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Volume Author/Editor: Miles L. Colean

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Chapter Author: Miles L. Colean

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CHAPTER 6

The Expansion of Federal Influence

THE passage of the Federal Reserve Act in 1913 marked the end of a period in which it was considered that the requirements of real estate finance (and particularly of farm finance) could be attained by general banking and currency reform. In spite of a number of concessions to the agrarian interest,[1] the Federal Reserve Board was hardly established when there were demands for special credit facilities to assure lower interest rates and a more ample supply of credit for farmers.

The main pressure for creating new financing institutions concentrated on the federal government, although a few states undertook similar experiments. For instance, during and soon after World War I, Minnesota and South Dakota established specialized institutions—wholly capitalized and wholly owned by their governments—for making farm loans.[2] These, however, were quite apart from the main current. They set no precedent, and they rapidly sank into the background with the growth of a new federal system.

FEDERAL LAND BANK SYSTEM

Several years of official study and discussion resulted in the passage of the Farm Loan Act in 1916 [3] and the establishment of the Federal Land Bank System. The original characteristics of the System are well described by Sparks: [4] "These new land banks were a distinct departure from earlier land bank schemes in this country. They are entirely divorced from commercial banking and currency schemes, and are purely investment banks, attracting loaning funds

1 Such as the elimination of banker representation on the Federal Reserve Board, the provision that all notes of issue be governmental obligations, and the favored status given to farm paper.

2 Earl S. Sparks, *History and Theory of Agricultural Credit in the United States* (New York, 1932) Chapter 15. In addition to these institutions, many state endowment and pension funds were permitted, or directed, to lend money on the security of real estate mortgages (*ibid.*, Chapter 14).

3 39 Stat. 360 (1916); 12 U.S.C. 641.

4 E. S. Sparks, *op. cit.*, p. 115.

by the sale of bonds based on first mortgages and loaning only on first mortgages."

The new Land Bank System also differed significantly from the contemporary state land banks in that it was designed to be private in so far as sources of funds and managerial policies were concerned. The governmental function, in the initial concept, was limited to aid in organization, temporary financial support, and general supervision. This original concept was later modified because of failure to obtain sufficient capital from private sources to permit early withdrawal of government support and because of the unexpectedly prolonged farm depression following World War I, which brought demands for new functions and policies that appeared to be incompatible with private investment. Nevertheless, the cautious nature of the first interventionary step of the federal government and the prolonged discussion that preceded it are especially striking in view of the successively more drastic measures which were later adopted with progressively decreasing opposition.

The Land Bank System, as first organized, was placed under the jurisdiction of the Treasury and made subject to the immediate supervision of a Farm Loan Board. The Board included the Secretary of the Treasury and four members (later six) appointed by the President, one of whom was designated executive officer of the Board with the title of Farm Loan Commissioner (later Land Bank Commissioner). Salaries and expenses of the Board and of farm loan registrars (one for each land bank) were paid by the federal government. Subsequent reorganization (1933) placed the System in an independent agency, the Farm Credit Administration, and substituted for the Board a single administrative officer with title of Governor. In 1939 the Farm Credit Administration, including the Land Bank System, was transferred to the Department of Agriculture.[5]

From the start, the System has consisted of twelve regional federal land banks. The banks were authorized to obtain funds by issuing stocks and bonds (the bonds were exempt from federal and state income taxes until 1941) and to make first mortgage loans to local cooperative borrower organizations known as national

[5] Donald C. Horton, Harold C. Larsen and Norman J. Wall, *Farm Mortgage Credit Facilities in the United States,* Department of Agriculture, Misc. Pub. 478 (Washington, 1942) Chapter 6.

farm loan associations, or to farmers directly or through authorized agents in areas where no such privately capitalized association had been chartered. Originally, land bank loans were required to be for land purchase or productive purposes. Later, as credit became more stringent during the depression of the 1930's, the range of eligibility was broadened to include loans for refunding debt and even for current expenses.[6]

As evidence of the original emphasis on the private character of the System, six of the nine directors of each of the land banks were to be chosen by the local farm loan associations, the others being appointed by the Farm Loan Board, the governing body of the System. A change in attitude toward a more dominant governmental influence occurred in 1923 when the number of locally selected directors was reduced to three and, of the seven-man Board, four were named by the Farm Loan Board.[7] The abolition of the Board in 1933 with the substitution of a single governor and the subordination of the governor to the Secretary of Agriculture in 1939 carried the concentration of government influence still further.

