Financing housing — the Bryce Curry Seminar

By Eric Carlson

ORGANISED by the Federal Home Loan Bank of New York in memory of its long-time former president, the Bryce Curry Seminar has now become an annual event. This year's seminar, held in April, attracted lively participation from 300 of the leading chief executives and officials of the thrift industry in the United States.

Danny Wall, chairman, Federal Home Loan Bank Board, was the featured speaker, followed by three main panels on the topics: "Trends and Projections in Housing Finance," "Will Housing Finance be Profitable?" and "Public or Private Financing for Housing?" Congressman John J. LaFalce, of the House Banking Committee, reviewed "Current Banking Legislative Issues." During the seminar there was also discussion of the main recommendations of the recently presented Report of the National Housing Task Force led by James W. Rouse, of the Enterprise Foundation, and David O. Maxwell, of the Federal National Mortgage Association.

Mr Wall made it clear that despite severe problems in some areas the Federal Home Loan Bank System as a whole is working well and performing the functions for which it was established. The 3,200 thrift institutions have assets of over $1.25 trillion, hold $625 billion in residential mortgages, over one half of all the mortgage debt in the country, and they originated some $260 billion of residential mortgages in 1987.

There was an 80% growth in deposits between the years 1980 and 1987, and a substantial growth of net new deposits since October 1987. The 12 district banks of the Federal Home Loan Bank System have $154 billion in assets, and therefore in effect comprise the second largest financial institution in the United States. They have paid $1.32 billion in dividends.

Although 90% of the member institutions are doing well, 10% are in difficulties, causing severe pressures on the available resources of the Federal Savings and Loan Insurance Corporation (FSLIC) which has had to act to bail out troubled institutions, and to promote sales, mergers, or other consolidations.

The situation is especially serious in Texas which is said to be an overbanked State, with some 1,900 commercial banks and 280 thrift institutions with 1,811 offices, or one for every 3,500 people. The liquidation of some of these and consolidation of others is proceeding under the Southwest Plan of the FSLIC, with more than 200 bidders for the troubled institutions.

A special task force has been established to investigate "white collar crime" in certain areas. It has become recognised that enforcement must go together with deregulation and that there is a Federal interest and responsibility for depository institutions. New rules and regulations have been promulgated, and 2,400 examiners have received new training manuals and audio-visual teaching materials.

Mr Wall expressed certainty that the final results of the strategy of consolidation, while still seeking to preserve competition, will be a more efficient thrift industry, including considerable recovery of assets. Although some thrift institutions have been applying to become banks and thus avoid the increased fees of FSLIC insurance, he was sure that the thrift charter remains attractive, as evidenced by new applications.

James Christian, director of economics for the U.S. League of Savings Institutions, predicted that although there would be a 20% reduction in new household formation in the 1990s in the United States, there would still be an average annual growth of 4.9% in mortgage demand, which would be at a level of $250 billion per year. With the explosion of technology and the types of mortgage instruments available, the mortgage market has added a degree of flexibility and can expand and contract more easily.

Traditional investors are likely to become stronger in this situation, although non-traditional investors will function at both expanding and contracting levels. The sources for investment in mortgage backed securities will largely remain the same. As the baby boom generation becomes older in the 1990s larger savings rates and deposits can be expected.

According to Howard Altarescu, vice-president, Goldman Sachs & Co, the securitisation of mortgages has increased remarkably to the extent where today of $1.8 trillion in mortgages outstanding, $600 to $700 billion have been securitised in the secondary markets. Between 1984 and 1987 the proportion and mortgages securitised rose from 14 to 23%.

Various types of investors predominate for the offerings of each of the major agencies concerned, such as the Government National Mortgage Association (GNMA), the Federal National Mortgage Association (FNMA), and the Federal Home Loan Mortgage Corporation (FHLMC). This is reflected in the per-

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centage of sales or holdings of such groupings as the mortgage bankers, commercial banks, thrifts, insurance organisations, or the investment houses or dealers themselves.

