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Volume Author/Editor: Saul B. Klaman

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Chapter Author: Saul B. Klaman

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6. SHORT-TERM MOVEMENTS IN USES AND SOURCES OF FUNDS, 1953-1955

Quarterly data on the financial structure of selected mortgage companies were obtained in a special survey made for this study (see the second part of the appendix). While subject to some shortcomings usually associated with a mail questionnaire survey, the data are nonetheless useful as guideposts of short-run changes in uses and sources of funds during a period encompassing both stringency and ease in capital markets. The dollar volume and composition of assets and liabilities of responding mortgage companies is shown in Tables 27 and 28. The substantial agreement in the composition of resources for corresponding dates between the selected mortgage companies that reported quarterly data and the much larger number reporting annual data to FHA is seen by comparing Tables 20 and 28.[29] The close relationship between mortgage loans, notes payable, and total assets for both groups of companies is apparent also from a comparison of Charts 6 and 9.

The quarterly movements shown in Chart 9 reflect both changes in capital market conditions and the basic nature of mortgage company operations. During the first two quarters of 1953, the volume of mortgage inventory changed little as capital markets were under strong pressure from Federal Reserve restrictive actions and from persistent private demands for capital. The level of holdings showed little further change in the second half of 1953 when the market eased slightly, and interest rates generally declined. From the beginning of 1954 on, as investors became increasingly active in mortgage markets in a framework of continuing credit ease and declines in competitive interest rates, the growth in mortgage inventories held by companies was sharp and continued without interruption through the third quarter of 1955. The leveling off in the last quarter of 1955 reflected an earlier reduction in the rate of new investor commitments in a tightening capital market, and the sale of completed mortgages from inventory.

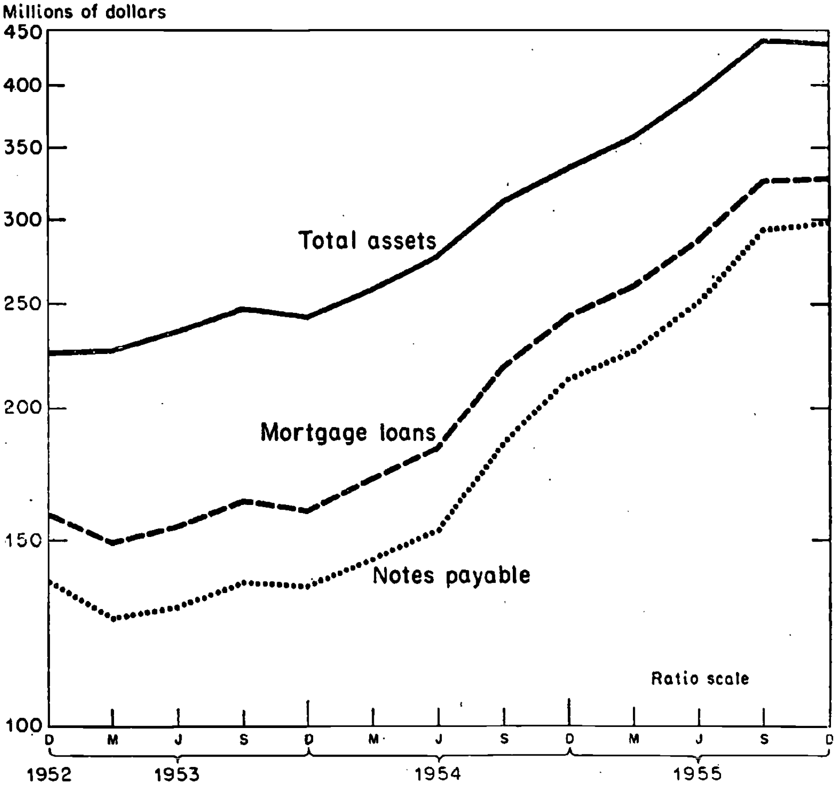
These movements in mortgage holdings are suggestive of time lags in

[29] For reasons noted in the second part of the appendix, the most appropriate comparison is between the September 30 figures for each year in Table 28 and the corresponding annual figures shown in Table 20.