When the Land Bank System was created, the Secretary of the Treasury was required to subscribe to all capital stock in the regional banks not taken up by the public within thirty days. Since little public subscription was made, the great bulk of the banks' initial capital represented governmental rather than private investment. There was a gradual but continuous increase in the amount of stock subscribed by the member institutions of the System until, by the end of 1931, the federal stock investment had been almost retired and nearly all the federal land bank stock was held by national farm loan associations and direct borrowers. During the depression of the thirties, however, there was a new infusion of federal funds. In 1940, as recovery came, the Treasury holding had been reduced from its peak of $125 million to a little over $67 million; but, by 1943, in order to assist the wartime expansion of

[6] *Ibid.*, pp. 79, 83-85. The direct loan provisions were not much used. The land banks were also authorized to charter and supervise joint stock land banks, privately capitalized farm mortgage institutions authorized to issue tax-exempt bonds at a ratio to capital and surplus of 15 to 1. The joint stock land banks operated for seventeen years, until their liquidation was brought about by the Emergency Farm Loan Act of 1933 (*ibid.*, Chapter 8).

[7] *Ibid.*, pp. 70-71.

agriculture, the government again increased its investment to $120 million.[8] During the high farm-yield years of World War II, reduction was again resumed, and by the middle of 1947 the last of the federal capital was retired.[9]

In addition to the government support rendered by direct capitalization, the Secretary of the Treasury was also authorized to subscribe to the paid-in surplus and to buy the bonds of the banks, thus leaving no phase of the financial operation without governmental participation. Because, at the outset, questions of constitutionality discouraged the purchase of the land bank issues by the public, the Treasury was authorized to purchase the bonds during the years 1918 and 1919 and subsequently also during 1920 and 1921 up to a total of $200 million. Although the doubt was resolved in favor of the land banks in 1921,[10] the Treasury continued to be a substantial holder of land bank bonds through the early 1920's and did not liquidate its holdings until 1926. Land bank bonds were also made eligible for purchase by the Federal Reserve banks, which have acquired them only on a few occasions and held them only for short periods of time. In addition, short-term loans to the land banks have also been made by the Reconstruction Finance Corporation. Subscriptions by the Treasury to paid-in surplus of land banks (authorized in 1931) represented another substantial form of support, amounting as late as 1943 to more than $142 million.[11]

The retirement in 1947 of the federal capital and paid-in surplus put the Land Bank System—so far as its ownership was concerned—in a position comparable to the Federal Reserve System. In spite of this withdrawal—unique in the annals of federal intervention—the continued power to appoint all land bank officials combined with the general authority of the Secretary of Agriculture over the Farm Credit Administration left the Land Bank System completely under governmental influence.[12]

8 *Statistical Abstract of the United States, 1944-45,* p. 374.

9 *The Fourteenth Annual Report of the Farm Credit Administration, 1946-47.*

10 Smith v. Kansas City Title and Trust Co., 255 U.S. 180 (1921), based on Section 8 of the Constitution. See Edward S. Corwin, *The Constitution and What It Means Today* (Princeton, 1940) pp. 29-30.

11 D. C. Horton, et al., *op. cit.,* pp. 79-80, and 82. In June 1947, the Treasury was reimbursed for the last of its outstanding contribution to paid-in surplus (*Statistical Abstract of the United States, 1948,* p. 449).

12 The Hope Bill of 1947 would again have modified the organization by placing

The significant feature in the Land Bank System was the direct use for the first time of federal funds for capital and paid-in surplus. The early provision for Treasury purchases of the land bank bonds was also significant, since it temporarily gave the System a quasi-central banking support rather similar in effect, if not in form, to the facilities given to commercial banking through the Federal Reserve System,[13] and led the way to other kinds of public support in later emergencies.

Beginning of Intervention in Urban Realty Finance—The Home Loan Bank System

Widespread public awareness of an urban housing problem was first brought about, following World War I, by high costs, high rents, and tight credit. The state of New York at that time made its first experiments with tax exemption as an inducement to house-building activity. Wisconsin enabled municipalities to lend funds to housing corporations. The North Dakota legislature empowered the state to engage in home building. California made state funds available for home loans to veterans.[14] Suggestions for modifications of the federal income tax on mortgage interest and profits on home-building operations were offered.[15] In the main, however, the approach to the problem was through the credit system.

New York led the way with the creation in 1915 of the Land Bank of the State of New York (later changed to the Savings and Loan Bank of the State of New York).[16] This bank offered a reservoir of credit, created by, and available to, the savings and loan associations of the state. During the period between World War I and the depression, institutions of a somewhat similar character were established in other states, notably California, Florida, Massachusetts, and Ohio.[17]

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the System under an Agricultural Credit Agency, separate from the Department of Agriculture and directed by a seven-man Agricultural Credit Board; but this measure (H.R. 1677, 80th Congress) was not passed.

