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# CHAPTER 5

# Flow of Funds into Mortgage Markets

THE impact on mortgage markets of the dynamic forces appraised in Chapter 3 and of mortgage yield factors analyzed in Chapter 4 is recorded ultimately in shifts in the flow of mortgage funds. Demonstration of precise economic cause and effect relationships throughout the period under investigation, especially during the relatively short quarterly intervals, is precluded by the nature of the data and by special institutional factors. One impediment is varying time lags between actions and results of actions in mortgage and other capital markets. Other drawbacks are general but unmeasured seasonal influences and basic differences in market practices among financial institutions. Perhaps most important is that net flow data, upon which most of the analysis in this chapter depends, obscure developments which would be apparent from figures on gross lending and repayment.[1] The statistical record developed here nevertheless illustrates and permits broad analysis of the varying impact of changes in the basic elements influencing mortgage and other capital markets upon different mortgage sectors and major types of lenders.

## *Net Flow of Mortgage Funds Under Expansionary Influences, 1946–1950*

The dominance of expansionary forces in the mortgage market during most of the early years of our period, described in preceding chapters, resulted in a large and generally increasing flow of funds into mortgages, culminating in a record 1950 volume not exceeded until four years later. But the picture is not one of simple growth. The flow of mortgage funds from the main types of financial institutions into the different sectors of the mortgage market fluctuated, absolutely and relatively, as lenders and borrowers adjusted to shifting capital market conditions. In total

[1] Comprehensive analysis of the gross flow of mortgage funds, upon which much of the basic groundwork was done in the course of this study, awaits future opportunity. New information developed includes annual gross lending and gross repayments data, broken down between contractual and all other types of repayments. It is at hand in considerable detail by type of mortgage for life insurance companies, mutual savings banks, and savings and loan associations. Inadequate basic data for commercial banks precluded estimation of gross flow figures for that major type of mortgage lender. Nor was it possible, in view of the primitive state of existing statistics, to develop gross flow figures for other less important types of mortgage lenders. It is hoped that preparation of refinements in the data and remaining adjustments to annual estimates of the gross flow of mortgage funds through three of the main types of financial institutions can be brought to a stage warranting publication in the near future.

figures, the flow of funds into home mortgages was markedly larger than into all other types combined, and the flow into federally underwritten mortgages exceeded that into conventional mortgages.

## MORTGAGE FLOWS RELATIVE TO OTHER CAPITAL MARKET FLOWS

The total net flow of funds into mortgages during 1946–1950 was three-fourths larger than into corporate securities and three times larger than into municipal government obligations. Outstanding federal obligations declined sharply in those years (Chapter 3). In three of the first five postwar years, the annual flow of mortgage funds was substantially larger than the combined flow into other capital market instruments. The ratio of mortgage flows to total capital market flows, as shown in Chart 12, ranged from a high of over three-fourths in 1946 to a low of about two-fifths in 1949. The range was generally lower in the last five years of the decade.

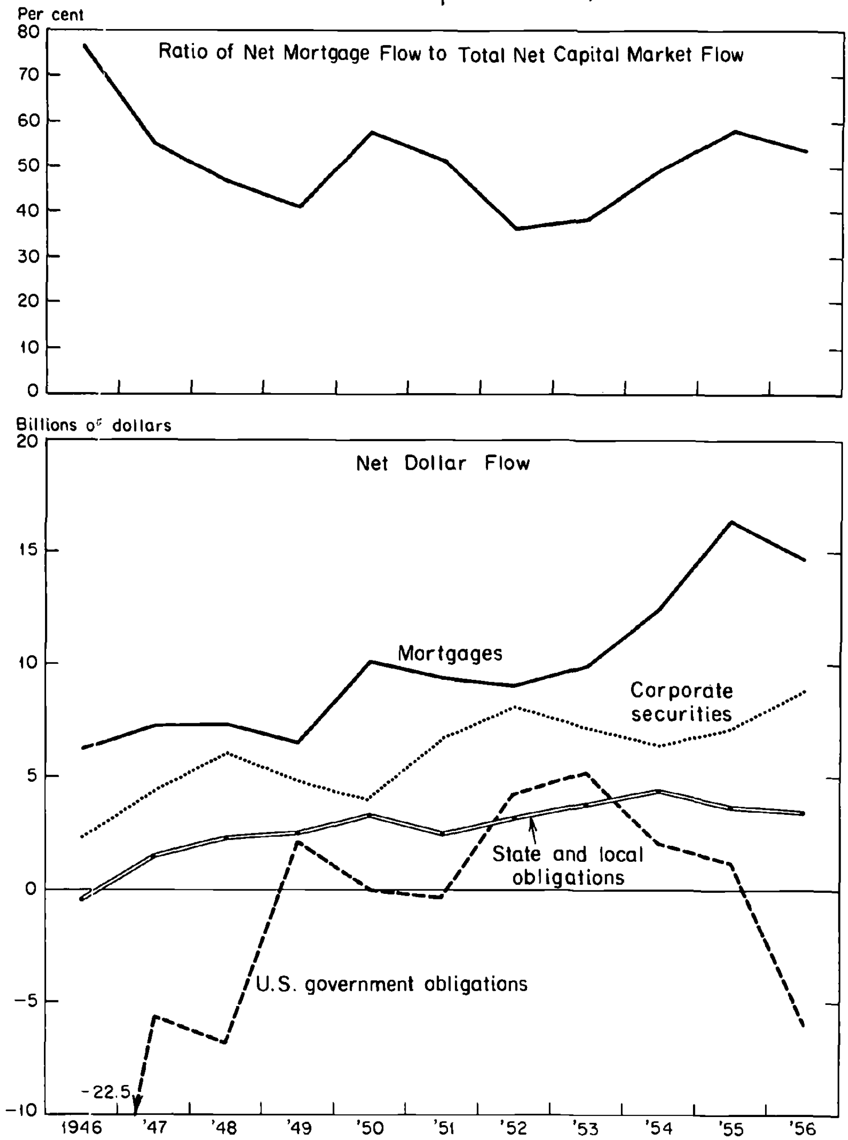
The steadily declining ratio of mortgage flows to other capital market flows from the unusually high level of 1946 to the end of 1949 appears to contradict the increased attractiveness of mortgages to investors during the period, suggested in earlier chapters. The explanation lies largely in the sources of funds for investment—mortgage funds come chiefly from the four main types of financial institutions, while the bulk of funds for corporate and municipal securities come from other origins.[2] Within the total net issue of mortgages and securities, therefore, the relative attractiveness of mortgages to investors active in different sectors of the capital market may be obscured. The appeal of mortgages, relative to other capital market instruments, to the main institutional investors during 1946–1950, may be seen more clearly in Chart 13. The shifting roles of these investors within the mortgage market are indicated in Chart 14.

The unusually liquid position of financial institutions at the close of World War II (Chapter 3) led to their common goals—conversion of large holdings of government securities into higher-yield assets and development of new outlets for the inflow of savings. The speed of conversion and of new investment and the degree to which they availed themselves of opportunities in the mortgage market reflected varying financial policies and practices, legal restrictions, and organizational problems. Notwithstanding institutional differences, it is clear from Chart 13 that savings

[2] See the tables on "Summary of Flow-of-Funds Accounts" in *Flow of Funds in the United States 1939–1953*, Federal Reserve System, December 1955, pp. 24–38; and in *Federal Reserve Bulletin*, April 1957, pp. 376–381. See also Morris Mendelson, "The Flow of Funds Through the Capital Market, 1953–1955: A Progress Report," *Journal of Finance*, May 1957, pp. 164–165.

# CHART 12

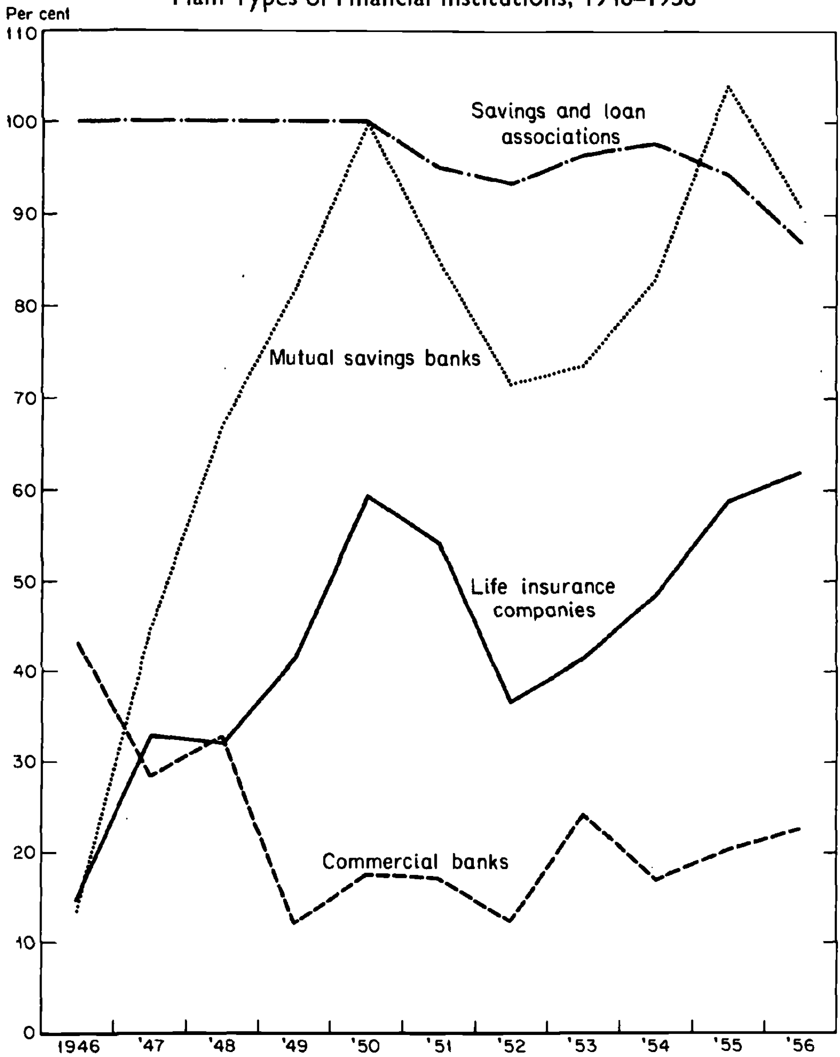
## Net Flow of Funds into Capital Markets, 1946–1956




Source: Data represent net annual changes in outstanding obligations. For net mortgage flows, data for all years are from Klaman, Technical Paper 13. For other series, data for 1946–1949 are from the Board of Governors of the Federal Reserve System, *Flow of Funds in the United States , 1939–1953;* and for 1950–1955 from *Federal Reserve Bulletin, Summary Flow-of-Funds Accounts, 1950–55,* April 1957. 1956 figures are unpublished Federal Reserve estimates. See also Table A-8 below.

The ratio in the upper panel of the chart represents the relationship between the net increase in mortgages outstanding to the total net increase in corporate, state and local, and U.S. government securities. Net decreases in U.S. government securities are treated as sources rather than uses of funds.