The thrifts remain large investors for many offerings, and there is also considerable sale of mortgage obligations to overseas investors. Problems arise when the agencies take up too large a market share in dual roles in mortgage origination and in holding mortgage debt.

The "paper" of the Federal agencies has been marketed aggressively around the world by both public and private sectors. However, the former deep appetite for such paper by Japanese investors has now been considerably curbed as the result of the decreasing value of the dollar against the yen, and there has been a divestment of such mortgage bonds by the Japanese, after substantial losses. There is a perceived need to stabilise the value of the dollar.

The panel session on "Will Housing Finance Be Profitable?" attracted spirited debate and comments with respect to the stated destructive competition and other fundamental forces affecting the thrift industry. Particular problems were said to exist with regard to the irrational pricing of adjustable rate mortgages (ARMS), with interest spreads in some cases too low for profitability or even survival.

A major competitor to the thrifts has become the Citicorp group, which pays licensed realtors a percentage fee for originating loans, and also has reduced documentation requirements and speeded loan approvals. It offers loan to value ratios of up to 80% compared to the 75% which is otherwise typical for the thrift industry.

Though branch networks are valuable, they are also expensive, and there are limits on expansion unless they can become retail financial centres covering a spectrum of services. Thrifts may have opportunities to develop new product lines by focusing on the needs of special groups such as the young or elderly, or by specialising more in areas such as rehabilitation of housing stock.

Whether housing finance will be profitable certainly depends on the degree of competent and efficient management in the particular institution concerned, as fundamentally housing finance *is* a profitable business.

A final panel on "Public or Private Finance for Housing?" reviewed the role of the Federal Government in developing the housing finance system over the past 50 years. The FNMA had been established in 1938, but it was only in 1958 that it had become an independent corporation, with agency status, and an infusion of $2.5 billion in borrowing authority from the US Treasury.

The Federal government's role in housing had taken many forms, including a mortgage insurance system, capital grants, and authority for the issuance of tax exempt bonds for public housing, and now the issuance of housing vouchers. Major new changes will undoubtedly occur when a new administration takes office.

Other panel members pointed to the fact that the role of the states with respect to facilitating housing finance was increasing, especially to make more affordable housing possible. Large doses of public initiative were needed so that resources could be combined for financing on a partnership basis. There would also have to be a focus on real needs, as indicated by population statistics and demographics.

In New York State the need for housing investment funds was in competition with critical requirements for huge new investments for roads and bridges. It was necessary to devise projects and programmes which would write down costs on an up-front basis.

Limited profit development should be encouraged and public-private partnerships should be fostered, in co-operation with community based organisations. Several models or demonstration projects had paved the way for what could be much larger programmes.

The recently released report of the National Housing Task Force gives considerable stress to new forms of public private partnerships, with the caveat that new resources must be tightly targeted, to take account of the fact that while there are severe shortages in some areas, overall there is a 7.7% vacancy rate nationally for rental housing. The report urges that localities be given more discretion, and that key decisions for housing fund allocation should be made at local level.

The report recommends further incentives for savings, especially for first time home buyers. It re-establishes a system of matching block grants to the states, and urges that the housing voucher programme be expanded.

During the seminar a number of examples were provided about how thrift institutions had co-operated with state and local authorities. In Connecticut, for example, public employee pension funds had been invested in mortgages for low income households; in New York thrifts had participated in a consortium with city and state agencies in providing funding for community preservation and neighourhood reinvestment. The high cost of funds from the capital markets made it clear that the functional utility of promoting savings for housing is still highly important. Thrifts still supply the bulk of financing for housing, but the relative efficiencies of housing finance and the sensitivities of the mortgage markets must be carefully assessed.

Although problems remain, the nation still enjoys a delivery system for housing and housing finance that is working well. New combinations of public-private co-operation are emerging to help resolve and to expand the provision for financing and credit for housing.

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