13 See Donald C. Horton, *Interwar Credit Aids Associated with Farm Ownership and Operation,* Department of Agriculture (Washington, mimeographed, 1945) p. 17.

14 *Housing Problems in America,* Proceedings of the Eighth National Conference on Housing, 1920, pp. 323-24.

15 For instance, S. 2094, 66th Congress.

16 *History of Building and Loan in the United States,* Morton Bodfish, ed. (U. S. Building and Loan League, Chicago, 1931) p. 506.

17 Report of the Liquidity Committee of the New Jersey Building and Loan League, 1931.

Pressures created by the post-World War I housing problem soon made themselves felt on Congress. In this connection it should be noted that, despite the wartime experience of the federal government with government-owned housing, no serious effort was made to maintain this type of activity. In fact the liquidation of its housing, which was ordered immediately after the war, indicated the desire of the government to divest itself of this responsibility.[18] When the pressure for aid was reasserted, it was in the form of demands for improved credit facilities rather than for direct action in the field of construction.

The first of these proposals called for the discount of home mortgages by the Federal Reserve banks and for the expansion of the Land Bank System to cover urban as well as farm mortgages, but it met with successful opposition.[19] During the 1920's and early 1930's, bills were repeatedly introduced in Congress calling for the establishment of a central mortgage bank, with power of loan and discount,[20] but support for these proposals was not widespread. The less ambitious home loan bank plan took precedence and, in the subsequent wave of depression legislation, the idea of a central mortgage bank quietly succumbed.

The earliest discussions of a federal home mortgage credit system came in 1918 and were followed a year later by the introduction of the first bills on the subject.[21] However, interest in federal action waned as the postwar expansion developed and was not revived until after 1928 when serious weaknesses in the mortgage situation had begun to appear. Following a widely publicized *Conference on Home Building and Home Ownership* called by President Hoover in 1931, a bill to create a Federal Home Loan Bank System was introduced and, speeded by the already apparent realty collapse, was passed in 1932.[22] The System was established in the same year.

18 See Miles L. Colean, *Housing for Defense* (The Twentieth Century Fund, New York, 1940) Chapter 1.

19 M. Bodfish, *op. cit.*, pp. 207 ff.

20 For instance, H.R. 10518, 66th Congress; H.R. 8049, 68th Congress; S. 4310, 68th Congress; S. 3013, 70th Congress.

21 S. 1469, S. 2492, H.R. 6371, H.R. 7597, all 66th Congress.

22 Federal Home Loan Bank Act, 47 Stat. 725 (1932); 12 U.S.C. 1421 *et. seq*. The Conference had other less immediate, but in many ways more far-reaching, effects than the passage of the Home Loan Bank Act. The beginning of the present widespread public interest in slum clearance, public housing, limited dividend and co-

The new System followed the pattern of the Federal Reserve System and the original Federal Land Bank System in that it had a central governing board appointed by the President and a group of regional banks. These federal home loan banks were authorized to make loans to member institutions, which might be any state-chartered institution (savings and loan association, savings bank, or insurance company) engaged in placing mortgages on houses and small buildings.[23]

As in the case of the land banks, Treasury stock subscriptions were used in launching the System, with the great bulk of initial capital coming from this source. In spite of the introduction of numerous bills for the purpose, however, the Treasury, through 1949, had not been authorized to purchase home loan bank bonds, as it had with respect to land bank bonds. Nor were any federal contributions made to the paid-in surplus of the home loan banks. Notwithstanding these differences, the Home Loan Bank System has continued to be strongly influenced by the federal government in administration and financing.[24]

Impact of the Depression

Neither the Federal Land Bank System nor the Federal Home Loan Bank System was able to cope effectually with the flood of foreclosures that swept over the nation in the early thirties. Far-reaching governmental action was taken, and the next decade and a half saw developments that completely altered the relationships between government and the public, government and lending institutions, and lending institutions and the public.

The developments were almost wholly federal in character, al-

operative housing companies, "large-scale" housing operations, neighborhood planning, and housing for minority groups, may be traced to the reports of Conference committees. These reports were published in eleven volumes under the title *President's Conference on Home Building and Home Ownership* (Washington, 1931).

[23] Membership has been almost wholly confined to state- or federally-chartered savings and loan associations.