## CHART 13
### Ratios of Net Mortgage Flow to Total Net Capital Market Flow Through Main Types of Financial Institutions, 1946–1956

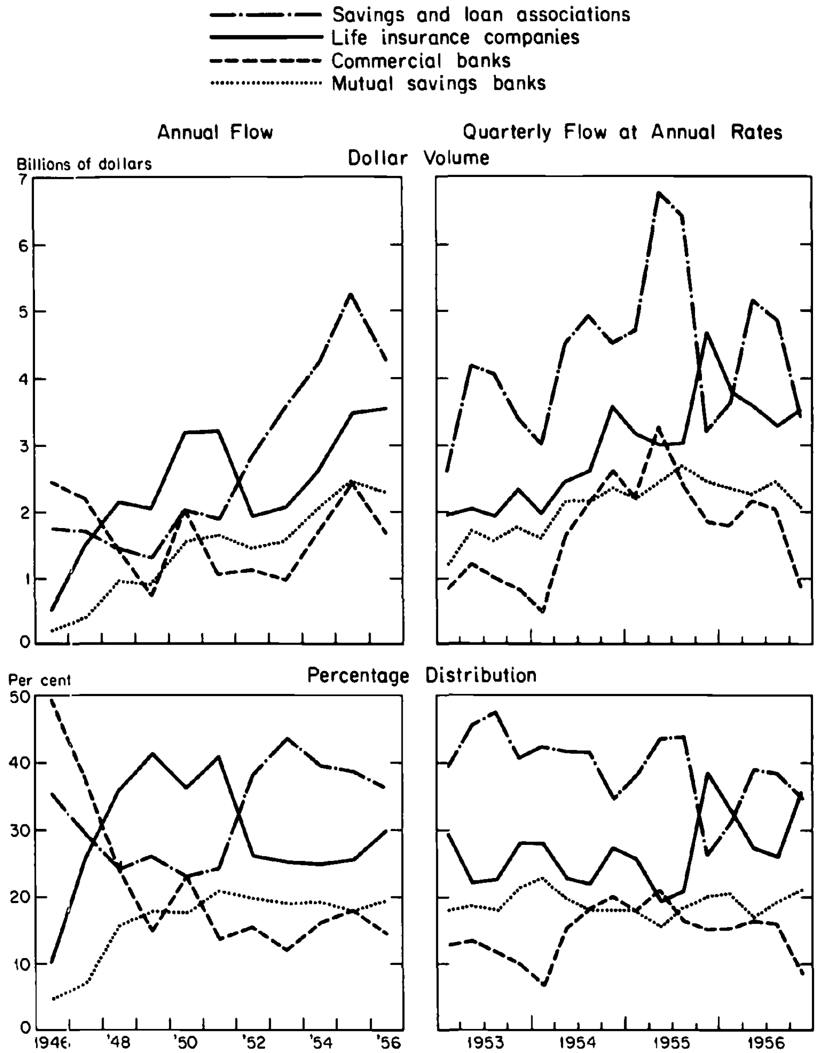



SOURCE: For each type of financial institution except commercial banks, the ratios represent the relationship of the net increase in mortgages outstanding to the total net increase in corporate, state and local, and U.S. government securities. For commercial banks the ratio is based on the same items plus bank loans. Net decreases in U.S. government securities are treated as sources rather than uses of funds.

Except for mortgage figures, taken from Klaman, Technical Paper 13, Tables 37–40, the basic net flow data upon which the ratios were taken from internal Federal Reserve Board sources. The outstandings data from which net flows figures may be calculated appear in the following *Federal Reserve Bulletin* tables: "Principal Assets and Liabilities and Number of All Banks, by Classes," "Savings Institutions: Life Insurance Companies," and "Savings and Loan Associations," *Bulletin*, April 1957, pp. 429 and 439. An additional source of information used for mutual savings banks is the National Association of Mutual Savings Banks. See also Table A-9 below.

CHART 14

Net Flow of Mortgage Funds from Main Types of Financial Institutions, 1946–1956




SOURCE: Klaman, *Volume of Mortgage Debt*, Table 23.

institutions regarded mortgage investments with maximum or steadily increasing favor during the five years ending in 1950.[3] Commercial banks, on the other hand, faced with a different situation at the war's end and having investment programs and objectives basically different from those of the other types of financial institutions, committed a much larger share of their net loans and investments to mortgages in the immediate postwar years than in subsequent years.[4]

Action of commercial banks in the early postwar years was unique, due largely to the unusually heavy volume of their federal government security holdings at the end of 1945. In 1946 and 1947 they reduced these holdings by more than $20 billion, representing two-thirds of their net sales during the entire period through 1956. Liquidity needs were small while the price of government bonds was supported by the Federal Reserve. With mortgage portfolios depleted and mortgage yields attractive relative to other loans and securities, banks placed an exceptionally large share of funds into mortgages during each of the years 1946–1948 compared with later postwar years. Net acquisition of mortgages by commercial banks, as shown in Chart 13, amounted to over 40 per cent of their net loans and investments in 1946 and to about 30 per cent in 1947 and 1948. The record 1946 share was about three times the proportion committed to mortgages by savings banks or life insurance companies.

The net dollar flow of mortgages originating with commercial banks in 1946 and 1947 was also appreciably larger than that of any other type of institutional investor—nearly one-half in 1946 and two-fifths in 1947 of the combined net flow from the others (Chart 14). After their swift postwar readjustment of investment portfolios, commercial banks reduced their acquisition of mortgages steadily through 1949, but sharply increased them in 1950, as construction and real estate activity accelerated. From then on, commercial banks receded as suppliers of permanent mortgage funds and advanced as suppliers of short-term construction and interim mortgage financing.[5]

[3] Savings and loan associations always try to maximize mortgage investments, in keeping with their specialized functions.

[4] See Chapter 6 for a discussion of mortgage lending policies and practices of the main types of financial institutions. Capital market activities of other types of institutional investors, which played an insignificant role as suppliers of postwar mortgage funds, are excluded here. As shown in Table 5, the net flows of mortgage funds through financial institutions other than the four main types amounted to less than 5 per cent in the full postwar decade.

[5] See Chapter 6 for a discussion of the practices and policies of commercial bank mortgage lending. See also "Commercial Banks in the Mortgage Market," *Monthly Review of Credit and Business Conditions*, Federal Reserve Bank of New York, April 1956.

Life insurance companies, like commercial banks, sold about one-third of their U.S. government obligations in the first five years after the war in order to acquire higher-yield assets. Unlike commercial banks, however, their readjustment to peacetime capital markets was less immediate, as they continued during 1946 to increase slightly their holdings of federal obligations. From a low that year of only 15 per cent of their net capital market investments in mortgages, they raised their share to nearly one-third in the following two years, about equal to the proportion for commercial banks. By 1950, their ratio of mortgage to capital market flows had risen to 60 per cent in response to the expansive forces of large borrower demands, favorable yields, Federal Reserve support of government bond prices, and liberalized federal mortgage programs. The absolute flow of mortgage funds from life insurance companies between 1948 and 1951, following two years at relatively low levels, was substantially greater than that from other types of financial intermediaries (Chart 14).

The relatively slow entrance of life insurance companies into mortgage markets after the war stemmed in part from a generally cautious attitude toward mortgage investments and in part from problems of market organization and techniques of mortgage acquisition. Some companies with acute memories of the thirties were skeptical about early postwar real estate values and sensitive about the possibility of foreclosure actions. As nationwide lenders, life insurance companies, unlike commercial banks and savings and loan associations, acquire the bulk of their residential mortgage loans through mortgage correspondent or branch office organizations.[6] Dismantled after many years of reduced mortgage activity during depression and war, their restoration was a prerequisite to effective volume operation. The time consumed delayed participation of life insurance companies in mortgage markets, particularly in the burgeoning VA mortgage loan program. The net flow of funds from financial institutions into VA-guaranteed mortgages amounted to almost one-half of their total net mortgage flow in 1946 and 1947, when insurance company mortgage lending was lagging. Multifamily and nonresidential real estate and construction markets, in which life insurance companies are leading lenders and generally place loans directly, are relatively much less important outlets for funds than home mortgages. As they gradually developed effective channels for home mortgage loan acquisition, and the favorable climate for such investment continued, life insurance companies sharply expanded their participation

[6] See Chapter 6.

in mortgage markets. By 1948, they had become the leading supplier of mortgage funds—a position held through 1951.

The investment behavior of mutual savings banks in the early postwar years was conditioned by their limited outlets for mortgage loans. They are located principally in the eastern part of the country, where real estate and construction markets were less active than in more rapidly growing areas. Moreover, until 1949 and 1950, most state statutes limited savings bank investments in mortgages to properties located within specified geographic areas, generally inside state boundaries. Thus, savings banks acquired a much smaller volume of mortgages in the immediate postwar years than their net inflow of savings and holdings of government securities would have allowed; indeed, their purchases of government securities in 1946 and 1947 amounted to $1.2 billion, almost twice the net acquisition of mortgages in those years.

When real estate and construction activity picked up generally, and banking laws of most states were amended to permit the acquisition of out-of-state FHA and VA loans, savings banks were free to expand in the field. They liquidated Treasury securities from 1948 to 1950 about as rapidly as they had acquired them in the two years before and invested an increasing share of funds in higher-yield mortgages. The share of their net capital market investments put into mortgages rose from a low of 13 per cent in 1946 to 67 per cent in 1948 and to 100 per cent in 1950. In absolute amounts, savings banks increased their net acquisition of mortgages from a little over $200 million in 1946 to over $1.5 billion in 1950, a relative gain of from 6 to 18 per cent in the total net flow of mortgage funds from the main types of financial institutions (Chart 14).

Savings and loan associations, limited by law mainly to investment in mortgages and federal government obligations, placed nearly all of their net capital market investments, 1946 to 1950, in mortgages (Chart 13). At the same time they liquidated nearly $1 billion of government bonds. Their absolute net flow of mortgage funds through 1951 was less, however, than the flow from commercial banks during the early part of the period and from life insurance companies during the latter part. While the associations did not again during that decade limit their net investment activity entirely to mortgages, after 1951 their net flow of mortgage funds exceeded those from other main types of financial institutions by a wide margin (Chart 14).

The change in relative importance of savings and loan associations as suppliers of mortgage funds was owing mainly to the amounts of their investment funds in comparison with those of other financial intermediaries. The relative attractiveness of mortgages to competing institutions may also have been a factor, however. It is possible, for example, that commercial banks and life insurance companies, having extraordinarily large reservoirs of low-yield government securities to sell in a guaranteed par market and looking favorably upon mortgage yields, reduced the opportunities for mortgage investment by savings and loan associations. Although, the associations used the bulk of their net inflow of funds from share capital and sale of governments to acquire mortgages, they could also have met larger demands for mortgage credit by increasing their borrowing from the Federal Home Loan Banks.

