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New Housebuilding under FHA and VA Programs

From 1935 through 1951, almost 4 million new dwelling units were financed with mortgage loans insured by the Federal Housing Administration or guaranteed by the Veterans Administration. This number represents about 40 per cent of all new dwelling units built during this period, and equals more than half the entire volume constructed during the twenties. Of the 4 million dwelling units, over 2½ million were financed with FHA and VA loans made during the six postwar years 1946 to 1951. How the size of these programs changed over time is shown in Chart A and Table 1.

The number of new dwelling units financed[1] with mortgage

[1] The terms "financed with" and "built with" FHA insured or VA guaranteed mortgage loans require qualification. The data for new dwelling units built under FHA auspices are based on "first compliance" inspections and denote starts of dwelling units. A varying proportion of dwelling units built with FHA inspection have been sold upon completion with conventional mortgage financing or, since 1945, with mortgage loans guaranteed by the Veterans Administration. After June 1950, the data for new dwelling units built under VA auspices are also based on compliance inspections. For preceding periods, they represent rough estimates by the Housing and Home Finance Agency of the starts of new dwelling units sold with VA-guaranteed first mortgage loans. In terms of final financing of the acquisition of new residential construction, the data overstate somewhat the importance of FHA-insured loans and understate somewhat the importance of VA-guaranteed loans. Thus the combined FHA and VA totals are more accurate than the separate data for FHA and VA. Any overstatement of the combined ratio of new units financed with FHA and VA loans to total units should be small. Cases in which construction was started with either an FHA or VA loan but finally financed with a conventional mortgage are at least partially offset by cases in which houses were started with conventional loans but sold upon completion with FHA-insured mortgage financing or VA-guaranteed loans. The above qualifications apply to Chart A, Tables 1 and 8, and all text references to ratios of new dwelling units financed or built with FHA and VA loans to the total number of dwelling units. Moreover, the timing of starts as estimated by the Bureau of Labor Statistics and of starts based on FHA and VA compliance inspections is not quite synchronous. These differences are minor and do not affect the orders of magnitude.

loans insured by FHA increased rapidly from 1935 to 1941 and represented about one-third of all new dwelling units started during the three years preceding Pearl Harbor, as against 6 and 16 per cent, respectively, in 1935 and 1936. The relative importance of FHA-insured loans in the financing of new construction rose sharply during World War II in conjunction with the war housing program. During these years, more generous mortgage insurance benefits were employed under Title VI of the National Housing

TABLE 1

New Nonfarm Dwelling Units Financed under FHA and VA Programs as a Per Cent of all Privately Financed New Nonfarm Dwelling Units 1935-1951

	PER CENT OF ALL UNITS			PER CENT OF UNITS FOR OWNER-OCCUPANCY			PER CENT OF RENTAL UNITS
	FHA	*VA*	*Combined*	*FHA*	*VA*	*Combined*	*FHA*
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1935	6	....	6	7	....	7	3
1936	16	....	16	19	....	19	1
1937	18	....	18	20	....	20	6
1938	30	....	30	32	....	32	18
1939	35	....	35	37	....	37	20
1940	34	....	34	37	....	37	6
1941	36	....	36	39	....	39	6
1942	55	....	55	59	....	59	18
1943	79	....	79	82	....	82	67
1944	67	....	67	67	....	67	69
1945	20	3	23	20	3	23	15
1946	10	13	23	11	13	24	4
1947	27	25	52	23	27	50	71
1948	32	11	43	26	13	39	75
1949	36	11	47	30	13	43	69
1950	36	15	51	27	17	44	99
1951	26	15	41	20	16	36	89

SOURCE: See Table 8 for absolute numbers, sources, and notes.

Act to overcome the anticipated risks involved in the location of war housing, the reduced construction standards imposed by materials restrictions, and the credit standing of the mortgage borrowers. In 1943 almost 80 per cent of all privately financed new dwelling units were started under the FHA program.