[24] According to the *Statistical Summary, 1949,* issued by the Home Loan Bank Board in May 1949, government stock in the home loan banks at the end of 1948 amounted, for the first time, to less than half the total (49.7 percent). The actions of the Home Loan Bank Commissioner in 1945 in disapproving the election of the President of the Los Angeles Bank and the forced merger of the Los Angeles and Portland Banks, whatever the merits of the cases, indicate the extent of the power claimed and exercised by the federal authority. (See U. S. Congress. House. Hearings Before the Select Committee to Investigate Acts of Executive Agencies Which Exceed Their Authority, Washington, 1947, 79th Congress, 2nd sess., June 12-14, 1946.)

though there was state legislation designed to relieve mortgage debtors.[25] While these state relief measures were often more drastic than in earlier years, the pattern was not substantially changed. The effect of state action was, at best, only temporarily and partially alleviative; its deeper import was negative and aggravating, for the balance of the law, now so strongly tipped in the debtor's favor, threatened to block recovery.

In this situation, the federal government's initial measures were designed to make foreclosure unnecessary by refinancing delinquent mortgage loans on farm and home property. Under the Emergency Farm Mortgage Act of 1933 [26] (and later amendments to the Federal Farm Loan Act), the rate of interest on land bank loans was successively reduced, reaching a minimum of 3.5 percent between July 1, 1940 and July 1, 1944, with the Treasury paying to the land banks the difference between the rate so established and the contract rate—the first appearance of outright subsidy in a federal credit mechanism.[27] The Emergency Farm Mortgage Act also permitted a five-year moratorium after March 4, 1933 on principal payments on the outstanding land bank loans if the borrower was not in default on any other covenant of the mortgage. The interest subsidies were not ended until 1942.[28]

Under the same act, the Land Bank Commissioner, from a $200 million fund made available by the Reconstruction Finance Corporation, was empowered to make farm mortgage loans not to exceed $7,500 but up to 75 percent of value (as against 50 percent for the land banks) to refinance indebtedness, provide working capital, and redeem foreclosed property. An additional $100 million was made available to the Commissioner for loans to joint stock land banks of which one-fourth was reserved for facilitating a two-year postponement of foreclosure of delinquent loans.[29]

This activity was superseded by the Federal Farm Mortgage Corporation (created by the Federal Farm Mortgage Corporation

25 See Chapter 3.

26 48 Stat. 48 (1933); 12 U.S.C. 1016.

27 From mid-1944 to mid-1945 the maximum interest rate to farmer-borrowers was set at 4 percent and, thereafter, at 1 percent more than the interest rate on land bank loans to national farm loan associations.

28 D. C. Horton, et al., *op. cit.*, p. 86. A deferment of principal payments on new loans was later authorized for the first three years of the loan.

29 *Ibid.*, pp. 109-10.

Act of 1934)[30] to which the funds of the Land Bank Commissioner were transferred to provide the capital stock of the Corporation. In addition to the authority inherited from the Land Bank Commissioner, the Corporation was empowered to assist in financing the land banks through an exchange of bonds. It was authorized to issue $2 billion in bonds, fully guaranteed as to principal and interest. The same interest subsidies were made available to loans of the Land Bank Commissioner and the Federal Farm Mortgage Corporation as were provided for land bank loans.[31]

The actions taken in connection with farm credit were paralleled in the field of urban mortgage finance. In 1933 the Home Owners' Loan Corporation (wholly capitalized by the federal government) was established under the directorship of the Home Loan Bank Board.[32]

This, the second credit institution to be wholly owned and wholly operated by the federal government, was granted a capitalization of $200 million and an ultimate loan authorization of $4.75 billion to be used for taking over and refinancing mortgages on one- to four-family dwellings that were either delinquent or held in frozen lending institutions.[33] The debentures of the Corporation were given a Treasury guarantee first for interest and later (when the bonds could not be sold at par) for principal also.

The RFC Mortgage Company, a wholly owned subsidiary of the Reconstruction Finance Corporation, was organized to assist in refunding defaulted mortgages on urban commercial property and, as a bank of last resort, to make new loans on such property. Later, this institution was used to provide support for various other federal mortgage financing activities such as the mortgage insurance of the Federal Housing Administration and the loan guarantees of the Veterans' Administration, by providing a market for mortgage loans made under the auspices of these agencies.[34]

30 48 Stat. 344 (1934); 12 U.S.C. 1020. See D. C. Horton, et al., *op. cit.*, Chapter 7, for description of the organization and activity of the Federal Farm Mortgage Corporation.

31 *Ibid.*, pp. 110-12.

32 The Home Owners' Loan Act, 48 Stat. 128 (1933); 12 U.S.C. 1461 *et seq.*

33 Ultimately $3.49 billion of the authorization was used. The HOLC stopped making new loans in June 1936, although lending for repair and refinancing continued. By December 31, 1948, outstanding loans had been reduced to $369 million, and only twenty foreclosed properties were still in the hands of the Corporation.