### FLOWS INTO VARIOUS MORTGAGE MARKET SECTORS

Two basic facts stand out in even a cursory analysis of postwar mortgage market flows:[7] nearly all funds in each year were supplied by the four main types of financial institutions, and they were used to finance one- to four-family properties (Charts 15 and 16). While all other types of private lenders combined were reducing their relative mortgage market participation from over one-fourth in 1946 to less than one-tenth in 1950, the four main types of financial institutions were increasing their share of the market from four-fifths to almost nine-tenths. The 1950 proportion of the total net flow of mortgage funds provided by the main financial institutions was larger than in any other year on record through 1956. For all but commercial banks this flow represented a larger share of their net capital market investments than in any other year of the postwar decade except 1955 and 1956. Federal agencies, meanwhile, expanded their share of the market from a negative percentage in 1946 to close to one-tenth in 1949 before decreasing it again in 1950. The combined federal lending, shown in Chart 15, resulted from offsetting actions of the Home Owners Loan Corporation, which was steadily liquidating mortgages acquired during the thirties, and of the Federal National Mortgage Association, which was acquiring mortgages in support of the federally underwritten mortgage market.[8]

The absolute and relative decline in net mortgage flows from the main types of financial institutions in 1949 followed the rise in bond yields during 1948 and 1949, which attracted institutional funds. Declines in consumer demands for housing and in business demands for external

[7] For details of the analysis recapitulated here, see Chapter 3.

[8] The varying participation of FNMA in the market for VA and FHA mortgages is discussed in Chapter 7 and shown in Charts 19 and 20.

CHART 15
Net Flow of Mortgage Funds from Broad Lender Groups, 1946–1956

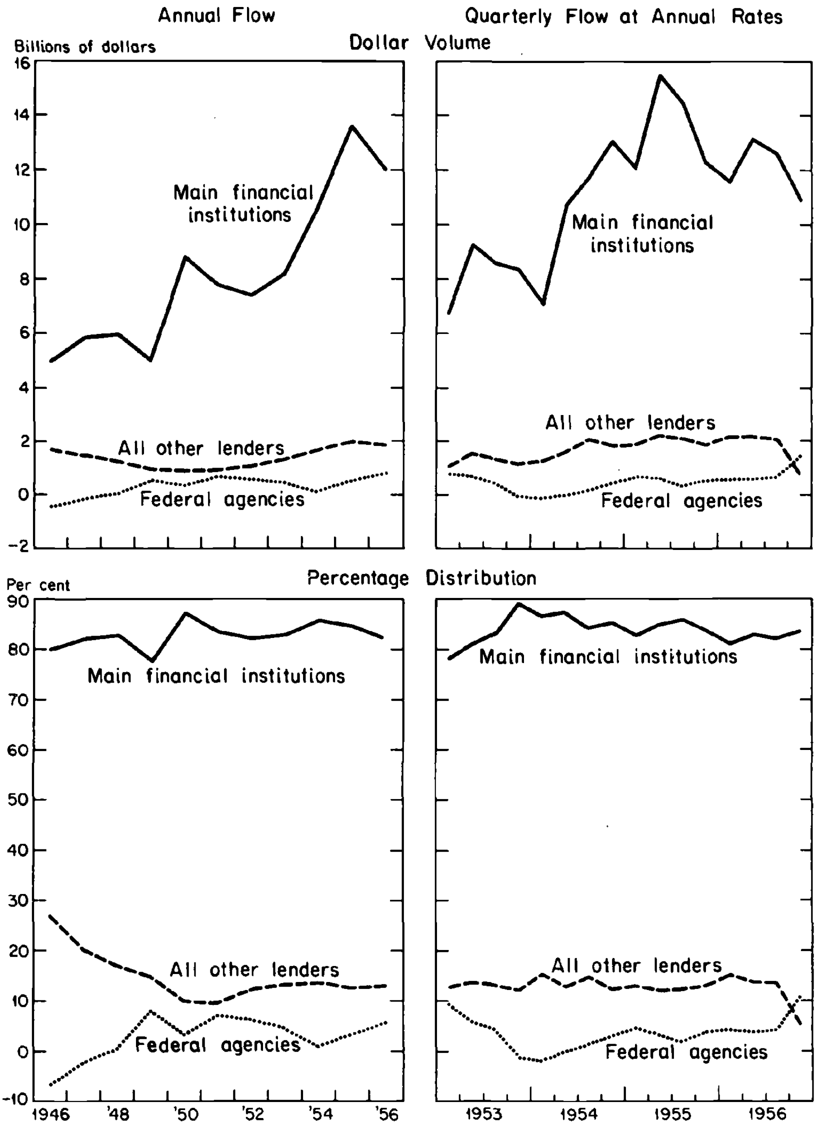
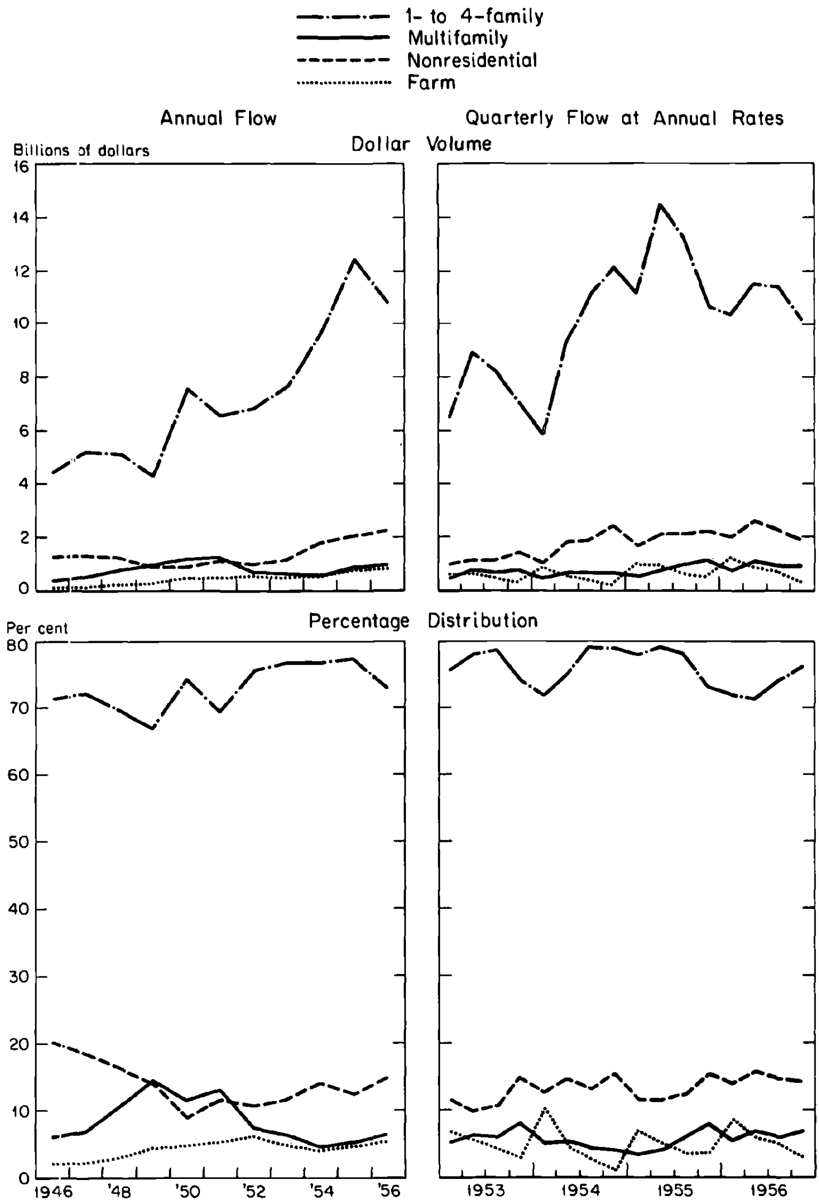


CHART 16

Net Flow of Mortgage Funds for Loans on Main Classes of Property, 1946–1956




SOURCE: Klaman, *Volume of Mortgage Debt*, Table 22.

financing accompanying the 1948–1949 business recession were also significant factors in reduction of both one- to four-family and nonresidential mortgage flows in 1949. Legislation permitting FNMA to provide increased support to the market for federally underwritten mortgages undoubtedly lessened the decline. The continued increase in the flow of mortgage funds into multifamily properties during 1949, shown in Chart 15, was due entirely to the profitable and riskless effects of the government's liberal FHA Section 608 program. Conventional mortgage financing of multifamily properties declined in 1949 following small increases in the two years before.

The short-lived 1948–1949 recession was followed by a rapidly accelerating business recovery in 1950. In real estate and mortgage markets the year 1950 stands out as one of the most expansive in the postwar decade. Even before the Korean War began in June, a combination of private market and federal government influences was at work to produce the previously mentioned record-breaking flow of mortgage funds. The production of new private housing reached a record annual rate of close to 1.5 million units in the summer of 1950, sales of existing properties were also unusually large, and nonresidential contract awards and construction were expanding rapidly. The large volume of credit readily available, however, under progressively broadened and liberalized federal mortgage underwriting programs and easier conventional lending terms, was in itself an important stimulant to the demand for housing—so dependent on credit availability and terms.

Continued unfulfilled needs for basic physical facilities, full employment, high and rising incomes, substantial liquid asset holdings, and high rates of family and household formation were, of course, basic stimulants of housing demand in that period. The large volume of credit readily available, however, under progressively broadened and liberalized federal mortgage underwriting programs and easier conventional lending terms, was in itself an important stimulant to the demand for housing—so dependent on credit availability and terms.

## HOME MORTGAGE FLOWS, BY TYPE OF MORTGAGE AND FINANCIAL INSTITUTION

While home financing dominated mortgage markets throughout the postwar decade, types of mortgages and chief sources of funds varied with shifting market forces. Among the most striking developments was the almost complete reversal of the positions of federally underwritten and conventional mortgage lending between the first and second halves of the decade. During the first half of almost uninterrupted federal expansionary policies, federally underwritten mortgage flows amounted to well over one-half to two-thirds of total net home mortgage flows. Through most of the second half-decade, conventional mortgage flows were substantially larger than federally underwritten.

The wisdom of expansionary federal residential mortgage programs and policies during the early postwar years, described in Chapter 3, when demands were pressing against limited resources of materials and labor has often been questioned. In the view of some, the result of those policies was not additional housing but rather higher prices for houses that would have been produced anyway.[9] But there can be little doubt that the demand for mortgage funds must have been increased whether to finance additional units or the same number at higher prices. Moreover, the liberal loan-to-value ratios of federally underwritten mortgage terms further spurred the volume of mortgage funds associated with a given volume of real estate and construction activity.