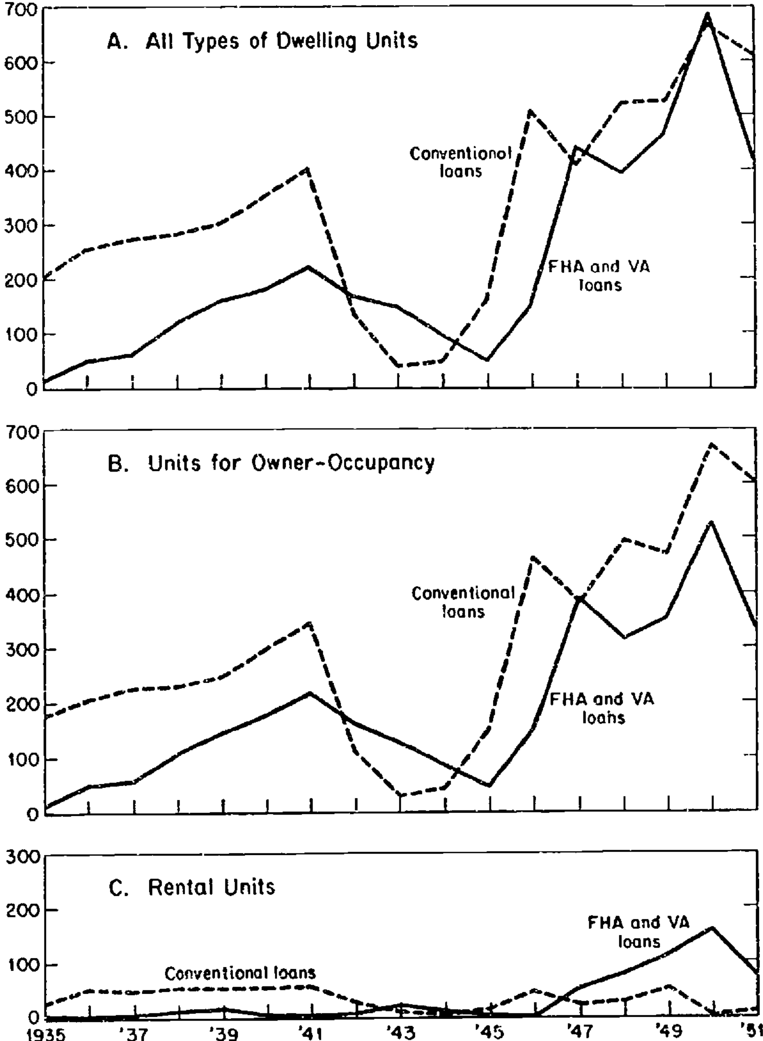
In 1945 the home loan guarantee provisions of the Veterans Administration, under the Servicemen's Readjustment Act of 1944, began to operate. Nevertheless, the relative importance of the FHA and VA programs combined was low in 1945 and 1946, accounting for only 23 per cent of the total number of dwelling units started. From 1947 through 1951, however, approximately one-half of all privately financed new dwelling units were acquired with loans insured by FHA or guaranteed by VA, as against the maximum of one-third reached before World War II under the FHA program alone. The increased proportion of construction under these government aids was accompanied or preceded by the introduction of more liberal credit or guaranty terms for both FHA and VA mortgages, until the Korean conflict caused the introduction of credit curbs in the summer and fall of 1950. The credit restrictions and the withdrawal of rigid Federal Reserve support of government securities, which tended to raise bond yields and made investment in FHA and VA loans at fixed maximum interest rates less attractive, account for the decline in the proportion of new dwelling units financed with government-insured mortgages from 1950 to 1951.

In addition to FHA and VA loans on new construction,[2] other government aids, such as the Home Owners' Loan Corporation, the credit facilities of the Federal Home Loan Banks, and the investment of federal funds in savings and loan associations, have had an influence on the volume of residential building at various times since 1933. Their effects, however, have been less direct than those of the FHA and VA programs. Several states and cities have developed financial aids for privately sponsored new construction, particularly for the benefit of veterans, but their aggregate importance has been small. The influence of the operations of the Federal National Mortgage Association is discussed in Section III.

[2] For simplicity, the terms FHA loans and VA loans are used to denote mortgage loans insured by the Federal Housing Administration or guaranteed by the Veterans Administration.

CHART A

Number of New Nonfarm Dwelling Units Financed with Conventional and with FHA-Insured and VA-Guaranteed Loans 1935-1951



Source: Table 8

A: Sum of columns 1 and 4 for FHA and VA, and column 5 minus sum of columns 1 and 4 for conventionol.

B: Sum of columns 2 and 4 for FHA and VA, and column 6 minus sum of columns 2 and 4 for conventional.