CHART 9

Total Assets, Mortgage Loans, and Notes Payable of Sixty-six Mortgage Companies, Quarterly, December 31, 1952 through 1955

(end of quarters)



Source: Special survey of mortgage companies.

mortgage company activity following changes in capital market conditions. The most rapid rate of growth occurred after mid-1954, about a year after markets began to ease. In that period, institutional investors were increasing their allocations of funds and commitments for mortgages to mortgage companies. Most of these arrangements did not result in completed mortgages until the third quarter of 1954, when mortgage inventory increased sharply together with bank borrowing to finance the loan closings. Mortgage inventories and bank loans continued to expand at a somewhat faster rate than total assets through the end of 1955. This trend can be seen from Chart 9 but is probably somewhat clearer in Table 28, which shows an increase in the ratio of mortgage loans to

TABLE 27

Combined Quarterly Balance Sheet of Sixty-six Mortgage Companies, December 31, 1952 through 1955

(millions of dollars)

Balance Sheet Items	1952 Dec. 31	1953 Mar. 31	1953 June 30	1953 Sept. 30	1953 Dec. 31	1954 Mar. 31	1954 June 30	1954 Sept. 30	1954 Dec. 31	1955 Mar. 31	1955 June 30	1955 Sept. 30	1955 Dec. 31
1. Total assets	225.0	225.9	235.7	247.1	242.9	257.7	276.6	310.5	334.6	356.8	392.8	439.8	437.5
2. Cash (inc. escrows)	33.1	37.8	38.9	42.2	42.0	46.2	50.9	48.4	47.3	53.4	57.5	61.9	54.4
3. Mortgage & construction loans, total	158.0	149.4	154.1	162.9	159.8	171.3	182.5	218.0	243.4	259.3	286.4	325.0	327.3
4. Mortgage loans	129.6	121.7	126.2	131.2	128.4	140.5	142.0	170.3	185.3	195.2	219.8	257.9	265.7
5. Construction loans	28.4	27.7	27.9	31.7	31.4	30.8	40.5	47.7	58.1	64.1	66.1	67.1	61.6
6. Notes receivable	3.1	3.5	5.0	4.6	5.1	6.2	6.9	7.2	8.6	8.0	9.3	9.1	10.2
7. Accounts receivable	5.0	5.9	6.1	6.4	7.0	5.5	7.5	8.6	7.4	6.7	8.1	8.5	8.5
8. Other assets	25.8	29.3	31.6	31.0	29.0	28.5	28.8	28.3	27.9	29.4	31.5	35.3	37.1
9. Total liabilities & net worth	225.0	225.9	235.7	247.1	242.9	257.7	276.6	310.5	334.6	356.8	392.8	439.8	437.5
10. Escrows	21.3	27.9	31.5	33.6	27.8	34.2	40.2	39.3	33.0	39.2	45.8	49.1	39.5
11. Notes payable, total	136.7	126.9	129.8	136.5	135.9	143.8	152.6	184.0	212.6	225.8	250.9	292.6	298.0
12. To banks	130.8	123.1	124.3	129.1	130.5	137.8	146.1	177.8	207.3	219.7	244.6	284.4	290.3
13. To others	5.9	3.8	5.5	7.4	5.4	6.0	6.5	6.2	5.3	6.1	6.3	8.2	7.7
14. Accounts payable	5.5	4.6	5.6	5.5	7.4	6.4	7.4	6.9	5.6	7.0	6.9	6.6	7.4
15. Undisbursed mortgage loans	10.0	8.6	11.5	13.3	14.6	14.1	16.7	19.7	22.5	21.5	23.7	21.2	17.8
16. Other liabilities	14.9	18.7	18.1	18.1	17.0	17.2	15.9	16.3	17.3	16.7	19.1	20.4	24.6
17. Net worth	36.6	39.3	39.1	40.2	40.2	42.0	43.8	44.3	43.6	46.6	46.4	49.9	50.2

Source: Special survey of mortgage companies.