## *Type of Home Mortgage Flows*

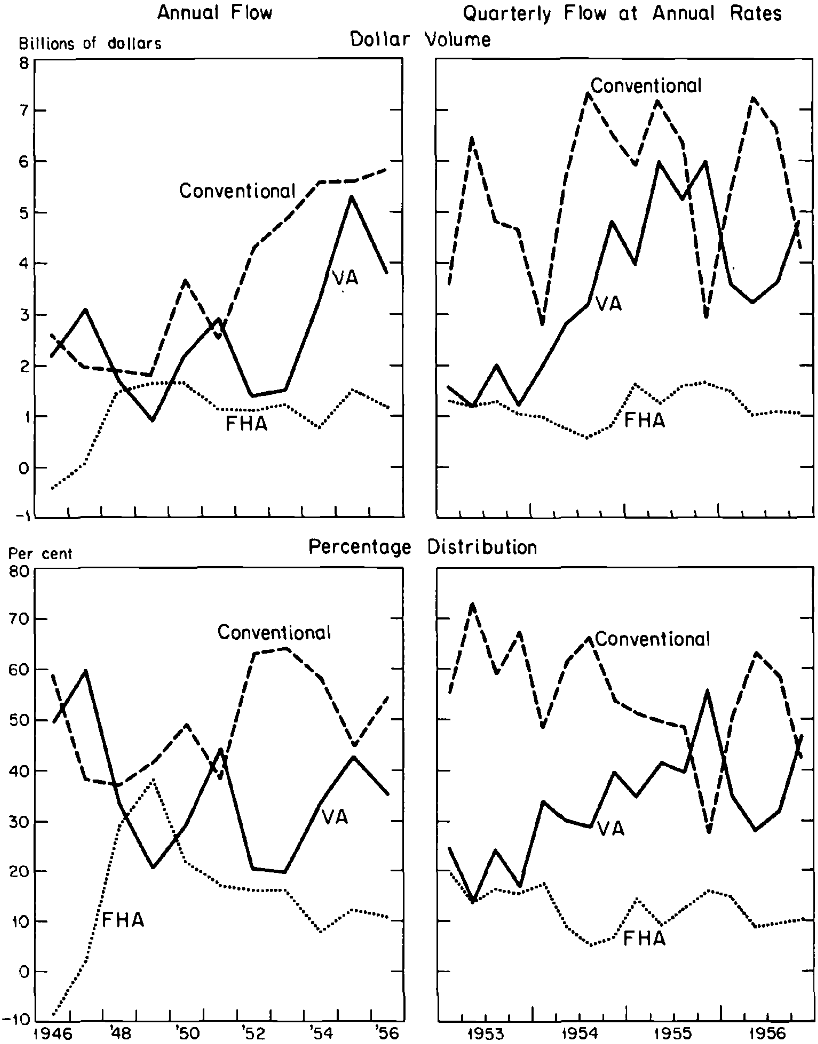
The substantially larger volume of federally underwritten home mortgage flows compared with conventional in most years through 1951 resulted from sharply shifting and nearly compensating movements between FHA and VA loans. Clearly, the two federal mortgage underwriting programs, though similar in principle and operation, have enough basic differences in their internal characteristics and the market areas served to respond differently to changing economic forces. This is evident whether loan volume is measured in terms of net mortgage flows (Chart 17), influenced by the varying pattern of repayments as well as by other independent forces, or in terms of gross flows (Chart 18), unaffected by repayment rates. On either basis, the volume of VA financing has fluctuated more widely and irregularly than either FHA or conventional mortgage financing.

The VA mortgage guarantee program, following the liberalizing amendments of late 1945 (Chapter 3), was at once attractive to both potential lenders and borrowers in the immediate postwar years. In view

[9] On this point, see Marriner S. Eccles, "Inflationary Aspects of Housing Finance," *Federal Reserve Bulletin*, December 1947, pp. 1,463–1,465; Leo Grebler, "Stabilizing Residential Construction," *American Economic Review*, September 1949, and *The Role of Federal Credit Aids in Residential Construction*, Occasional Paper 39, New York, National Bureau of Economic Research, 1953, pp. 64–65; Miles L. Colean and Robinson Newcomb, *Stabilizing Construction, the Record and Potential*, New York, 1952, pp. 145–147; and R. J. Saulnier, Harold G. Halcrow, and Neil H. Jacoby, *Federal Programs of Lending, Loan Insurance, and Loan Guarantees*, Princeton University Press for NBER, 1958, pp. 336–347.

CHART 17

Net Flow of Home Mortgage Funds, by Type of Mortgage, 1946–1956

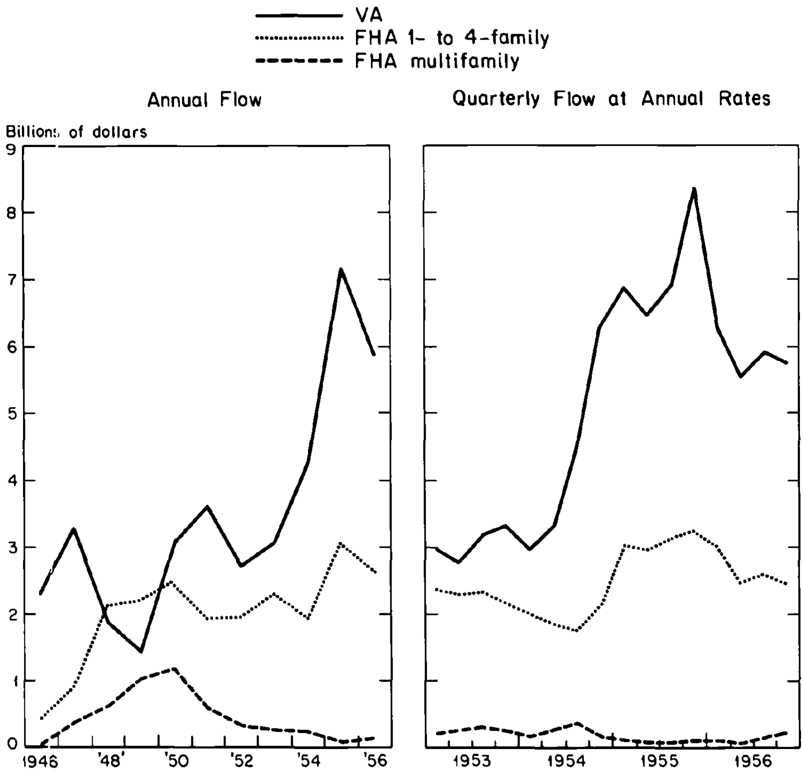



SOURCE: Klaman, *Volume of Mortgage Debt*, Table 22.

of yields available at the time on capital market securities of comparable risk, institutional investors were quite willing to lend on federally guaranteed obligations bearing a contract interest rate of 4 per cent. After the rapid demobilization of the armed forces in 1945 and 1946, veterans placed mounting pressure on the existing housing supply and, unable to find suitable rental quarters, were quite willing to borrow on

CHART 18

Gross Flow of Federally Underwritten Mortgage Loans, 1946–1956




SOURCE: Data in annual reports and monthly releases of the Federal Housing Administration and Veterans Administration.

liberal VA loan terms to finance home ownership. The flow of VA-guaranteed mortgage funds increased rapidly during 1946 and 1947, its net being a larger share of the total flow of home mortgage funds than in any other postwar year. Gross VA mortgage lending amounted to $3.3 billion in 1947, nearly four times the gross volume of FHA-insured home mortgage lending, and a volume not again reached until 1951. The Veterans Administration found that "the limited supply of housing rather than a limited flow of investment money proved to be the chief restraining influence on the volume of housing loan applications."[10]

The decline in home mortgage lending during 1949, noted earlier, was almost entirely in VA loans, which had also dropped sharply in 1948.

[10] Veterans Administration, *GI Loans—the First 10 Years (1944–54)*, VA Pamphlet VA-11, June 22, 1954, pages 8–9.

Underlying the two-year decrease were a readjustment from the earlier rapid rise to unusually high levels, and the reduced attractiveness to investors of the 4 per cent VA contract interest rate in view of rising government and other bond yields (Chapter 4). Also important was the fact that, during part of the period, no secondary market facility existed to support the VA loan program.

In the general economic expansion of 1950 there was a sharp turnabout in the volume of VA mortgage lending, as borrower demands accelerated and investors once again found yields on VA loans attractive in the prevailing easy credit markets. Special factors tending to stimulate the flow of VA mortgage funds included the broadening of FNMA's authority to purchase VA loans and the liberalization of the VA program for both borrowers and lenders under the Housing Act of 1950 (Chapter 3). An indication of the easy credit markets that prevailed in 1950 was the fact that well over two-fifths of all VA loans made in that year called for no down payment, a proportion not approached again until 1955. The large volume of loan applications and commitments made in the unusual 1950 market pushed VA loan closings higher in 1951, after FHA and conventional home mortgage lending had already turned down.

The sharply fluctuating fortunes of the veterans' mortgage loan program during the first half of the postwar decade were not shared by FHA mortgage programs, as shown in Charts 17 and 18. The gross flows of funds into FHA-insured one- to four-family and multifamily housing mortgages rose steadily from a very low level in 1946 to a peak in 1950, while the flow of VA mortgage funds was going through a complete cycle. The low level of FHA-insured mortgage financing immediately after the war was brought about by reduced demands relative to those for VA and conventional loans and by discontinuance of the liberal Title VI programs under which most wartime residential construction had been financed. During 1946, in fact, the volume of FHA mortgage insurance written was markedly less than the average volume written during the war and smaller than in any year back to 1938. The reintroduction of Title VI programs on both homes and rental projects in late 1946 was followed by a sharp increase in the flow of FHA mortgage funds. On rental projects practically all FHA loans from 1947 to 1950 were made under that program. Its expiration resulted in a rapid decline after 1950 in FHA multifamily financing, and in all other multifamily housing construction. For one- to four-family houses the Title VI program was replaced by a broadly liberalized Title II program in 1948, which continued to attract an increasing amount of funds to FHA home mortgages through 1950.[11]

In addition to the stimuli provided by liberalized programs, and the unusually low level of activity in 1946–1947, there were other factors behind the increased flow of FHA mortgages in 1948–1949, years of reduced VA mortgage activity. First, the contract interest rate differential—FHA home mortgage loans at 4½ per cent and VA loans at 4 per cent—gave FHA loans more appeal while "free market" interest rates and yields were rising. Second, the Federal National Mortgage Association provided a secondary market facility for FHA, but for VA loans during only part of the period. Third, after the gratitude-inspired rush to provide home loans for returning veterans had subsided somewhat, many institutional investors reduced their VA loan activity from the very high levels to which it had risen in favor of the tried and familiar FHA mortgage program and higher-yield conventional mortgages. Also the VA program provided only 50 per cent guarantee as against 100 per cent insurance for FHA loans.

Unlike the pattern of flows into VA and FHA mortgages, the flow into conventional home mortgages was relatively stable during 1946–1949 but increased sharply in the 1950 general expansion. The stability and rise reflected in large part the flexibility of conventional mortgage interest rates, which, after a time lag inherent in mortgage operations, rose along with rates on other capital market securities (Chart 7).[12] Investors, therefore, did not turn away from conventional mortgages as they did from VA loans when bond prices fell. It is not unlikely that the flow of funds into conventional mortgages would have been greater in the early postwar years if consumer demands for such loans had been greater. Interviews with investment officers of large financial institutions indicate that they were not able to obtain as many conventional mortgages as they wanted in this period. The same was true in most later postwar years.

