Housing industry shows its impact on other industries

U.S. League of Savings Associations worries 1980 only first of many disastrous years ahead for housing

The housing industry is not easily detached from the commercial building sector. When housing starts to slump, and the cycle advances, drops in commercial building are never that far behind.

This has been a bad year for housing. And the industry’s impact on other industries has already been demonstrated as the recession has deepened.

According to James N. Kendall, director of public relations for the United States League of Savings Associations, the 1980 cycle may be only the portent of things to come.

“1980 may be just the beginning of a string of disastrous housing years, unless some threatening trends are reversed,” Kendall notes. “Housing’s future is complicated by the newly popular reindustrialization concept—especially by those advocates who believe the funds necessary to retool the nation’s industries must come from the housing sector. The nation’s industrial might must be rebuilt, but not at the expense of housing.”

Kendall says the reindustrialization picture is further complicated by recent activities on the part of the Depository Institutions Deregulation Committee, an organization formed to monitor an orderly, six-year program leading to the eventual elimination of savings rate controls. The break-in period was intended to give savings associations—the major source for housing funds—time to adjust to the new power generated by an unregulated savings market.

Kendall says the recent DIDC actions effectively cut the six year period to 60 days. Kendall says the issue is important to all construction industries, consumers and other businesses that depend on the availability of housing to spur market activity, because the DIDC activities, he claims, may reduce the survival life of many savings and loans.

Following is a set of relevant questions and answers pertaining to the future of the housing industry, the DIDC actions and the probable financial impact some of its actions may bring in the future.

Q. — What are the main issues involved in the controversy over the DIDC?
A. — Whether housing and home ownership will continue to have a national priority, or whether money shall be channeled to other sectors instead. In particular the debate is over whether money should be diverted from housing and used to rebuild our aging production lines, a process called “reindustrialization.” The savings and loan position is that capital formation should be encouraged for both housing and reindustrialization.

Specifically, it comes down to whether savings and loan associations are to be allowed and encouraged to continue specializing in financing home buyers, carrying out their traditional role as the major provider of home mortgage credit—or whether they will have to become a form of commercial bank in order to survive. Over the long term, the disappearance continued on page 28
of this specialized system of home credit institutions would erode all home values and make home ownership less desirable.

Q. — What is the DIDC?
A. — A new super-regulatory agency that through its power over savings interest rates at financial institutions controls the purse strings for the nation’s home buyers. Its members are the heads of the financial institution regulatory agencies (the chairman of the Federal Reserve Board; the chairman of the National Credit Union Administration; the chairman of the Federal Home Loan Bank Board and the Comptroller of the Currency, a non-voting member). It was established in the Depository Institutions Deregulation and Monetary Control Act of 1980, a massive financial reform bill signed into law earlier on March 31, 1980.

Q. — What is the DIDC’s job?
A. — Congress established it to oversee an orderly six-year transition toward removal of deposit rate controls. This phase-out was to be dovetailed with the phasing-in of new powers granted to savings associations and other home-lending institutions in the bill. These new powers were to compensate for the loss of the controls.

Q. — What controls are we talking about?
A. — The limits that can be paid on savings accounts and, particularly, the housing differential that has allowed home lending institutions to pay a slightly higher rate than commercial banks on most accounts. Savings rate controls are spelled out in Federal Reserve Regulation Q, which is why these controls are sometimes referred to as “Regulation Q” controls.

Q. — Why were these controls established in the first place?
A. — The first controls were imposed on banks in the 1930s to curb cut-throat savings rate competition. To assure that funds would remain available to home buyers during periods of high inflation, Congress brought home-lending institutions under the controls system in 1966 and the housing differential was established by regulatory action. Five years ago, the differential was formally brought under the protection of federal law on account types that existed at that time.

Q. — Why did inflation make it necessary to put ceilings on all savings rates? Why couldn’t home-lending institutions just pay the going market rate, whatever that was at the time?
A. — Because these institutions hold a lot of old mortgages made years ago when interest rates were much lower. When inflation increased all interest rates, total earnings of home-lending institutions were held to a lot less than they were getting on new mortgages. Bear in mind that mortgages run for as long as 30 years, and that some old outstanding mortgages have interest rates of 6 percent or less. And of course nobody can stay in business if they must pay more for raw materials—in this case, for savings—than they earn on the final product, which is the return on their total mortgage portfolio. On the other hand, banks have most of their money in short-term loans made at today’s high rates. Without ceilings, the banks and other general lenders could quickly raise rates to savers and pull money out of home-lending institutions.

Q. — Why is the housing differential allowing home-lending institutions to pay slightly more than commercial banks on some types of accounts so important?
A. — There are many more commercial bank offices, and commercial banks are empowered to offer many services which thrift institutions cannot offer. The record shows that when savings rates are equal, savings are drawn into commercial banks and out of the thrift institutions making home mortgages.

In fact, the quarter-point differential is the main factor responsible for the flow of mortgage money to housing throughout the inflationary period that began in 1966. Without it, money would have been drained out of housing and into the commercial banking system, shutting down housing markets and lowering all home values.

Q. — Can’t savings associations get money for home buyers from other sources?
A. — Yes, and they’re expanding these efforts as much as possible. They’re selling securities to institutional investors and using the secondary market to sell old mortgages to
raise money for new mortgages. And there’s always a strong cash flow from payments and payoffs on old mortgages.

Nevertheless, without strong flows of new savings there can never be enough mortgage money to meet demand.

Q. — When it passed the bill that would end savings-rate controls, why did Congress specify a phase-out period of as long as six years?