34 The RFC Mortgage Company was liquidated under 1947 amendments to the RFC Act; 61 Stat. 202 (1947).

While these operations were getting under way, the government was already concerning itself with other means of reopening and widening the channels of mortgage credit. Adapting the safety-fund device, which had a long history in New York and Massachusetts, Congress created the Federal Deposit Insurance Corporation, designed to insure depositors in state and national banks that became members of the Corporation against loss up to $5,000.[35] The federal government subscribed to somewhat more than 50 percent of the capital stock of the Corporation, the remainder being taken by the Federal Reserve banks, and the bonds of the Corporation were made purchasable by the RFC and the Treasury. Insurance premiums were set at a level expected to cover operating expenses and claims. Close on the heels of the FDIC came a similarly constituted institution for savings and loan associations—the Federal Savings and Loan Insurance Corporation[36] —with a $100 million capitalization wholly subscribed by the HOLC. In this case, bonds that might be issued by the Corporation were neither guaranteed nor purchasable by the Treasury.[37]

Both of these institutions played important parts in restoring public confidence in commercial banks and savings and loan associations and, indirectly, in overcoming the paralysis of the mortgage market. They reduced, although they could not altogether stop, the withdrawal of funds caused by fear and panic rather than cash needs. Through these means, they minimized further liquidation of mortgage loans and paved the way for a resumption of lending activity.

More direct methods, however, were considered necessary to encourage building and to increase the supply of funds for new lending. One means to this end, the recapitalization of the land banks, has already been mentioned. The act that established the HOLC also provided for the chartering of federal savings and loan

[35] The FDIC was created subject to the provisions of the Banking Act of 1933, 48 Stat. 168 and subsequent amendments, 12 U.S.C. 264.

[36] Created by Title IV of the National Housing Act, 48 Stat. 1246 (1934).

[37] It may be noted that, although in both instances the federal investment was assumed to be temporary, dividends were not paid on the Treasury or HOLC stock until 1947 nor were any plans for the retirement of the government stock seriously considered. In 1947, an act of Congress (61 Stat. 773) provided for the cancellation of the capital stock of the FDIC. A bill providing for gradual retirement of the capital stock of the Federal Savings and Loan Insurance Corporation was adopted by the House but died in the Senate. During 1949 no further action was taken.

associations in order to create new mortgage lending facilities for underserviced areas. Provision was also made for federalizing institutions already organized under state charter. The Treasury was authorized to subscribe up to 50 percent of the shares in any one federal association, with a total actual investment of $50 million. In 1935 the HOLC was authorized to purchase shares in federal associations or state associations that were members of the Federal Home Loan Bank System or of the FSLIC. The total share subscription by the Treasury and the HOLC came to a little over $261 million.[38]

Up to this point the Home Loan Bank Board had been the main focus for measures to stimulate nonfarm home finance. The home loan banks were subject to its supervision; and the chartering and examination of federal associations were in its jurisdiction. The members of the Board served also as directors of the HOLC and of the FSLIC. The National Housing Act of 1934, however, created a separate independent agency, the Federal Housing Administration, to give an impetus to new lending. This was to be accomplished by insuring private lending institutions against losses that might be incurred in connection with unsecured loans for repairs to real property and first mortgage loans on one- to four-family dwellings and larger rental housing properties.[39]

The repair loan plan was at first considered to be wholly for the emergency, with all expenses and claims paid directly by the government. As time went on, however, the original stimulative purpose of the plan was forgotten, and the repair loan insurance became in effect a permanent activity. The principal feature of the FHA scheme, both in concept and practice, was, however, the insurance of mortgage loans.

The idea itself was not new. Mortgage guarantee companies had flourished briefly and collapsed spectacularly in the years just past. But many features of the FHA plan were new. First was the initiation and support of the scheme by the federal government—support that involved the provision of initial insurance funds, payment of operating expenses in whole or in part for a five-year period, full

[38] Of the total amount of $261 million in Treasury and HOLC shares in insured institutions at the peak in 1938, only $6,093,000 (or 2.3 percent) remained outstanding as of December 31, 1947, according to the Home Loan Bank Board, *Statistical Summary, 1949,* Table 6.

[39] 48 Stat. 1246 (1934); 12 U.S.C. 1422 *et seq.*

Treasury guarantee of the principal and interest of the debentures issued in payment of claims, and provision of a secondary market for insured mortgages, first by The RFC Mortgage Company and later by the Federal National Mortgage Association.[40] The second innovation was the mutual character of the insurance. Examination fees and premiums were paid into the insurance fund (from which claims and operating expenses were paid) by the mortgagors, who shared in the ultimate proceeds, if any, of the particular accounts into which their loans were placed.[41] The third innovation was the substitution of long-term debentures (representing substantially the amount of the claim) for a cash payment in case of foreclosure.