### *Sources of Home Mortgage Funds*

The shifting importance of the various types of home mortgage financing, just described, was matched by changes in market participation of

[11] The basic importance of the FHA Title VI program to the market for multifamily construction has been suggested in Chapter 3. For a further discussion see Leo Grebler, *The Role of Federal Credit Aids in Residential Construction,* New York, NBER, 1953, pages 26–28. Changes in FHA Title VI and Title II programs are discussed in Chapter 3, above.

[12] The nature of time lags in mortgage interest rates and in mortgage operations generally is discussed in Chapters 4 and 7.

financial institutions, including the Federal National Mortgage Association. Those changes in sources of mortgage flows are shown in Charts 19, 20, and 21. It is clear that the main shifts in ranking among lenders in both halves of the decade occurred in the market for VA mortgage loans. In the markets for FHA and conventional home mortgage loans one type of lender was dominant in most of the period through 1950—life insurance companies in FHA, and savings and loan associations in conventional. Savings and loan associations continued to be the dominant conventional mortgage lender in the second half of the decade, but life insurance companies relinquished their position of leadership in the FHA market to commercial banks and savings banks.

In the years immediately following the war, savings and loan associations and commercial banks were by far the leading participants in the rising market for VA loans. Yields were relatively favorable, their patriotic appeal was high, while life insurance companies and mutual savings banks were temporarily handicapped by underdeveloped mortgage correspondent systems and restrictive state laws, noted earlier in this chapter. In the changing capital market environment of 1948–1949, all the main types of financial institutions except mutual savings banks reduced their VA mortgage lending sharply. The savings banks increased their acquisition of VA mortgages slightly, as out-of-state lending was permitted by some states and as limited alternative investments at home offered little better yields.

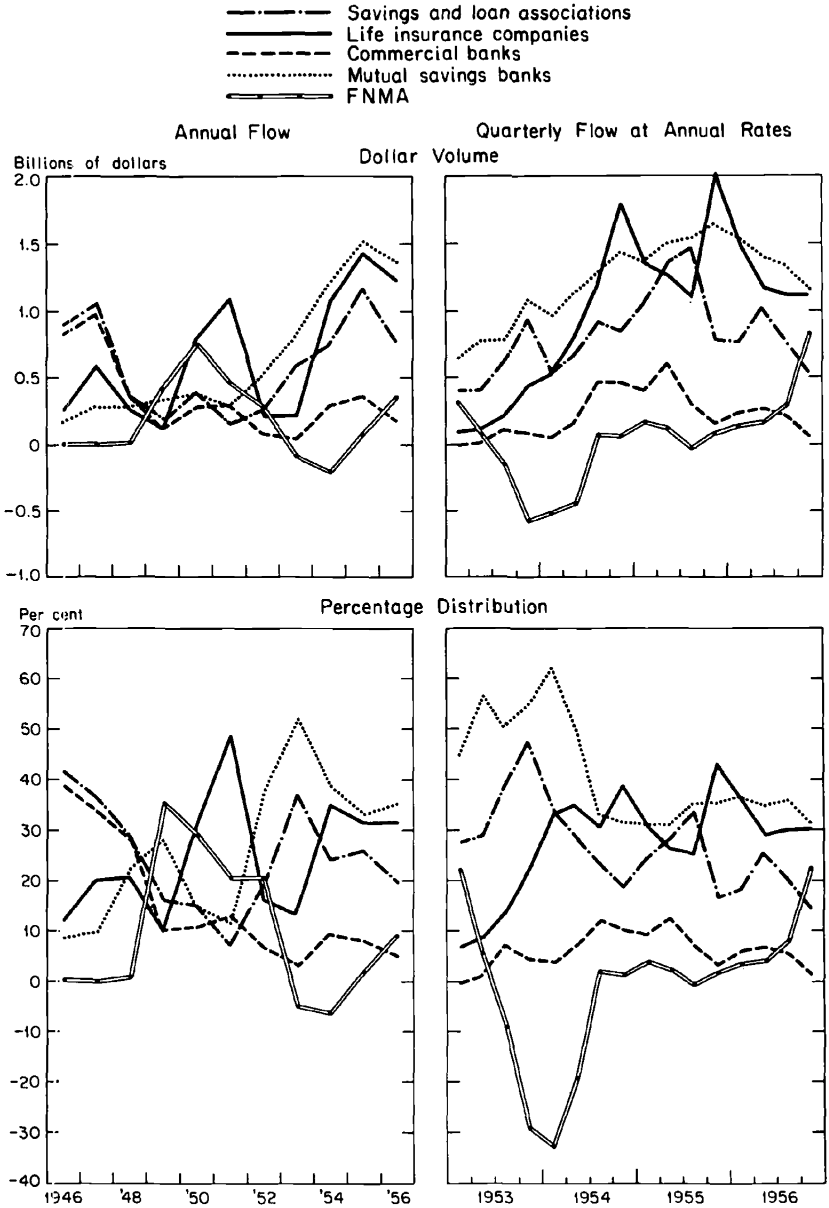
During 1950 and 1951 only life insurance companies among the private lenders contributed importantly to the sharp upturn in the flow of VA mortgages. Most of the VA loan acquisitions by these institutions through 1951, after the Federal Reserve–Treasury accord, were closings based on the large volume of commitments made in the easy credit markets of 1950 and early 1951. Other private mortgage lenders showed only modest changes in their VA loan activity.

The significance of the reorganization of FNMA in 1948 (Chapter 3) with authority to purchase VA mortgages under advance commitments on an increasingly liberal basis is clearly visible in Chart 19. During 1949, when the private market for VA loans was depressed, the Association acquired more than one-third of the total net flow of VA mortgages, a larger share than any of the main types of private financial institutions. In the expanded 1950 VA loan market, only life insurance companies supplied a net volume of funds for GI loans larger than FNMA did.

FNMA played a much less significant role in the market for FHA loans during the first half-decade, being a net purchaser only during 1948

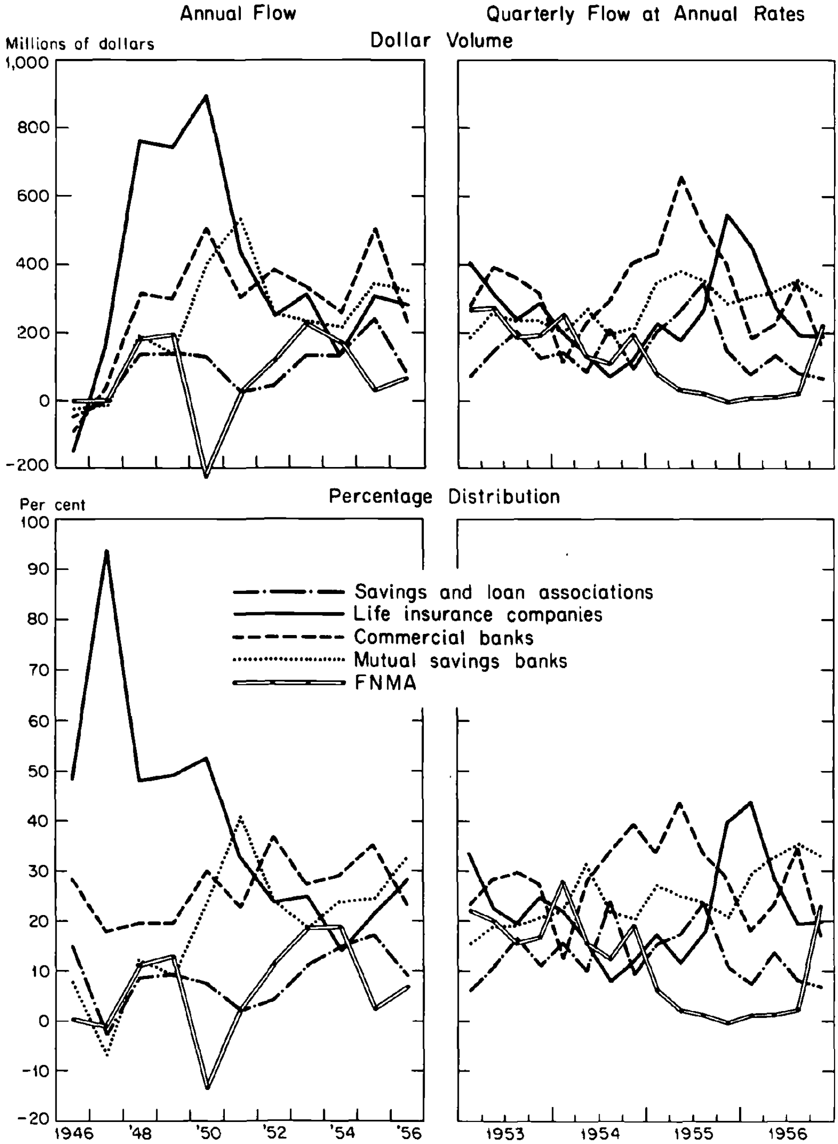
## CHART 19

### Net Flow of VA-Guaranteed Mortgage Funds from Main Types of Financial Institutions, 1946–1956




SOURCE: Klaman, *Volume of Mortgage Debt*, Tables 33 and 41.

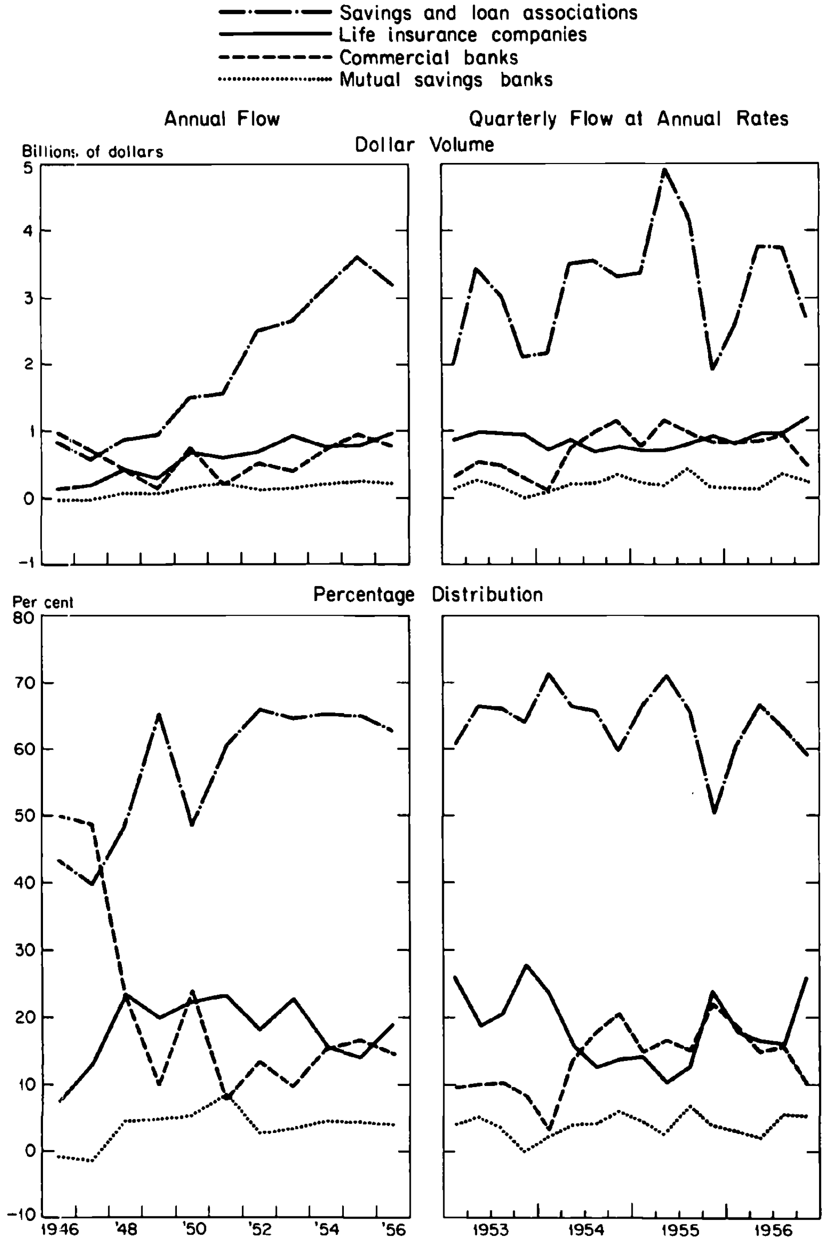
CHART 20
Net Flow of FHA-Insured Home Mortgage Funds from Main Types of Financial Institutions, 1946–1956




SOURCE: Klaman, *Volume of Mortgage Debt,* Tables 31 and 41.