TABLE 28

Percentage Distribution: Combined Quarterly Balance Sheet of Sixty-six Mortgage Companies, December 31, 1952 through 1955

	1952	1953				1954				1955			
BALANCE SHEET ITEMS	Dec. 31	Mar. 31	June 30	Sept. 30	Dec. 31	Mar. 31	June 30	Sept. 30	Dec. 31	Mar. 31	June 30	Sept. 30	Dec. 31
1. Total assets	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
2. Cash (inc. escrows)	14.7	16.7	16.7	17.1	17.3	17.9	18.4	15.6	14.1	15.0	14.6	14.1	12.0
3. Mortgage & construction loans, total	70.2	66.1	65.4	65.9	65.8	66.5	66.0	70.2	72.8	72.7	72.9	73.9	74.8
4. Mortgage loans	57.6	53.9	53.5	53.1	52.9	54.6	51.3	54.8	55.4	54.7	56.0	58.6	60.7
5. Construction loans	12.6	12.2	11.9	12.8	12.9	11.9	14.7	15.4	17.4	18.0	16.9	15.3	14.1
6. Notes receivable	1.4	1.6	2.1	1.9	2.1	2.4	2.5	2.3	2.6	2.2	2.4	2.1	2.4
7. Accounts receivable	2.2	2.6	2.6	2.6	2.9	2.1	2.7	2.8	2.2	1.9	2.1	1.9	1.9
8. Other assets	11.5	13.0	13.4	12.5	11.9	11.1	10.4	9.1	8.3	8.2	8.0	8.0	8.5
9. Total liabilities & net worth	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
10. Escrows	9.5	12.3	13.4	13.6	11.5	13.2	14.5	12.7	9.9	11.0	11.7	11.2	9.0
11. Notes payable, total	60.7	56.2	55.0	55.2	55.9	55.8	55.2	59.3	63.5	63.3	63.9	66.6	68.1
12. To banks	58.1	54.5	52.7	52.2	53.7	53.5	52.8	57.3	61.9	61.6	62.3	64.7	66.3
13. To others	2.6	1.7	2.3	3.0	2.2	2.3	2.4	2.0	1.6	1.7	1.6	1.9	1.8
14. Accounts payable	2.5	2.0	2.4	2.2	3.0	2.5	2.7	2.2	1.7	2.0	1.7	1.5	1.7
15. Undisbursed mortgage loans	4.5	3.8	4.9	5.4	6.0	5.5	6.0	6.3	6.7	6.0	6.0	4.8	4.1
16. Other liabilities	6.6	8.3	7.7	7.3	7.0	6.7	5.8	5.2	5.2	4.7	4.9	4.6	5.6
17. Net worth	16.3	17.4	16.6	16.3	16.6	16.3	15.8	14.3	13.0	13.0	11.8	11.3	11.5

Source: Table 27.

total assets from 66 to 70 per cent between June 30 and September 30, 1954, and to 75 per cent on December 31, 1955.

While the rates of change in mortgage company assets and mortgage inventories varied considerably between quarters, a rather definite seasonal pattern of operations is suggested by the data. As shown in Table 29, the rate of growth in total assets, mortgage loans, and notes payable tended to be successively larger through the first three quarters of each year and to decline in the fourth quarter. The greater rate of increase in the third quarter of 1954 compared with the other years is a reflection of the abrupt change in capital markets between mid-1953 and mid-1954, noted above. Further, the continued large increase in the fourth quarter of 1954 was undoubtedly the result of the unusually heavy buildup of commitments in earlier months of that year.

TABLE 29

Quarterly Percentage Changes in Total Assets, Mortgage Loans, and Notes Payable of Sixty-six Mortgage Companies, 1953-1955

END OF QUARTER	*Total Assets* (1)	*Mortgage and Construction Loans* (2)	*Notes Payable* (3)
1953			
March 31	0.4	−5.4	−7.3
June 30	4.3	3.1	2.3
Sept. 30	4.8	5.7	5.2
Dec. 31	−1.7	−1.9	−0.4
1954			
March 31	6.1	7.2	5.8
June 30	7.3	6.5	6.1
Sept. 30	12.3	19.5	20.6
Dec. 31	7.8	11.7	15.5
1955			
March 31	6.6	6.5	6.2
June 30	10.1	10.5	11.1
Sept. 30	12.0	13.5	16.5
Dec. 31	−0.5	0.7	1.8

Source: Special survey of mortgage companies.