C: Column 3 for FHA, and column 7 minus column 3 for conventionol.

For a review of the effects of FHA and VA aids on new privately financed residential construction, at least three related questions suggest themselves. Have these programs increased the total volume of residential building over and above the level that would have been attained without them? Have they widened the market for new dwellings, by reducing carrying costs to a point where occupancy of new housing became possible for buyers and renters who otherwise would have been unable to afford new housing? Have they changed the distribution of new construction as between dwellings for sale and rent?

Effects on the Volume of Construction

The question as to the precise impact of FHA and VA aids on total residential building activity will forever remain unanswerable. There is no basis for estimating what the level and movement of residential construction would have been without the federal programs.

It would be rash to assume that all of the new construction financed with FHA and VA loans represents additional volume that would not have been produced without these aids. Much of the building sponsored under the FHA and VA programs would probably have occurred without them, for the two facilities have operated largely in a period of rising or high incomes conducive to an expanding demand for new residential construction. It would be equally rash to deduce that these programs had no influence on the volume of residential construction.

There is some reason for believing that the FHA program in the mid- and late thirties helped to accelerate the expansion of residential building — which was indeed its principal purpose. Recovery in housing construction is usually dependent upon substantial improvement in occupancy and prices and rents of existing facilities, and on the abatement of foreclosures and distress sales. By 1935 when the FHA mortgage insurance system began to operate, residential real estate markets in most areas had only moderately recovered from the Great Depression. The refinancing program of the Home Owners' Loan Corporation was still in progress. Fore-

closures were still at a high level though declining. The rent index of the Bureau of Labor Statistics reached bottom in 1935 and remained low in the next few years. Residential vacancies were still high.[3] In the face of these obstacles there would probably have been even less recovery in residential construction during the second half of the thirties had it not been for the FHA program.

Moreover, if government credit aids succeeded in continuously widening the market for new housing, they tended to raise the level of new construction. Many changes in federal housing policies since the middle thirties may, in fact, be interpreted as efforts to widen the market for new residential facilities by differential credit terms favoring lower-priced dwelling units and lower income groups. It is important, therefore, to trace briefly the development of this objective and to indicate the extent to which it has been met.

Widening the Market

The change in the orientation of the FHA-insurance program furnishes an instructive record on this point. Hearings and Congressional debates leading to its enactment in 1934 reveal an almost exclusive concern with stimulation of residential construction and home purchase and modernization, as part of an economic recovery program, and with improvement of the mortgage system. There is hardly any reference to the possibility of using FHA-insurance as a device for making new or better housing available to consumers who would otherwise be unable to afford it. The emphasis was on encouragement of mortgage lenders to lend rather than on encouragement of consumers to borrow. Subsequent legislation, however, has given the FHA an increasing consumer orientation. The terms of FHA-insured loans have been more and more differ-

[3] Nonfarm real estate foreclosures totaled 229,000 in 1935 as against a depression peak of 252,000 in 1933. The number declined to 185,000 in 1936, 151,000 in 1937, and 59,000 in 1941 (Foreclosure Reports of the Home Loan Bank Board). The BLS rent index stood at 94.2 in 1935 and increased to 96.4 in 1936 and 100.9 in 1937, as against a level of roughly 140 to 150 in the twenties (1935-1939 = 100). The Real Property Inventories for 64 cities revealed an average vacancy ratio of 7.8 per cent on January 1, 1934, with a ratio of 12.9 per cent for 5-or-more family structures (David L. Wickens, *Residential Real Estate,* National Bureau of Economic Research, 1941, p. 22).

entiated between various price and rental groups on the basis of social needs rather than of mortgage loan risks (although these two criteria need not always be in conflict).[4] This differentiation has been carried so far that, under the FHA terms operative in the winter of 1952, the minimum downpayment on a house appraised at $11,000 was about five times as large as the minimum downpayment on a house appraised at less than $7,000.

