans foreclosed, as compared with something less than 10 percent for insurance companies. Similarly, the losses in percent of original loan amount on loans secured by properties other than one- to four-family dwellings were more than twice as high for commercial banks (36.1 percent) as for insurance companies (13.4 percent). However, it is interesting to observe that, for both types of institutions, loss ratios were highest where the time-span between the origination of the loan and the period of the property's disposal was greatest.

TABLE VI — FORECLOSURE RATES FOR URBAN MORTGAGE LOANS ON ONE- TO FOUR-FAMILY DWELLINGS MADE BY LIFE INSURANCE COMPANIES AND COMMERCIAL BANKS, CLASSIFIED BY YEAR MADE, 1920–46 [a]

Year Made	*24 Leading Life Insurance Companies*	*116 Commercial Banks*	*Year Made*	*24 Leading Life Insurance Companies*	*116 Commercial Banks*
1920	6.2%	2.1%	1935	3.4%	.8%
1921	4.9	2.3	1936	2.5	.0
1922	3.2	2.0	1937	1.8	5.0
1923	7.9	2.5	1938	1.7	.0
1924	12.0	5.6	1939	1.9	.1
1925	15.0	10.6	1940	.4	.0
1926	19.6	8.9	1941	.1	.0
1927	21.8	11.1	1942	.3	.0
1928	28.5	14.1	1943	.4	.0
1929	29.6	13.7	1944	.0	.0
1930	22.0	6.4	1945	.0	.0
1931	23.9	9.0	1946	.0	.0
1932	16.7	4.6			
1933	.0	2.5			
1934	5.2	.0	*Total*	*9.3%*	*3.4%*

[a] For a definition of foreclosure rate, see footnote [a] of Table 19, Chapter 4.

The insurance company and commercial bank samples again show the same general pattern of experience when gain or loss, expressed in percent of the original amount loaned, is studied according to the characteristics of the loans involved. For both types of institutions the loans made on one- to four-family dwellings on a

nonamortized basis had a higher loss rate than those made on a full- or even partial-amortization basis, though the differences are considerably greater for commercial banks than for insurance companies. Differences in experience according to the terms on which the loans were made—i.e., contract lengths, interest rates, and loan-to-value ratios—are unsystematic in both cases.

A final measure of commercial bank and insurance company experience in the field of mortgage investment is provided by a comparison of the contract interest rates and realized yields on loans of different types, and by the "loss rate," that is, the difference between the contract rate and realized yield. General conformity is found to exist between the two types of institutions in these respects. Loss rates for both insurance companies and commercial banks were lower on one- to four-family dwellings than on all other types of property combined. Loss rates on one- to four-family loans made in different periods were roughly similar for insurance companies and commercial banks—being lowest on loans made in 1920–24 and highest on those made in 1925–34—but the record is relatively uneven when loss rates are studied by contract length and by loan-to-value ratios.

In general, one would expect higher loss rates to be associated with relatively high contract interest rates, that is, for differences in realized yields to be less than differences in contract rates. However, this expectation is not borne out by the loan experience records of either commercial banks or insurance companies. In the case of insurance company loans, little difference is found between the contract interest rates on loans secured by one- to four-family properties and those secured by "all other" properties, when loans of the same size are compared. Yet the loss rates for any given size class of loans are sometimes higher on those secured by one- to four-family properties, sometimes higher on those secured by other properties. A particularly notable fact is that the very largest apartment and nonresidential loans—those of $100,000 and over in original amount—had the lowest contract interest rates of all size groups and in general the highest loss rates. Roughly the same was found to be true in commercial bank experience. In the main, therefore, the facts suggest that financial institutions failed to make adjustments in interest rates sufficient to counterbalance ultimate differences in loss experience.

Finally, we may contrast commercial banks and insurance companies with respect to the costs of acquiring and servicing mortgage loans. In this respect the information available for commercial banks is very much less complete than the data on loan administration costs for life insurance companies, yet the results are broadly similar. The gross income of commercial banks on their mortgage loan portfolios —from 4.26 to 4.75 percent of average loan investment for the majority of banks—ranged somewhat higher than the gross income earned by life insurance companies, but the closeness of the cost ratios is particularly striking. For 1946 a limited group of banks reported costs which averaged 1.35 percent of their average loan investment, whereas life insurance companies with the smaller loan portfolios—which would be the group most closely comparable in scale of operations—reported an average cost of 1.17 percent. As a result, the ratios of net income to average loan investment for commercial banks and insurance companies with relatively small portfolios as of 1947 are fairly close—in the neighborhood of 3 percent.

These comparisons of the characteristics of loans made by commercial banks and insurance companies and of the investment experience of the two types of institutions tend, in general, to strengthen the confidence that may be placed in the sample data for banks. The comparisons also point up the over-ruling fact that mortgage investment experience, over the period 1920–47, varied only narrowly from one type of institution to another.

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