The peaking of growth in mortgage inventory in the third quarter of each year results from the nature of the relationship between mortgage companies and institutional investors, and the seasonal nature of building activity. Financial institutions, especially life insurance companies dealing regularly with mortgage companies, usually make their allocations and commitments for mortgages early in each calendar year. Arrangements to finance residential construction and sales are then made by mortgage companies. The houses and permanent mortgages are not completed or delivered until several months later. As mortgages are closed on houses finished and sold, the temporary mortgage inventories held by mortgage companies increase at an accelerating rate to a peak rate in the third quarter. By the fourth quarter of the year, the rate of building and of completing new mortgages slows down, while mortgages already completed and processed are taken up by permanent investors, with a resulting decline or a slowing down in the rate of increase in mortgage companies' inventories. The close relationship between quarterly rates of growth in mortgage inventory and bank borrowing to finance such inventory is evident in Table 28.

There is little reason to expect any similarity of movement during the year or a consistent relationship between total home mortgage debt and mortgage debt held by mortgage companies, and none seems to be indicated by a comparison of columns 1 and 2 of Table 30. Changes in total home mortgage debt reflect the combined actions of several different types of institutions and of individuals acquiring mortgages generally for permanent investment rather than short-term inventory. As market conditions changed, the quarterly peak rate of growth in total home mortgage debt shifted from the second quarter in 1953 to the fourth quarter in 1954, and back to the second quarter in 1955; but this did not alter the seasonal pattern of mortgage companies' inventory holdings.

There does, however, appear to be a definite complementary relationship between growth in mortgage company inventories and in mortgage holdings of life insurance companies, which predominate in purchases of mortgage loans from mortgage companies. As indicated in columns 3 and 4 of Table 30 the greatest increase in life insurance company mortgage holdings occurs consistently in the fourth quarter of each year, reflecting chiefly acquisitions of VA-guaranteed mortgages. The clear implication is that the rate of growth in mortgage company inventories declines sharply in the fourth quarter of each year as life insurance companies increase the rate of their acquisitions of federally underwritten mortgages, especially, the chief market interest of mortgage companies.[30]

[30]Figures on gross mortgage acquisitions by life insurance companies are, of course, a more direct measure of market activity but were not used in Table 30 because no comparable quarterly figures exist for other institutions. Actually, examination of the gross acquisitions figures for the years 1953-1955 indicates that the largest volume of mortgages was acquired by life insurance companies in the fourth quarter of each year, bearing out the above analysis based on net acquisitions data.

TABLE 30

Quarterly Percentage Changes in Mortgage Inventory of Mortgage Companies and in One- to Four-family Mortgage Debt Outstanding, 1953-1955

END OF QUARTER	*Change in Mortgage Holdings of Mortgage Companies* (1)	Change in 1- to 4-Family Mortgage Debt: Total (2)	*Held by Life Insurance Companies*: Total (3)	*Held by Life Insurance Companies*: VA-guaranteed (4)
1953				
March 31	–5.4	2.7	2.9	0.7
June 30	3.1	3.7	2.9	0.9
Sept. 30	5.7	3.3	2.8	1.6
Dec. 31	–1.9	2.7	3.2	3.2
1954				
March 31	7.2	2.2	2.7	3.6
June 30	6.5	3.4	3.3	5.5
Sept. 30	19.5	4.0	3.5	7.8
Dec. 31	11.7	4.2	4.6	10.7
1955				
March 31	6.5	3.8	3.6	7.3
June 30	10.5	4.7	3.5	6.3
Sept. 30	13.5	4.1	3.5	5.2
Dec. 31	0.7	3.3	5.4	9.0

Column 1 is from col. 2 of Table 29. Columns 2, 3, and 4 are from various issues of the *Federal Reserve Bulletin,* for example, May 1956, pp. 490 and 491.