The first step in this direction was a 1938 amendment to the National Housing Act, which permitted easier credit terms for newly constructed small homes.[5] The second step was the removal of the "economic soundness" requirement for loans insured under the wartime amendments to the Act. War housing financed with FHA-insured loans was to be "channeled" to war workers, many of whom would be unable to buy houses without more liberal financing and borrower credit ratings. The use of mortgage insurance for "channeling" new housing into lower income groups was transferred to the Veterans Emergency Housing Program of 1946, which stated this use as one of its specific objectives.[6] Congressional hearings on comprehensive housing legislation during the late war and the postwar periods reveal a consistent emphasis on the development of special financing tools for construction suited for "middle-income families," the groups between those served by private enterprise with existing government aids and those to be

[4] Lower-priced houses have a larger resale market and may therefore be sounder security for mortgages with high loan-to-value ratios.

[5] Miles L. Colean, *op. cit.*, p. 98.

[6] The program, as announced by the Housing Expediter on February 7, 1946, included the following recommendation: "Channeling the largest part of material into homes and rental housing, both farm and urban, selling for not more than $6,000 or renting for not more than $50 per month" and specified: "To provide moderately priced homes with a maximum of rental units, it is necessary for the government to offer greater incentives for the building of such housing. This can be achieved by insuring mortgages on low-cost homes for builders to the extent of 90 per cent of value. Furthermore, such mortgages must be based on necessary current costs of construction rather than on long-term economic value and they should be amortized over a long period." (Mimeographed statement of the Housing Expediter). These changes were incorporated in amendments to Title VI of the National Housing Act, enacted May 22, 1946.

served by publicly financed housing.[7] Such tools were provided in the Housing Acts of 1948[8] and of 1950.[9]

The extent to which the objective of widening the market has in fact been met is difficult to determine, even in the relatively simple case of new single-family houses for owner-occupancy. Some of the new programs are too recent to permit a judgment of their effectiveness in this respect. The credit restrictions, issued in 1950 upon the outbreak of hostilities in Korea and suspended in September 1952, and the temporary materials restrictions caused by the military preparedness programs tended to limit the use of the financing tools enacted in 1948 and 1950. Moreover, the historical data required for assessing the influence of government aids on the demand structure for new single-family houses are not available. The Federal Housing Administration reports the income distribution of purchasers of new single-family houses financed under its mortgage insurance program. Similar information exists for all purchasers in selected metropolitan districts for recent years. But there are no comprehensive time series on the distribution of incomes of buyers of new houses, of purchase prices, downpayments, and debt charges classified by government-insured and conventional mortgage financing. However, a few observations are possible by comparing the characteristics of new house

[7] For example, *Hearings before the Subcommittee on Housing and Urban Redevelopment of the Special Committee on Postwar Economic Policy and Planning, pursuant to Senate resolution 102*, particularly pp. 1301-5 (79 Cong., 3 Sess.). Also, *Report of the Senate Committee on Banking and Currency on S. 1592*, (General Housing Act of 1946), No. 1131 (79 Cong., 2 Sess.).

[8] Miles L. Colean, *op. cit.*, pp. 124-5, particularly Nos. 5, 6, 7 and 9.

[9] Public Law 475, 81st Congress, approved April 20, 1950. The principal features of this Act designed to widen the market are special financing provisions for cooperative housing (Section 213), and more liberal financing terms for small homes (Sections 8 and 611), as well as for rental housing projects (Section 207). These measures were taken "with the object of encouraging greater production of homes for middle-income families" (*Fourth Annual Report*, Housing and Home Finance Agency, 1950, p. 213). In addition, the law authorized a maximum of $150,000,000 in direct loans by the Veterans Administration under specified conditions, increased the guaranty for VA home loans generally from 50 per cent of appraised value not to exceed $4,000 to 60 per cent not to exceed $7,500, and extended the maximum maturity from 25 to 30 years.

TABLE 2

Distribution of Purchase Prices of
New Owner-Occupied Single-Family Houses
Financed with Mortgage Loans, by Type of Mortgage Financing
1949 and 1950

PURCHASE PRICE CLASS	FHA AND VA FIRST MORTGAGES		CONVENTIONAL FIRST MORTGAGES		FHA AND VA AS PER CENT OF TOTAL IN EACH PRICE CLASS[b]
	Number	*Per Cent*	*Number*	*Per Cent*	
(1)	(2)	(3)	(4)	(5)	(6)
Less than $ 4,000	4,000	1	54,000	17	7
$ 4,000 to $ 5,999	13,000	3	43,000	14	23
$ 6,000 to $ 7,999	126,000	31	46,000	15	73
$ 8,000 to $ 9,999	139,000	34	42,000	13	77
$10,000 to $11,999	73,000	18	39,000	13	65
$12,000 to $13,999	27,000	7	25,000	8	52
$14,000 or more	27,000	7	64,000	21	30
Total reporting	407,000	100[a]	312,000	100	57

[a] Components do not add up to 100 because of rounding.