As originally conceived, the FHA was to be merely an adjunct to the existing mortgage credit system, operated strictly on a pecuniary basis. While the credit under the plan was to be liberal, with loan-to-value ratios up to 80 percent, low interest payments, with amortization spread over twenty years for owner-borrowers (on one- to four-family houses) and longer for rental housing, risk was to be carefully measured and the terms of the loan patterned in accordance. Moreover, the plan was expected to become fully self-supporting as to payment of claims and operating expense out of fees and insurance premiums, an end accomplished after the first few years of operation.[42]

Once adopted and successfully operating, however, the insurance idea opened possibilities of federal intervention far beyond original contemplations. The first step in this process was taken in 1938 when, by insuring up to 90 percent the twenty-five-year mortgage loans on newly constructed houses valued at $6,000 or less, the insurance device was used as a means for directing credit into a specialized sector of the total market. The further uses to which

40 An institution organized in 1938 under Title III of the National Housing Act, with capital furnished by the Reconstruction Finance Corporation, 48 Stat. 1246 (1934); reconstituted by 62 Stat. 1206 (1948); 12 U.S.C. 1716 *et seq.*, familiarly referred to as "Fanny May," from the initials FNMA.

41 The first payment on these accounts was made in 1944. See the *Eleventh Annual Report of the Federal Housing Administration*, p. 8.

42 Although some income from fees and premiums had been used to pay operating expense prior to mid-1939, at that time all appropriations from public funds for that purpose ceased. Because of economic conditions prevailing during the period covered, claims, of course, have been light. The combined capital and operating reserves of all insurance accounts by the end of 1948 amounted to $200,369,176 (*Fifteenth Annual Report of the Federal Housing Administration*, p. 19).

the idea has been put, and the changes in the original business approach involved, will be reviewed in the following chapters.

SECONDARY IMPACTS OF THE DEPRESSION

Without doubt, the measures described above contributed to the moderation and reversal of the deflationary movement and also greatly augmented the sources of real estate credit. The latter was accomplished not only through the new lending agencies but also through the expansion of realty lending by existing institutions, particularly commercial banks and mortgage companies, as a result of FHA operations.[43]

Federal intervention, however, did not cease at this point. Two situations of profound significance had developed. First, through the HOLC, the Federal Farm Mortgage Corporation, and the numerous measures for direct relief, precedents had been established for granting federal aid to the individual in time of emergency—a term, as later discovered, capable of a wide range of definition. Second, the persistence of the depression brought to the fore social and economic inequities which were viewed as insoluble by the relatively unplanned processes of state and private action but capable of yielding to federal action. Since the best avenue of federal intervention lay in the monetary power in the Constitution, as broadly interpreted in the land bank decision, the forthcoming devices for coping with these situations were mainly financial in character. Unlike the facilities provided through the land banks, the home loan banks, and the FHA, which were broadly available to all applicants without distinction except as to their credit standing, the new approach concerned itself with special groups whose resources were so inadequate as to mark them for special aid and benefit. Of note are the operations of the Farm Security Administration, which brought aid to special groups of farmers and rural

[43] Mortgage companies, in particular, were assisted by the FHA program in increasing their market for selling mortgages, since FHA processing and regulations resulted in a relatively standardized transaction with security appraised as well as guaranteed by a disinterested governmental agency. These companies, which are generally not supervised by state or federal regulatory agencies, use a comparatively small fund of capital and borrowings for originating mortgage loans to be sold to long-term investors. These institutions found the market for their mortgages expanded from a local to a national scale when the purchasers could rely on the FHA guarantee rather than on their own investigations.

workers, and the United States Housing Authority, which had for its province special groups of urban tenants.

The Farm Security Administration grew out of the Emergency Relief Appropriations Act of 1935 [44] which, among other things, provided for "rural rehabilitation and relief in stricken agricultural areas" and included loans "to finance, in whole or in part, the purchase of farm lands and necessary equipment by farmers, farm tenants, croppers, or farm laborers." After a number of changes in policy and name, the FSA was established in the Department of Agriculture to carry out these functions as defined in the Bankhead-Jones Farm Tenant Act of 1937,[45] and as provided for in subsequent relief appropriation acts. Under the tenant purchase program, loans are made at 3.5 percent interest for forty years—terms much more liberal than are available in the private lending market; and in some cases payments for interest and principal may be mainly on the basis of a percentage of products sold.