A. — Because home-lending institutions must have at least that much time to position themselves for the end of controls.

It’s true that the bill authorized many new powers to make up for the loss of controls. However, some of the regulations spelling out how these powers are to work and allowing home-lending institutions to start using them haven’t even been adopted yet. And it will take many years before these new services will make a substantial contribution to earnings. The start-up costs for some of them will be considerable.

Q. — What did the DIDC do to create this controversy?

A. — On May 28 it dismantled the heart of the savings rate control system. This was accomplished in sixty days, not the six years intended by Congress.

And as noted, it was done before home-lending institutions even had a chance to start using the new powers that supposedly would compensate for the loss of these controls. For instance, one of the most important of these new powers—the ability to start using NOW accounts nationwide—won’t become effective until next year. And obviously it will be a much longer time before it becomes profitable.

Q. — Specifically, what actions did the DIDC take?

A. — First, it greatly narrowed the housing differential on money market certificates (MMCs), by far the most important savings instrument. The MMC differential is now effective only when market rates for 26-week Treasury Bills are between 7.25 and 8.75 percent. It also suspended the housing differential for commercial bank MMC rollovers.

In addition, it raised ceilings on MMCs and the new 2½-year savings certificates. And it allowed above-market rates to be paid on both of these instruments when market rates fall below specified levels.

This latter action not only assured double-digit mortgage rates for home buyers by keeping savings rates high, but it was also contrary to the intent of Congress that savings rates not be allowed to move higher than market rates during the six-year phase-out period.

Q. — If they are not reversed, what will the short-term impact of these actions be?

A. — To slow the housing recovery, keep home mortgage rates high and prolong the recession.

We estimate that because of the DIDC’s actions $17 billion will be lost to the already depressed housing market in the next six months alone. The higher mortgage rates, caused by higher savings costs, will also depress housing demand—and to the extent that the housing recovery is slowed, recovery from the recession will be slowed too.

Q. — What would the long-term consequences be?

A. — If savings-rate controls are not phased out in the orderly fashion intended by Congress, home-lending in-
Institutions would have to stop specializing in financing home buyers and start making more short-term loans instead.

In effect this would move them in the direction of becoming banks—and allocate funds out of housing and into other sectors of the economy.

This would be in accord with the thinking of those people in and out of government who have made it their goal to downgrade housing’s priority. It would mean an erosion of our long-standing policy of supporting home ownership—and we think that’s far too important a decision to be made by a six-man committee of unelected officials.

Q. — But doesn’t the industrial sector of the economy need money too?
A. — Of course. There’s no doubt that more capital is needed to rebuild our aging production lines to make them more competitive in world markets.

But we don’t think it makes any sense to reindustrialize at the expense of housing. Rather than choking off money for housing and home buyers, we think it makes more sense to create savings incentives and other programs to raise capital for all segments of our economy.

In fact, the reasons for maintaining housing’s priority are more compelling than ever.

Q. — What are the reasons?
A. — There will be a tremendous demand for housing in the 1980s. We’ll need 22 million new housing units just to meet the demand created as the “baby boom” generation comes of age. A record 42 million people will reach the prime home-buying age of 30 in the 1980s, nearly one-third more than in the 1970s.

Housing affordability is already a great problem. High interest rates and a dwindling supply of mortgage money would just make that problem worse and result in mounting housing shortages.

We’ll also need billions of dollars to rehabilitate and revitalize our older housing units in big cities and smaller towns, a need made even more urgent by the energy crisis.

Finally, home ownership has always been one of the great stabilizing forces in our society and has enabled millions of people and families to upgrade their living standards. We think future generations of Americans should also have this opportunity.

Q. — Other than the DIDC’s actions, are there any other signs of a drift toward downgrading housing in priority?
A. — Yes, a number of them. This lack of concern for housing was reflected in the report of an Interagency...
Task Force charged with recommending solutions to the long-term problems of home-lending institutions.

While the task force paid lip service to the idea of variable-rate mortgages, it backed away from the more important question of what to do with the many old, low-yielding mortgages on thrift institutions’ books. And the Task Force failed to recommend any major tax incentive program to stimulate savings.

Another disturbing development is the way in which the power of the Federal Home Loan Bank Board, the traditional regulator of the home-lending industry, is being usurped in favor of bank-oriented regulators.

The financial reform bill look the authority to set savings rates for home-lending institutions from the FHLBB and gave it to the DIDC, which is controlled by commercial banking regulators.

It also made home-lending institutions subject to transaction account reserve requirements with the Federal Reserve Board, a commercial banking agency. Subsequently the Federal Reserve issued regulations which go beyond the intent of Congress by making far too much of the deposits of thrift institutions subject to reserves. This gives this bank-regulating agency significant power over the lending policy of thrift institutions.

Q. — What would downgrading housing in priority do to housing markets?

A. — Savings and loan associations hold more one-to-four family mortgages than all other private sources combined. If savings associations are forced to pull out of housing markets and become a form of commercial bank, nobody else in the private sector will be able to move in and take up that much slack.

Certainly the decade of the 1980s would see growing housing shortages, with families forced to double up and lower their living standards. And eventually more and more homes financing would have to be taken over by government programs, with the expense borne by all taxpayers.

Q. — What would happen to home values?

A. — They would be lowered, affecting everyone who now owns a home or condominium. As the supply of private mortgage money dried up, it would become harder and harder to finance a home purchase. This would make owning a home less desirable, eroding the concept of home ownership.

Millions of Americans view their homes as a form of savings—and for many of them, a home is the most valuable asset they will ever own. Downgrading housing in priority would cause them to suffer a great financial loss.