[b] Column 2 as a per cent of the sum of columns 2 and 4.

SOURCE: Based on Bureau of the Census, *1950 Census of Housing*, Preliminary Reports, Mortgaged, Residential, Nonfarm Properties Acquired During 1949 and First Half of 1950 (Series HC-9, No. 1), Table 5. The data are from a sample survey and are subject to sampling errors detailed in the Census publication.

purchases financed with FHA and VA loans and of those financed with conventional mortgages during 1949 and 1950.

Purchases financed with government-insured loans are concentrated in the $6,000 to $12,000 price class (see Table 2). More than four-fifths of all FHA- and VA-financed purchases, and only two-fifths of purchases financed with conventional loans, fell into this category. Within this price range, the government programs operated largely in the $6,000 to $10,000 class. Almost two-thirds of FHA- and VA-financed purchases, and only 28 per cent of purchases with conventional loans, were for houses priced at $6,000 to $10,000. On the other hand, only 4 per cent of all houses purchased with government-insured loans were priced at less than

$6,000, whereas almost one-third of the houses purchased with conventional mortgages were in this price group. Only 14 per cent of all FHA- and VA-financed purchases, as against 29 per cent of all purchases financed with conventional loans, were in the price class of $12,000 or more.

About three-fourths of all new mortgaged houses bought for $6,000 to less than $12,000 were financed with government-insured loans (column 6 of Table 2). Here again, the corresponding ratios for the lower-priced and higher-priced houses are much smaller.

Thus the federal programs were operative largely in the medium price field, with emphasis on the lower range of this field. Their small share in the price class under $6,000 may be due to failure of many of these houses to meet minimum construction standards of FHA and VA. Also, large numbers of lower-priced houses are in small towns where FHA and VA facilities are less accessible or are built in locations unacceptable for mortgage insurance or guaranty. In any event, the number of all houses in this price class accounted for less than 16 per cent of the total.

Downpayments made on these purchases varied significantly with type of financing. The median downpayment was 8 per cent of the purchase price for houses bought with VA first mortgages, 22 per cent for those bought with FHA first mortgages, and 35 per cent for those purchased with conventional first mortgages.[10] These differences in conjunction with the purchase price data would suggest that reduction of downpayments through federal insurance and guarantee programs was a factor in stimulating demand for medium- and low-priced houses which otherwise would have been out of reach of many families.

Nevertheless, the evidence is by no means conclusive. The reduction of downpayments may have had the effect of causing a number of house purchasers to devote a smaller proportion of their liquid assets to this purpose than they would have done otherwise, or to

[10] Based on Bureau of the Census, *1950 Census of Housing*, Preliminary Reports, Mortgages, Residential, Nonfarm Properties Acquired during 1949 and First Half of 1950 (Series HC-9, No. 1), Table 12. The data are from a sample survey and are subject to sampling errors detailed in the Census publication.

buy more expensive houses.[11] Also, from a historical point of view, downpayments have been reduced much less than a comparison of maximum loan-to-value ratios for government-insured and for conventional loans would indicate. Before the institution of the federal programs, junior mortgages often filled much of the gap between purchase price and first mortgage. The substitution of high-percentage first mortgages for combinations of first and junior loans would reduce carrying charges, other things being equal. But other things have not been equal since the early thirties. The almost universal inclusion of payments on principal in debt service on single-family houses, though a sounder financing practice, has tended to absorb much of the advantage to borrowers resulting from the consolidation of multiple loans into high-percentage first mortgages at lower interest rates and for longer contract terms.[12]

Thus the extent to which the federal programs have succeeded in widening the market for new construction is not determinable from available data, but some progress in this direction has probably been made. At the same time, widening the market for new residential building has clearly emerged as a continuous and major objective of federal housing policies and one that has direct bearing on the volume of housing construction in the long run.