Like the FSA, the USHA was an outgrowth of emergency measures taken early in the depression. RFC loans to limited dividend housing companies engaged in providing "low-rental" housing were provided for in the Emergency Relief and Construction Act of 1932.[46] Later this power was transferred to the newly formed Public Works Administration, where, due to a lack of borrowers who could meet the requirements of that agency, the loan facilities were dropped in favor of direct building operations. Under this plan, 45 percent of the investment was written off as an outright grant with the remainder to be recaptured from the rental income of the property over sixty years at 3 percent interest, title remaining in the federal government.[47] In this way "public housing," as it came to be known, was born; and at once pressure developed for a permanent and more generous means for providing new housing for underprivileged urban families.

In 1937, after the passage of the United States Housing Act,[48]

[44] 49 Stat. 115 (1935). See D. C. Horton, et al., *op. cit.*, Chapter 9.

[45] 50 Stat. 522 (1937); 60 Stat. 1072 (1946); 7 U.S.C. 1000-1006.

[46] 47 Stat. 709 (1932); 39 U.S.C. 277; 48 Stat. 351 (1934); 5 U.S.C. 796.

[47] The authority of the PWA to engage in housing operations came through the National Recovery Act of 1933, 48 Stat. 200-201 (1933); 40 U.S.C. 8, 402. See Miles L. Colean, *American Housing* (The Twentieth Century Fund, New York, 1944) pp. 276-77.

[48] 50 Stat. 888 (1937); 42 U.S.C. 1401 *et seq*. See Charles Abrams, *The Future of Housing* (New York, 1946) Chapter 20, for a complete description of the USHA and its methods of operation.

this function was placed in a new agency, the United States Housing Authority, subject to the general supervision of the Secretary of the Interior. Henceforth, construction, ownership, and operation of public housing properties were to be in the jurisdiction of specially constituted local housing authorities. The USHA was empowered to make loans to these authorities representing 90 percent of the cost and to pay annual subsidies which in effect might meet, or more than meet, the carrying charges on the loans. The municipalities were required to contribute annual amounts equivalent to 20 percent of the federal payments. Local contributions might be, and usually were, in the form of property tax abatements rather than of cash outlays.

As the plan developed, it was discovered that loans and annual payments from the federal government often provided a sufficient guarantee to permit local authorities to finance their housing projects by offering their own bonds at rates lower than those at which the federal government could borrow. This condition was made possible by the fact that local authority bonds were exempt from federal income taxes and resulted in a further federal subsidy in lost tax receipts. The initial legislation in 1937 authorized $800 million in loans and a maximum of $28 million a year in annual subsidies to finance these local public housing projects. The bulk of this had been contracted for at the outbreak of World War II.

Through these several means, the federal government discovered that credit could be used not only to better the living conditions of selected groups but also to accomplish social objectives not directly related to a financial transaction. A few examples will suffice for illustration. In connection with the farm loan agencies, it was found that credit might serve as a tool for broad agricultural policy. The subsidized urban housing program was used as a means of applying certain federal labor policies in strictly local situations.[49] The mortgage insurance program provided a means of directing credit in favored price ranges, and of imposing federally-prescribed standards for land planning, construction, and design upon the users of the system.

[49] Except on government construction contracts, payment of prevailing wages, application of wage-hour laws, barring of "kick-backs," prohibition of racial discrimination, etc., all were beyond the reach of the federal government because no interstate commerce factor was present. See C. Abrams, *op. cit.*, p. 273.

Impact of World War II

In 1940 economic conditions had improved sufficiently to dull the demand for further intervention and a trend toward withdrawal of the federal government's influence in realty finance was evident. And also in 1940, the Federal Land Bank System, with the government stock retired from the majority of the banks, gave indications of soon being self-sufficient. The Federal Home Loan Bank System at least held the hope of doing the same. The FHA was operating without further direct appropriations and showed a strong likelihood of continuing to be a self-sustaining institution. The Federal Farm Mortgage Corporation and the HOLC were being liquidated. The FSA was operating in a very restricted field. The USHA had practically reached its initial limits, and Congress had refused its insistent requests for an additional authorization.

The upsurge of war preparations early in 1941, followed by the concentration on war production late that year, violently reversed this trend. It was soon concluded that lending operations based on customary risk considerations would not supply the credits necessary for the industrial expansion and the related housing that were required to meet the demands of war. In many cases, manufacturing plants were built directly with government funds. In other cases, liberal credit was provided by a new RFC subsidiary, the Defense Plants Corporation.[50] While private institutions were not absent from the program, the bulk of the load was carried, one way or another, through federal activity. Government funds were appropriated (following the precedent of World War I) for temporary and permanent housing needed to shelter war workers.[51] Federal funds were also made available for "community facilities"—roads, sewers, water extensions, nursery schools, shopping centers, and the like.[52] In addition, a new part (Title VI) was added to the National Housing Act. This created a nonmutual insurance system (from which the concept of "economic soundness" was omitted) and provided a special fund for the purpose of insuring 90 percent mort-