CHART 21

Net Flow of Conventional Home Mortgage Funds from Main Types of Financial Institutions, 1946–1956




SOURCE: Klaman, *Volume of Mortgage Debt*, Table 35.

and 1949, when it supplied about one-eighth of the total net flow. Participation of private lenders also varied significantly from their share in the VA market, as may be seen from Chart 20. All the main types of financial institutions were slow to invest in FHA mortgages in the immediate postwar years. Responding to reactivated and liberalized FHA mortgage programs and to the resulting increase in demands, most institutional investors, led by life insurance companies, significantly increased their net FHA mortgage flows through 1950. Savings and loan associations continued their prewar aversion to the FHA mortgage program; they supplied the smallest share of FHA mortgage funds, amounting at the maximum to less than 10 per cent during 1948 and 1949.[13]

Savings and loan associations, in sharp contrast to their minor role in the market for FHA home loans, dominated the conventional home mortgage market after 1947 as few lenders have dominated any other sector of the capital market. In the first two postwar years, however, commercial banks, in an unusually liquid position, acquired conventional home mortgage loans in larger volume than that of savings and loan associations or any other type of lender. Of the total conventional home mortgage flow from financial institutions in 1946 and 1947, one-half was from commercial banks, a proportion not again approached in the postwar decade.

## *Net Flow of Mortgage Funds in a Changing Capital Market Framework, 1951–1956*

The abrupt capital market changes following the outbreak of war in Korea and the Federal Reserve-Treasury "accord" have been described in Chapters 3 and 4. They resulted in marked shifts in the flow of mortgage funds relative to other capital market flows, and shifts also within the various mortgage market sectors. Responding to alternating forces of market restraint and expansion, the flow of funds into mortgages alternately contracted and expanded (in contrast to the almost uninterrupted expansion of the first half-decade). The tides of flows were governed largely by shifts in the supply of funds, since demands for funds continued generally strong throughout 1951–1956, though restrained for a time by Regulation X.

Financial institutions, no longer enjoying the almost unlimited liquidity of the pre- "accord" days, could not always meet all demands for funds

[13] See Chapter 6 for a discussion of the factors behind the aversion of savings and loan associations to FHA mortgage loans.

in the capital market. The basic importance of yield in choosing investments channeled more funds into conventional mortgages with flexible rates than into federally underwritten mortgages with their fixed maximum interest rates, except during periods of credit ease. Financial institutions with broad alternative investment outlets adjusted their total mortgage flows more frequently and widely than those with limited outlets. But all types of investors were influenced in their choice of mortgage investments by changing yields.

## MORTGAGE FLOWS RELATIVE TO OTHER CAPITAL MARKET FLOWS

The net flow of funds into mortgages, while fluctuating appreciably in the second half-decade, continued to exceed the flows into other capital market securities by a wide margin in most years. The margin narrowed markedly in 1951–1953 when advancing yields on corporate and other securities (Chart 7) attracted investors. The ratio of mortgage to other capital market flows declined to a low of less than two-fifths in 1952 and 1953 from close to three-fifths in 1950 (Chart 12). Subsequently, the ratio advanced through 1955, bolstered by the lifting of direct federal mortgage lending restrictions, the shift from general credit restraint to ease, and declines in yields on competitive instruments. The moderate 1956 decline in net mortgage flows followed the return during 1955 to a Federal Reserve policy of credit restraint and restrictive federal mortgage programs, and sharp increases in corporate borrowing to finance capital expenditures (Chapter 3).

Throughout the period, changes in the flow of funds into mortgages and into corporate securities were in opposite directions in every year but 1955. It is explained partly by the behavior of life insurance companies—one important source for both types of instruments—which, generally sensitive to market yields, matched each annual increase in net acquisition of one type by a decrease in the other.[14] Not only life insurance companies but also mutual savings banks and savings and loan associations reduced their shares of net capital market investments in mortgages in 1951–1953 (Chart 13). For savings and loan associations, the relative reduction was owing to net acquisition of government securities at increasingly favorable yields following net selling in earlier years. For mutual savings banks, as for life insurance companies, the reduction was in favor of corporate and municipal securities. Commercial banks, well before 1951, reduced their share of

[14] This sensitivity to market yields is not so clear on a quarterly basis because of differences in timing of acquisitions, which reflect the fundamental importance of prior commitments in the mortgage field. The sensitivity of life insurance companies to changes in market yields would undoubtedly be greater than it is if acquisitions were not based on commitments made several months earlier, often under different market conditions.

investments going into mortgages as part of a rapid readjustment in investment portfolios right after the war.

Beginning around mid-1953, mortgages regained favor among financial institutions, responding to the previously described expansive forces. Life insurance companies and mutual savings banks, in particular, increased their mortgage investments strongly relative to other capital market securities through 1955. The continued high ratio for life insurance companies in 1956, after the return of restraining market forces, was due to the lengthened lag between commitments and acquisitions compared with earlier years.[15] The gradually increased ratio for savings and loan associations through 1954 was reduced later; the associations tried to improve liquidity ratios through acquisition of government bonds partly in response to requests of the Federal Home Loan Bank System that they hold mortgage commitments in line with savings inflows.

Financial institutions, in adjusting their investment activities to the new post-Korean capital market setting, showed wide variation in their patterns of net mortgage flows. Life insurance companies and commercial banks fluctuated most widely in acquisitions, going through a complete cycle between 1950 and 1956 (Chart 14). This resulted in part from their greater choice of alternative investments compared with savings and loan associations and mutual savings banks. The steep rise in annual net flow of mortgage funds from savings and loan associations after 1951 was in keeping with their specialized nature as mortgage lenders. With mortgage funds from other institutions reduced during 1952–1953, borrowers turned to savings and loan associations, which increased their share of the total net mortgage flow to well over two-fifths. That share was reduced gradually in 1954–1956 as banks and insurance companies increased their share of the total.

Quarterly movements in the flow of mortgage funds during 1953–1956, when federal monetary and housing policies were undergoing basic change, are somewhat more revealing—despite limitations of data—than annual flows are. An increase in mortgage flows from each of the main types of financial institutions through 1954, following the shift to monetary ease and removal of mortgage credit restrictions in late 1953, is apparent from Chart 14. While on an annual basis the pickup continued through 1955, quarterly data reveal important timing differences among the institutions.

Commercial banks reduced their net mortgage flows sharply after mid-1955, as the shift in Federal Reserve policy from ease to restraint quickly

[15] The use of the forward commitment by life insurance companies in 1954 and 1955 was fairly widespread, as noted in Chapters 7 and 8.

influenced reserve positions. Mutual savings banks, reacting somewhat more slowly to market changes, reduced their net mortgage flow—except into VA loans—after the third quarter of 1955 (Chart 19). The quarterly mortgage flow from life insurance companies and savings and loan associations is especially difficult to interpret because of seasonal operations and the technical timing pattern of mortgage acquisitions, discussed below. Allowing for these factors it seems correct that life insurance companies did not begin to reduce their net flow of mortgage funds until early in 1956 in response to restraining market influences that began almost a year earlier. The steep decline in the net flow of mortgages from savings and loan associations between the third and fourth quarters of 1955 was clearly more than seasonal. It may be traced directly to the tightening capital market at the time when the Federal Home Loan Banks found it increasingly difficult to raise funds and cautioned the associations against overextending themselves.

While the time period is too short to establish definite seasonal trends, it is unmistakeable that in the fourth quarter of each year net mortgage acquisitions of life insurance companies rose, and those of savings and loan associations declined. In the former case, the regularity of movement derives from a market technique whereby commitments or allocations of funds to originate mortgages are made early in the year to mortgage correspondents who generally complete and deliver them towards the end of the year.[16] In the latter case, it seems to result from changes brought about in part by consistent falling off at the end of each year of existing house sales, for which the associations make a considerable portion of their loans. In part the reduction of fourth-quarter savings and loan mortgage acquisitions is also to accommodate heavy seasonal withdrawals from share accounts and to pay down indebtedness to the Federal Home Loan Banks by the end of the year. No definite seasonal pattern can be discerned in movements of mortgage flows from commercial or mutual savings banks.

## FLOWS INTO VARIOUS MORTGAGE MARKET SECTORS

Changes in the net flow of mortgage funds during the second half-decade, as in the first, were compounded chiefly of changes in net flows from the four main types of financial institutions on one- to four-family properties. During the 1951–1953 and 1955–1956 periods of credit stringency, the main financial institutions reduced their mortgage market participation

[16] See Saul B. Klaman, *Postwar Rise of Mortgage Companies,* New York, NBER, 1959, for a discussion of differences in market timing between life insurance companies and mortgage companies.

relative to that of other lenders (Chart 15). Similarly, during the 1953–1955 period of credit ease they increased their participation more than other lenders did.

This broad conclusion derived from annual data on flows may be sharpened somewhat by reference to quarterly figures. In the relative market participation of financial institutions, these data disclose a steady quarter-by-quarter increase during 1953, followed by a halting decline through 1954. Their absolute participation, however, increased sharply during 1954. A further relative decline, on balance, occurred during the quarters of 1955 and 1956. The failure of the financial institutions to increase their relative mortgage market participation steadily during most of the easy credit period from mid-1953 to early 1955 can be explained in part by technical market adjustments. Mortgage companies (accounting for a large part of the holdings of "all other lenders") were expanding their inventories with the help of commercial bank credit, while permanent investors were processing the large backlog of earlier commitments.[17] Another important market factor during 1954–1955 was the increased participation of FNMA (accounting for most of the net flow from federal agencies shown in Chart 15) following the Housing Amendments Act of 1953 containing liberalized provisions. The reduced flow of funds from private lenders in the tightened mortgage market of 1956 was accompanied by a further expansion in the activity of federal agencies.