7. CONCLUDING COMMENTS

The modern mortgage company is a financial institution not quite like any other on the American capital market scene. Its functions are similar, in a way, to those of the municipal bond dealer and the corporate securities underwriter, who act as intermediaries between borrowers and lenders and carry temporary inventories with the help of short-term bank credit. They are similar, in other ways, to those of sales finance companies which rely heavily on commercial bank and other external financing to extend consumer credit, and carry large inventories of net receivables. The mortgage company is unlike these institutions, however, in that it operates largely on the basis of prior commitments from financial intermediaries, and originates loans primarily to obtain accounts for servicing mortgages. It thus maintains a close and continuing relationship with institutional investors which has no counterpart among other types of institutions.

This study establishes that the remarkably rapid postwar growth of mortgage companies has been closely associated with the introduction and expansion of federal mortgage insurance and guaranty programs. Between three-fourths and nine-tenths of mortgage loans closed by mortgage companies in each of the years 1953 through 1955 were VA-guaranteed or FHA-insured. Clearly, the future pattern of mortgage company development and growth will depend heavily on the future course of these federal credit aid programs. Efforts by mortgage companies to expand their conventional loan business might be blunted by legal restrictions on out-of-state operations of financial intermediaries, by competition from local lenders traditionally engaged in this type of operation, and by numerous problems in conducting a conventional loan business for investors at a distance and in attracting investors to it.

Among major types of financial intermediaries, only life insurance companies and mutual savings banks deal extensively with mortgage companies, and the banks are subject to geographic restrictions on their conventional mortgage lending activities. The already great dependence of mortgage companies on life insurance companies, therefore, would undoubtedly increase with an increased proportion of conventional lending. It is unlikely that mortgage companies could find increased outlets for conventional loans among commercial banks and savings and loan associations, typically competing in origination of loans rather than purchasing them from mortgage companies. In any case, savings and loan associations are also subject to geographic lending restrictions. Even among life insurance companies, many might be reluctant to expand their out-of-state conventional mortgage investments materially because of the lack of uniformity in mortgage contracts and in state statutes, the generally greater exposure to loss in case of default or foreclosure, and the need for closer examination and supervision of properties pledged. On the other hand, the experience and techniques developed by mortgage bankers in the origination of federally underwritten mortgages may be successfully adapted to conventional mortgage lending. A few mortgage companies already carry on a large volume of conventional mortgage origination and servicing for investors. In the final analysis, any significant expansion of conventional mortgage business by mortgage companies will depend on the ability and willingness of investors to increase their activity in this area, and of borrowers to adjust to the more restrictive conventional mortgage loan terms.

In any event, the likelihood that the role of the federal government in mortgage and housing markets will diminish significantly in the years ahead is not very great. Recent counter-cyclical policy has relied heavily on adjustments in federal housing and mortgage programs. Mortgage insurance under FHA is among the earliest and most basic federal aids in the field of real estate finance. It is now deeply entrenched in the American real estate scene and is likely to continue as a basic part of domestic economic policy independent of political events.

The more recently introduced VA-guaranty program for veterans of World War II has already been extended twice beyond its original expiration date of July 1957. Whether or not it will be allowed to terminate in 1960 as now scheduled, or at some subsequent date, will depend in large part upon prevailing economic conditions. Moreover, the Korean VA loan program is established until early 1965. Several million veterans remain eligible for loans under both programs.

While it is clear that the potential flow of mortgage funds under federally underwritten programs is large, it seems equally clear that this flow will continue to fluctuate widely so long as the federal government continues its policy of maintaining relatively inflexible interest rates on VA and FHA mortgages. The postwar record plainly indicates that alternate shifts between ease and stringency in Federal Reserve monetary policy and in capital market conditions have been accompanied by exaggerated swings in federally underwritten mortgage flows. These swings have been coincident with a widening and narrowing of the spread between the relatively stringent interest rates of VA and FHA contracts and the flexible yields of corporate bonds. The flow of conventional mortgage funds, on the other hand, has fluctuated only narrowly as private lenders have been free to adjust interest rates to changing financial conditions.

So long, therefore, as mortgage companies continue to concentrate their activities in federally sponsored mortgages, they will be particularly vulnerable, compared with other types of financial institutions, to changing financial conditions and to unpredictable federal statutory and administrative changes.