50 Created August 22, 1940, under § 5d of the RFC Act, 15 U.S.C., § 606b.

51 These powers for the most part were conferred by the Lanham Acts, 54 Stat. 1125 (1940); 42 U.S.C. 1521.

52 The Second Lanham Act, 55 Stat. 361 (1941); 42 U.S.C. 1521, 1523.

gage loans on housing for war workers when the loans were made either to builders or home buyers by private lending institutions. Most of the privately built wartime housing was financed in this way.[53]

A year later, construction not directly related to the war effort was drastically curtailed through exercise of the war powers delegated to the War Production Board.[54] The field of mortgage credit operations was greatly narrowed and numerous imbalances were created. The sharp competition for loans that developed within the restricted market, as well as the forced buying of houses, as units were shifted from the controlled rental market to a free sales market, set loose unforeseen inflationary forces.

In 1942 the housing agencies of the federal government—the Federal Home Loan Bank Board, the FHA, the USHA (with name changed to Federal Public Housing Authority), and various warborn housing activities—were combined by executive order into a National Housing Agency.[55] To this new superagency was given a novel function which, though limited to wartime, had far-reaching future significance. This function was "programming," or determining the location, amount, price range, and proportion of rental to sales accommodations of all new residential construction to be undertaken, and the method—whether by public or private initiative—under which the construction was to be done.

Another significant aspect of this consolidation was the subordination of the peacetime mortgage credit agencies to a general supervision, for the purpose of accomplishing a specific social aim —the housing of war workers. In this environment, the credit system was simply an instrument, and its functioning was geared

53 Amendments to the National Housing Act, March 28, 1941, 55 Stat. 55. For individual houses for sale the maximum mortgage to which these provisions were applicable was $4,000 raised in 1942 to $5,400. In 1942 the Act was amended to provide insurance for 90 percent mortgage on rental housing properties, with a maximum mortgage of $1,350 per room. 56 Stat. 301 (1942).

54 Construction of virtually all kinds was required to have WPB approval under the terms of the famous conservation order "L-41," first issued April 9, 1942. Similar action had been taken during World War I. See Bernard M. Baruch, *American Industry in War* (New York, 1941).

55 *Executive Order 9070,* February 24, 1942. Under this Order the Federal Home Loan Bank Board was abolished and all its functions and those of related agencies were transferred to a single commissioner. The name of the agency was changed to the Federal Home Loan Bank Administration. This action has been reversed and the Board restored. See Chapter 8, footnote 9.

to the advancement of the main purpose, irrespective of other considerations. There were also changes of viewpoint in regard to the operation of the agencies themselves. Thus in the new wartime amendments to the National Housing Act, the requirement for "economic soundness" was purposely dropped; and the making of insured loans was based entirely on immediate needs and current costs with little or no concern with the future.

By the time the war ended the following conditions prevailed:

(1) Practically all new nonresidential construction not related to military requirements or war production was prohibited by the War Production Board.

(2) Only residential construction conforming to the program of the National Housing Agency could be undertaken, though veterans, building for themselves, were given a blanket exemption.

(3) Residential rents were under the control of the Office of Price Administration,[56] except in the District of Columbia which had its separate rent control agency.

(4) The supply of rental housing was continually being reduced by removal of units from the controlled rental market to the uncontrolled sales market.

(5) Building materials, along with other commodities, were subject to price control. Efforts to control the prices of "construction services" had, however, proved unworkable.

(6) The supply of building materials was very short, and no steps had been taken by the government to permit a restoration of production to meet postwar demands.

(7) With the drastic curtailment of new construction, the field of real estate mortgage lending had been largely restricted to the refinancing of existing properties.

(8) Housing demand was already rising rapidly as both the marriage and birth rates increased. Higher incomes and savings from war activities and the special home financing terms given to World War II veterans combined to support an unprecedented total demand for housing.

[56] In all "defense rental areas," as designated by the OPA Administrator. The towns and cities thus covered comprised the greater part of the nonfarm population. Neither during nor after World War I did Congress enact a rent control measure, except for the District of Columbia. A few states enacted rent control measures during the immediate postwar period. The New York rent control law remained in effect until June 1929. See Edith Berger Drellick and André Emery, *Rent Control in War and Peace* (New York, 1939).

The beginning of the war found large sectors of realty finance subject to government control or influence; at its conclusion both had been vastly expanded. The extension of federal intervention during the thirties made further extension easier during the war. The suggestion of withdrawal evident in 1940 was lost amid the demands of this greatest in a long series of emergencies.