The impact of the readjustments in mortgage markets after 1950 on the main real estate sectors varied in both timing and intensity. The reduction in net mortgage flows during 1951, following the unusual expansion of 1950, was limited entirely to the one- to four-family sector. Multifamily and nonresidential mortgage flows did not decline until 1952, during the height of general credit stringency and federal mortgage credit restrictions. The much greater decline in multifamily mortgage flows, and their continued low level through 1954 after mortgage markets had eased and the flow into other sectors had turned up, showed the effects of termination of the liberal FHA 608 mortgage program in 1950 (see Chapter 3).

The changing significance of the dominant one- to four-family sector in the total mortgage market during periods of credit expansion and contraction is strikingly shown by quarterly data in Chart 16. The unusually rapid and nearly uninterrupted expansion in the flow of home mortgage funds between the first quarter of 1954 and second quarter of 1955 increased the share of that real estate sector in total mortgage flows from less than

[17] See Klaman, *Postwar Rise of Mortgage Companies*, for a discussion of mortgage company inventories and activity relative to institutional investors in the 1953–1955 period.

three-fourths to almost four-fifths. The impact of credit restraint, greater on the home mortgage market sector than on other sectors after early 1955, is manifest in the sharp drop in one- to four-family mortgage flows, while flows into other sectors showed relatively little change. The greater volatility of the one- to four-family mortgage sector during the 1955–1956 period of credit restraint as well as the 1954–1955 period of credit ease reflected chiefly the varying flow into federally underwritten mortgages. Conventional home mortgage flows were far less volatile during periods of changing capital market yields.

Before further discussion of developments within the home mortgage market, seasonal movements in the various types of mortgage flows shown by the quarterly data in Chart 16 will be touched upon. The period under observation is, of course, too short to establish definite conclusions, but some tentative observations appear justified. In the one- to four-family sector, second and third quarter flows were invariably highest, except in 1954, and there was a second-quarter peak in each year except 1954. The disruption of a possible seasonal pattern in net home mortgage flows during 1954 may be explained by an unusual year of steady mortgage expansion following two years of contraction. The otherwise regularly higher levels during the second and third quarters of each year, compared with the first and fourth quarters, appear to follow seasonal patterns of building and real estate activity.[18] No clear pattern emerges, however, in the multifamily mortgage sector. In the nonresidential and farm sectors, there are indications of a possible seasonal pattern, with peaks at opposite ends of the year—nonresidential in the fourth quarter of each year except 1956, and farm mortgage flows in the first quarter, except in 1953.

### HOME MORTGAGE FLOWS, BY TYPE OF MORTGAGE AND FINANCIAL INSTITUTION

The volatility of federally underwritten home mortgage lending (especially in the VA sector) compared with conventional home mortgage lending, which was clearly evident in the first half-decade, was strikingly apparent in the second half as well. Within the federally underwritten sector, the flow of funds into VA and FHA mortgages continued to vary markedly; fluctuations in volume and degree of change were great. Observations of changes in VA, FHA, and conventional mortgage flows during alternating periods of capital market stringency and ease suggest significantly different

[18] Quarterly data back to 1949, developed by the author at the Federal Reserve, indicate that in all years except 1949 the peak in one- to four-family mortgage flows was reached in the second or third quarters.

reactions of major financial institutions to investment opportunities. They suggest also changing demands of potential borrowers for different types of mortgages.

### *Types of Home Mortgage Flows*

Analysis of the impact of shifting market forces on the major home mortgage sectors during 1951–1956 is aided by the availability of annual estimates of gross mortgage lending to finance new and existing house purchases, shown in Chart 22.[19] Two things are readily apparent: the substantially greater importance of federally underwritten mortgages in markets for new houses than for existing houses; and the almost uninterrupted expansion in conventional mortgage lending in both new and existing house markets.

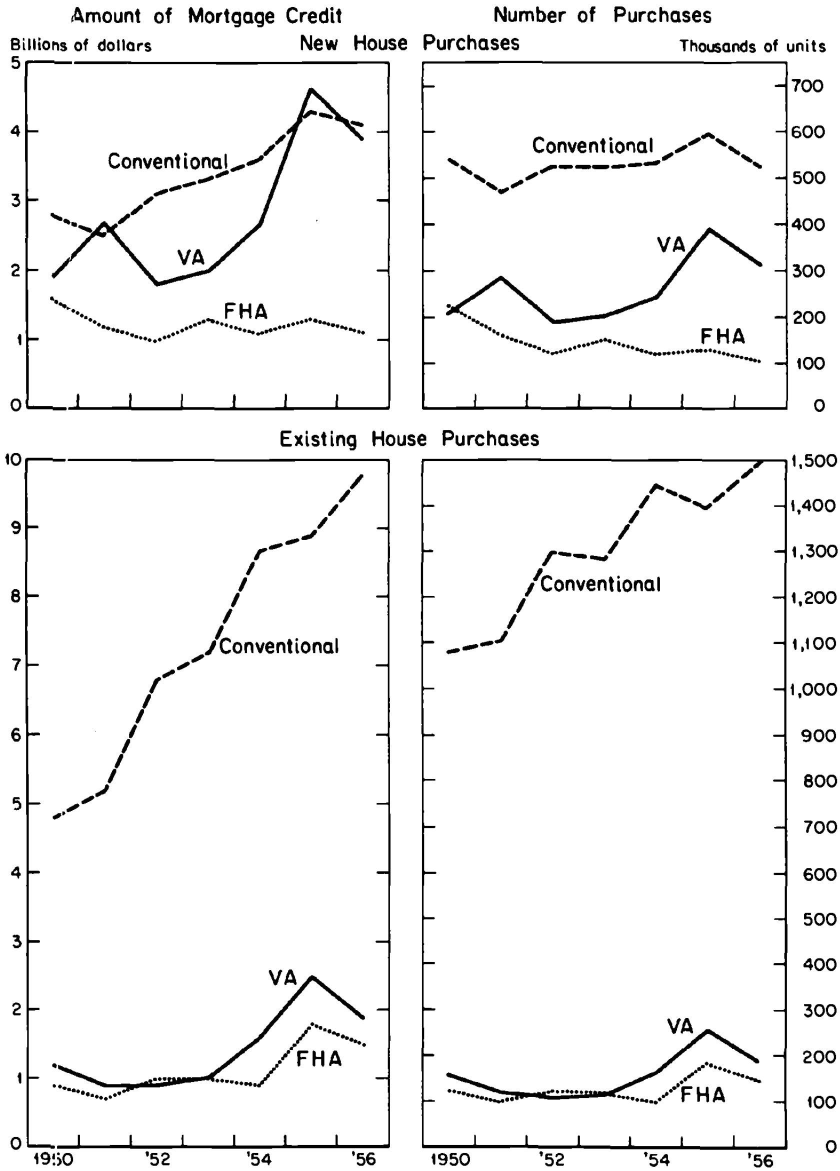
During 1951, the extension of conventional mortgage credit declined on new houses and rose on existing houses; this suggests the restraining influence of Regulation X, which was limited to markets for new houses. It suggests also the ineffectiveness of the voluntary credit restraint program, aimed at the extension of real estate credit on existing houses (Chapter 3). The effect of direct real estate credit restraint imposed through associated VA and FHA regulations was delayed because of the unusually large volume of mortgage commitments obtained by builders immediately before the effective date of the regulations.[20] Because of the outstanding commitments, both gross and net flows of funds into VA mortgages continued to rise sharply in 1951. Gross lending on VA and FHA mortgages to finance existing house purchases, also under direct federal regulation, declined in 1951, however. FHA lending on new houses also declined, notwithstanding a record volume of loan applications by builders. The decline is explained in large part by a shift to the more liberal VA loans, in heavy demand by veterans anxious to purchase under pre-Regulation X terms.

The direct effects of real estate credit controls are, of course, obscured by the influence on mortgage markets of stringent monetary and fiscal policies beginning in March 1951, and of FNMA's reduced purchasing authority in early 1952 (Chapter 3). All these actions undoubtedly played a part in the drop in federally underwritten mortgage lending in 1952 and its continued low level in 1953. In addition, a major deterrent to investment in

[19] Data are not available for years before 1950.

[20] The estimated number of requests to the Veterans Administration for appraisal of new houses exceeded 90,000 in October 1950, more than in any other month of the postwar decade. October applications to the Federal Housing Administration for insurance of mortgages were also an all-time high. Both dropped sharply in the later months of 1950 and in 1951.

CHART 22
Gross Mortgage Credit Extended to Finance House Purchases, 1950–1956




SOURCE: Data from the Federal Housing Administration and Veterans Administration and unpublished estimates made by the author while at the Federal Reserve Board. See also Table A-10 below.

guaranteed mortgages was the narrowing spread between rising yields on corporate and government securities and the fixed maximum contract interest rates on VA and FHA loans (see Charts 1 and 7). Conventional mortgages to finance both new and existing houses, meanwhile, attracted an increasing volume of funds during those years, as interest rates adjusted freely to changing capital market conditions. The share of net home mortgage flows going into conventional mortgages rose during 1952 and 1953 to well over three-fifths from around two-fifths in most preceding postwar years (Chart 17). It is, of course, not possible to say how much larger, if any, the flow of funds into conventional mortgages might have been during 1951–1953 in the absence of Regulation X. That Federal Reserve regulations and associated FHA and VA regulations may well have had a greater influence on the structure of real estate and mortgage markets—price shifts, types of houses purchased, relation between new and existing house purchases—than on the total flow of mortgage funds.[21]

The changed capital market environment after mid-1953—following reversal of monetary policy from restraint to ease, declines in bond yields and increases in FHA and VA contract interest rates, removal of mortgage credit restrictions, and renewed purchasing authority for FNMA—resulted in a relatively much greater increase in the gross flow of home mortgage funds than in the number of houses purchased with these funds. The rapid increase, 1953–1955, in VA mortgage flows on new houses (130 per cent) and on existing houses (150 per cent), for example, was larger than the increase in the number of new and existing houses purchased with such loans (91 per cent and 120 per cent respectively). The larger flow of mortgage funds per house purchase reflected in part a shift to higher-priced units and in part the ready availability of funds on unusually liberal terms. The proportion of VA loans made with no downpayment and thirty-year maturities increased from lows of about 5 per cent and 2 per cent, respectively, in early 1953 to peaks of about 45 per cent in the spring of 1955.