Sales Housing Versus Rental Housing

Have the federal programs influenced the proportions of new construction for rental and sale? The FHA has often been accused of

[11] Thus a survey of purchases from October 1950 to March 1951 revealed that about one-fourth of house purchasers had left over liquid assets valued at $1,000 or more, and about one-tenth had liquid assets valued at $2,000 or more, after purchase on terms prevalent before Regulation X (*Federal Reserve Bulletin,* July 1951, p. 779). See also Daniel B. Rathbun, "Liquid Assets: A Neglected Factor in the Formulation of Housing Finance Policies," *Journal of Finance,* December 1952, Vol. VII, No. 4. For the relationship between financing terms and purchase price, see Ernest M. Fisher, *Urban Real Estate Markets: Characteristics and Financing* (National Bureau of Economic Research, 1950), pp. 69-90.

[12] This point is examined in greater detail in a chapter "Long-Term Changes in Cost and Terms of Mortgage Financing" in the forthcoming monograph. See also "Influence on Cost and Terms of Financing," p. 49.

unduly promoting housing for owner-occupancy;[13] and the veterans home loan program is, of course, exclusively designed for purchase (although some houses bought by veterans may include additional dwelling units for rent in a small number of cases of loans on structures with more than one dwelling unit).

The facts on this point are complex. On the statistical record, the proportion of rental units in new multifamily structures to the total number of new dwelling units was lower in the period of FHA and VA operations than during any similar period since the turn of the century — about 11.5 per cent for 1935 through 1951.[14] Also, the volume of rental housing construction during the recent postwar period was relatively low compared to a similar period after World War I. From 1946 through 1951, less than 11 per cent of all new dwelling units were in multifamily structures (Table 8). From 1920 through 1925, almost double this percentage was of the rental housing type.

It does not follow, however, that government aids for rental housing were quantitatively less important in this field than in housing for sale. It is true that before World War II the proportion of FHA-financed rental construction to total rental construction was much lower than the proportion of FHA-financed building for owner-occupancy to total building for owner-occupancy (as is evident from a comparison of columns 6 and 7 of Table 1). But there was a reversal after the war. From 1947 to 1951, the proportion of FHA-financed rental construction to total rental construction was much higher than the proportion of owner-occupied housing built with both FHA and VA loans to total building for owner-occupancy. During these five years, about 80 per cent of the annual production of rental housing was financed by FHA loans.

The two phenomena of the small relative importance of rental

[13] See, for example, Charles Abrams, *The Future of Housing* (Harper & Brothers, 1946), pp. 224-5.

[14] See Table 8 for data 1935-1951, forthcoming monograph for data 1900-1934. Multifamily structures are defined as structures with three or more dwelling units. Structures with two dwelling units usually provide at least one unit for rent. The inclusion of these would increase the proportion of units for rent to total units, but would not change the statement that the 1935-1951 ratio was lower than that during any similar period since 1900.

housing since World War II and of the large share of FHA financing in rental housing can be reconciled. Many factors other than governmental financial aids have influenced the volume of rental housing construction. Among these are a possible long-term shift in consumers preference for single-family houses, fortified by the rise in real income and liquid assets since 1940 and the tax advantages of home ownership; the financial hazards of rental housing construction during a period of rapidly changing costs; and uncertainties over the long-run earning capacity of new projects when rent controls are removed.[15]

To meet the obstacles to rental housing construction during the postwar period, and in response to public pressure for a greater volume of rental housing, easy FHA financing arrangements under the wartime Section 608 of the National Housing Act were renewed until 1950 and even liberalized.[16] In spite of these efforts, the quantity of building for rent was relatively small, but the overwhelming proportion of this small quantity was financed by liberal FHA loans. The rewards for rental project builders using FHA financing were unusually attractive. In many cases, builders could fully or nearly "mortgage out" on loans representing 90 per cent of "necessary current costs" and were able to reap large profits on very thin equities. That these attractions did not produce any larger volume of rental housing is perhaps a measure of the postwar hazards of residential construction for rent. It is safe to conclude that the quantity of rental housing would have been even smaller if the liberal FHA aids had not existed.

[15] Cf. Leo Grebler, "Implications of Rent Control – Experience in the United States," *International Labour Review* LXV, No. 4, April 1952.

[16] Among other things, the appraisal basis was changed from "reasonable replacement cost" to "necessary current cost" and later to costs prevailing December 31, 1947, and higher maximum mortgage amounts per room were authorized.