The increased flow of funds into VA mortgages on both a gross and a net basis was markedly greater than into FHA or conventional mortgages during that period of capital market ease. FHA mortgage flows began to

[21] See, for example, the following analyses of the effects of real estate credit controls: R. J. Saulnier, "An Appraisal of Selective Credit Controls," *American Economic Review*, Papers and Proceedings, May 1952, pp. 247–268; H. B. Schecter, "Home Financing 1949-51—Changes Under Credit Controls," *Housing Research* (Housing and Home Finance Agency), Winter 1951–1952, and "New Home Price Shifts, 1951–1952 Under Credit Controls as Amended in 1951," *Housing Research*, March 1953; and "House Purchases in the Five Months Following the Introduction of Real Estate Credit Regulation," *Federal Reserve Bulletin*, July 1951.

increase only in 1955, and then chiefly for financing existing house purchases. That increase, amounting almost to doubling, grew out of the broadly liberalized terms of FHA existing house loans authorized by the Housing Act of 1954. The difference in terms between FHA loans on new and existing houses was almost eliminated. Just as the easing of capital markets during 1953–1955 affected the flow of funds into VA mortgages more than the flow into FHA or conventional mortgages, the return to stringency in 1955–1956 bore chiefly upon the flow of VA mortgages. Both the gross volume of VA mortgage lending on new and existing houses and total net VA home mortgage flows declined appreciably in 1956. In contrast, there were but modest declines in FHA mortgage flows and little change in conventional lending.

Why were VA home mortgage flows more volatile than those of FHA after mid-1953, when contract interest rates on both types of mortgages were raised to the same level? The reader is referred to the discussion in Chapter 4 of the tendency of investors to regard the quality of VA loans as lower than that of FHA loans. In general, investors tend to pull out of VA loan markets more quickly in periods when alternative investment opportunities increase and yields rise, and to re-enter them more quickly when alternative investment opportunities are reduced and VA yields again appear attractive.

A closer analysis of the timing of home mortgage market reactions to capital market changes is permitted by quarterly data on net mortgage flows (Chart 17) and on gross FHA and VA mortgage loans closed (Chart 18). Allowing for apparent seasonal movements, the expansion in VA mortgage lending following the mid-1953 change in capital markets did not begin until early 1954; it continued upward to a peak in late 1955, after restraining forces had already returned to the fore. The reaction to the restraining forces in VA mortgage lending was not evident until early 1956, when a sharp decline in net and gross flows occurred. Prelending activity, however, indicated by appraisal requests received by VA, had begun to turn down somewhat earlier from the unprecedented volume reached in mid-1955.

Charts 17 and 18 indicate that FHA mortgage lending activity, both gross and net, also lagged behind changes in capital market conditions. In the rise, the lag was somewhat greater than in VA activity and in the decline about the same. It was not until the last quarter of 1954 that the flow into FHA home mortgages turned up and continued at a new high level through 1955. The subsequent decline began during the first quarter of 1956, as in VA markets, and leveled out at the reduced second-quarter level. Activity in FHA multifamily mortgage markets showed little reaction to basic capital market changes during 1953–1956. The principal reason for its continued low level was the termination of the FHA Section 608 program.

*Sources of Home Mortgage Funds*

Changes in the flow of funds into VA, FHA, and conventional home mortgages during the second half-decade, as in the first, rested upon significantly different reactions of major types of institutional investors to changing capital market conditions. Those varied reactions in turn reflect the fundamental differences in purpose, policy, and function among the major financial intermediaries with respect to degree of specialization in mortgages, methods of mortgage acquisition, types of mortgages preferred, and opportunities for alternative investments.[22] Life insurance companies and commercial banks, though basically different in their mortgage and other lending operations, have in common wide opportunities for alternative investments compared with savings and loan associations, for example; hence they reacted more sharply to changing capital market yields between 1951 and 1956.

The wide swings between contracted and expanded participation of life insurance companies, and secondarily of commercial banks, in the market for VA loans accounted in the main for the previously noted volatility of VA mortgage flows. Just as the decisive increase in VA mortgage flows during 1950 and 1951 was almost entirely from life insurance companies, so was the decline from 1951 to 1953. Net acquisition of VA loans by these institutions dropped from $1.1 billion in 1951 to little over $200 million in 1952 and 1953. Commercial banks also reduced their net VA mortgage acquisitions drastically from $290 million in 1951 to less than $50 million in 1953. In contrast, savings and loan associations and mutual savings banks continued to regard VA loans favorably during the years of credit restraint and acquired a steadily increasing amount of such loans from 1951 to 1953. Mutual savings banks, especially, having then only recently gained the right to acquire federally underwritten mortgages beyond state boundaries, forged ahead in the market.

The varied assessment by lenders of the desirability of VA loans was to bring about an incisive realignment of the four main types of financial

[22] See Chapter 6 for discussion of mortgage lending policies of the major types of financial intermediaries. See also Klaman, "Effects of Credit and Monetary Policy on Real Estate Markets, 1952–1954," *Journal of Land Economics*, August 1956, for discussion of changes in residential mortgage lending activity of the major institutional investors during periods of credit ease and restraint.

institutions between 1951 and 1953. The positions of life insurance companies and mutual savings banks, in particular, were almost completely reversed. The former reduced their share of the net flow of VA mortgages from nearly one-half to little more than one-seventh, and the latter increased their share from one-eighth to more than one-half. The new position of leadership in VA loan markets acquired by mutual savings banks was maintained in later years of expansion and contraction, although not so dominant as in 1953.

While the savings banks and savings and loan associations continued their steady expansion of VA lending activity through 1955, life insurance companies and commercial banks reversed their 1951–1953 actions. They increased their net VA mortgage acquisitions during the period of market ease even more rapidly than they had reduced them earlier during market restraint. All four major types of private financial institutions reduced their net VA mortgage acquisitions during 1956 following the return to tightened capital market conditions in early 1955. As is evident from quarterly data, commercial banks reacted most promptly to the market change, beginning their reduction after mid-1955 (Chart 19). Mutual savings banks and life insurance companies, allowing for seasonal movements, waited to reduce their acquisitions until the first quarter of 1956. For mutual savings banks, the reduction in VA mortgage lending during 1956 was in contrast to their expansion during the earlier 1951–1953 period of general capital market stringency. It stemmed from—among other things—their built-up mortgage portfolio position and the high yields of other capital market securities. For savings and loan associations, the reduction reflected an adjustment from overcommitted positions and their reaction to pressures for restraint applied by the Federal Home Loan Banks.

The reduced availability of VA mortgage funds from private lenders during 1956 together with liberalized provisions for FNMA's purchase of mortgages led to a reversal of its policy after several years of reduced activity. Its increased participation in the VA loan market was both absolute and relative. Net purchases rose steadily from the mid-1955 low to a new record annual rate of over $800 million in the fourth quarter of 1956. FNMA's share of the VA market rose to over one-fifth to become larger than that of savings and loan associations and commercial banks.

A similar expansion occurred in FNMA's participation in the FHA home mortgage market during 1956, as private lenders withdrew from that market. Net purchases increased from an annual rate of minus $4 million in the last quarter of 1955 to a near record annual rate of plus $220 million one year later. Its one-fourth share of the net flow of FHA home mortgages in 1956 was exceeded only by the one-third share of mutual savings banks. In earlier post-1950 years of mortgage market contraction and expansion, the absolute and relative participation of FNMA in the FHA market was rising and falling in almost the reverse pattern of its participation in the VA market, to be seen by comparing Charts 19 and 20.

The varied pattern of FNMA market support is related to differences in the participation of private lenders in VA and FHA markets. The decline in net acquisition of FHA home mortgages by life insurance companies and commercial banks between 1950 and 1953 was accompanied by a decline in the net FHA mortgage flow from mutual savings banks and from savings and loan associations through 1952. In contrast, it will be recalled that in VA markets the last two types of institutions were increasing their acquisitions, while the first two were retrenching. Throughout 1954, only commercial banks increased significantly their FHA home mortgage flows (Chart 20). In the same year, the flow of institutional funds into VA mortgages, without exception, showed a big increase. Continued easing in capital markets finally brought increases in the flow of FHA funds from all types of financial institutions during 1955 to peaks almost coincidental with peaks in the flow of VA mortgages. Later declines through 1956, after the return to capital market stringency, also closely paralleled developments in VA lending activity of institutional lenders.

The differences in lender participation in VA and FHA loan markets clearly suggest differences in loan availability and in lender attitudes towards VA and FHA mortgages. Savings and loan associations have a long history of aversion towards FHA loans, as previously noted, but not carried over to VA loans. For mutual savings banks the uninterrupted rise in VA loan acquisitions from 1951 through 1955 was based on higher yields available on out-of-state lending and greater demand by borrowers for VA than for FHA loans. Similar reasons were behind the decisive increase in life insurance company acquisitions of VA loans between 1953 and 1955, while their increase in acquisitions of FHA loans was only moderate. At that time, many life insurance company mortgage loan officers, according to information in personal interviews, would have been willing to acquire more FHA loans if available through their mortgage correspondents. Commercial banks have been active in FHA loan markets since the inception of the program, both as loan originators and ultimate investors. Their activity in those markets between 1951 and 1956 and in the VA markets was similar, rising and falling in response to changes in alternative investment opportunities and to changes in reserve positions resulting from Federal Reserve credit actions.

The steady expansion in annual conventional home mortgage flows through periods of both market stringency and ease during 1951–1955 and the subsequent decline in 1956 were owing in large part to the activities of savings and loan associations (Chart 21). The regularity of the declines in the fourth quarter of each year from 1953 through 1956 also clearly reflected changes in savings and loan association activity. Reasons for such seasonal changes were suggested earlier (p. 123). The unusually sharp decline in savings and loan mortgage flows in the fourth quarter of 1955 was due in part to restraining actions taken by the Federal Home Loan Bank Board (Chapter 3).

Changes in the volume of conventional home mortgage flows among the other three main types of financial institutions in the 1951–1956 period were generally considerably smaller than those in the volume of VA and FHA home mortgage flows. Mutual savings banks, in particular, committed a consistently small amount of funds to conventional home mortgages in the period while sharply expanding their participation in newly gained out-of-state VA loan markets. Yields on conventional mortgages available to savings banks in eastern markets were often not as attractive as yields on VA loans in noneastern markets. Moreover conventional loans were not readily available in savings bank states during much of the period. Life insurance companies, however, able to make conventional mortgage loans on a nationwide basis, took advantage of flexible interest rates on them by increasing their acquisitions when yields were rising, while reducing VA and FHA loan acquisitions. Thus, the net flow from life companies into conventional mortgages increased appreciably, 1951–1953 and 1955–1956, while the net flow into federally underwritten loans declined. For both life insurance companies and mutual savings banks, the quarterly flow of conventional mortgage funds fluctuated within a narrower range than federally underwritten mortgage flows did.

Except during 1952, commercial banks tended to expand and contract their conventional home mortgage flows along with movements in federally underwritten mortgage flows. On a quarterly basis, the expansion in conventional mortgage acquisitions from the low 1954 first-quarter level culminated in a second-quarter 1955 peak and a subsequent steep decline through the fourth quarter of 1956. This cycle was similar to that traced by VA and FHA flows. The similarity of commercial bank flow patterns into the various home mortgage markets suggests that those institutions tend to adjust their home mortgage portfolios as a whole in relation to other loans and investments. They are not as concerned as life insurance companies are, for example, with internal mortgage portfolio adjustments. The difference lies in the fact that commercial banks are not as strongly committed to mortgage investments as are life insurance companies through their correspondent organizations. The broad problem of mortgage lending policies and techniques of the main financial institutions is the subject of the next chapter.