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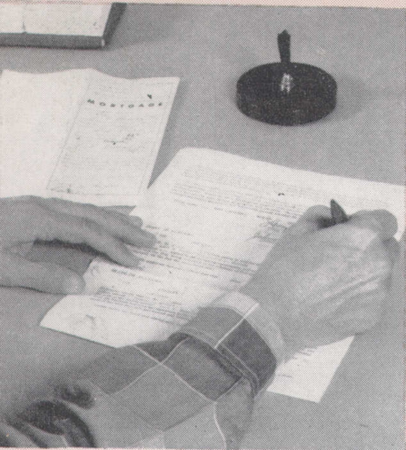
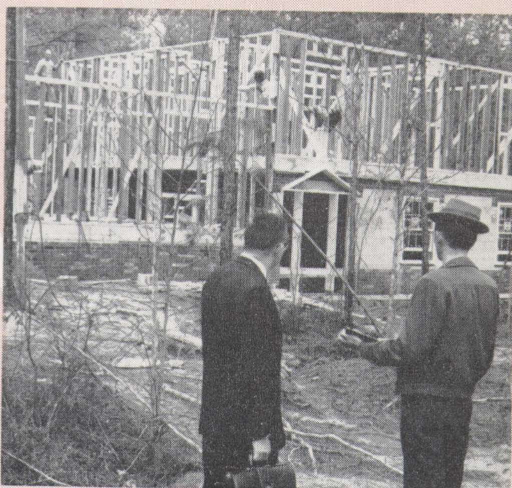


BULLETIN 333
JUNE 1961

Financing Rural Homes



Agricultural Experiment Station
AUBURN UNIVERSITY
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CONTENTS

Page

OBJECTIVES AND SCOPE OF STUDY 4

METHOD 5

SOURCES OF HOUSING CREDIT 6

Commercial Banks 7

Life Insurance Companies 8

Savings and Loan Associations 9

Federal Land Bank Associations 10

Production Credit Associations 10

Farmers Home Administration 11

Veterans Administration 11

COMPARISON OF LENDING ACTIVITIES 12

FACTORS AFFECTING AVAILABILITY AND COST OF HOUSING CREDIT 16

Willingness to Make Home Loans 17

Terms of FHA-Insured and VA-Guaranteed Loans 18

Terms of Conventional Home Loans 18

ABILITY AND DESIRE OF RURAL RESIDENTS TO UTILIZE HOUSING CREDIT 25

SUMMARY AND CONCLUSIONS 27

FIRST PRINTING 4.5M, JUNE 1961

FINANCING RURAL HOMES*

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THE SOUTHEAST has long been recognized as an area of dense rural population, small farms, low incomes, and poor housing. Substandard rural housing in this area is generally regarded as the result of low farm incomes.

For the past several years, the Southeast has been in a period of transition. There has been a shift to larger farms, with many farming operations becoming mechanized. These technological advances have lowered labor requirements and given increased impetus to part-time farming. At the same time, some rural families have stopped farming because of difficulty in meeting higher capital requirements of modern agriculture.

Industrial developments have created jobs for many of the people who can no longer work in agriculture. Some have moved from rural areas, but others have remained and commute to jobs in towns and cities. The greatest changes have been in where people work, rather than where they live.

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* The research on which this report is based was executed and financed under terms of a contractual agreement between the Agricultural Experiment Station of Auburn University and the Housing and Home Finance Agency, Washington, D.C. Funds for the study were provided under authority of Section 603 of the Housing Act of 1957. The study was carried out as State research project Ala. 1-016, "Financing of Rural Housing in the Southeast." Accuracy of statements or interpretations contained herein are solely the responsibility of the authors and publisher.

** Resigned.

*** The authors acknowledge the cooperation and assistance of all the rural residents and representatives of lending institutions who supplied the basic information on which this study is based.

Housing on relatively successful farms is likely to be regarded as typical rural housing. Although a larger proportion of rural than urban people live in houses that are dilapidated or lack certain improved facilities, substandard rural housing is not as obvious as urban slums. Substandard urban housing is concentrated in given areas, while comparable rural houses are distributed over wide areas. Probably for this reason, substandard rural housing and related problems have not received as much attention in recent years as have urban slums.

Occupational transition from farm to non-farm employment during recent years has resulted in a general increase in incomes of many rural resident families. As rural people acquire more non-farm employment and greater returns from farming, their incomes approach those of urban residents. When this occurs, there is a tendency for rural residents to desire standards of living, including improved housing, similar to those of urban people.

OBJECTIVES and SCOPE of STUDY

A mortgage credit study by the Subcommittee on Housing, United States Senate Committee on Banking and Currency, revealed that rural residents had not been provided the same opportunity and incentive for housing improvements as had urban residents.[1] This Subcommittee, therefore, proposed research to investigate the need for methods of financing housing in rural areas.[2] Congress appropriated funds for the research work in the Housing Act of 1957.

A national committee of agricultural economists representing four geographic regions of the country recommended that the limited amount of funds appropriated be used to support an intensive study in the area of the U.S. with the greatest need. It was subsequently agreed that the Southeast (Alabama, Georgia, Mississippi, and South Carolina) had the poorest rural housing and the greatest need for housing improvement, and that the major portion of the study should be made in this area. For purposes of comparison, pilot studies were to be made in eastern

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[1] Committee on Banking and Currency Subcommittee on Housing, United States Senate, *Study of Mortgage Credit,* U.S. Government Printing Office, Washington, D.C., 1958.

[2] Housing in rural areas or rural housing refers to that in towns of 2,500 population or less or housing in the open country.

Colorado (wheat area) and in northwestern Missouri (grain-livestock area).

The overall study was carried out in two phases: (1) an examination of policies and practices of lenders engaged in financing homes, and (2) an analysis of rural residents' needs, desires, and practices as related to their use of housing credit, including reluctance or inability to use existing credit facilities.

The Agricultural Experiment Station of Auburn University, under terms of a contractual agreement with the Housing and Home Finance Agency, was designated to coordinate both phases of the study in the Southeast. The collection, editing, coding, and recording of rural resident data were subcontracted to a private national research organization. Auburn University personnel were responsible for the tabulation, analysis, and interpretation of all data in the rural resident phase and for all work on the lender phase of the study.

This report presents information from the lender phase of the study. It is based primarily on data obtained from private and governmental lenders.[3]

METHOD

During the summer of 1959, 171 lenders or their representatives who were familiar with the policies and practices in financing homes were interviewed.

Prior to selecting a sample of respondents to be interviewed, a mail questionnaire was sent to all commercial banks and life insurance companies operating in the study area. A 92 per cent response from insurance companies indicated that 75 per cent had made home loans but less than half the companies had made such loans in the Southeast since January 1, 1957. An 85 per cent response from banks showed that 92 per cent had made home mortgage loans since January 1, 1957.

Only banks and insurance companies that reported making home mortgage loans since January 1, 1957 were included in the population to be sampled. Since other types of lenders were legally authorized to make mortgage loans, they were all included

[3] A companion report entitled, "Rural Housing Situation and Needs," published as Auburn University Agricultural Experiment Station Bulletin 334, presents information from the rural resident phase of the study.

TABLE 1. TOTAL NUMBER OF LENDERS, NUMBER IN SAMPLE, AND PERCENTAGE SAMPLE NUMBER IS OF POPULATION, SOUTHEASTERN U.S., 1959

Type of lender	Total number of firms	Firms in sample	Proportion sample of total
	Number	*Number*	*Per cent*
Commercial lenders			
Commercial banks	694	69	10
Savings and loan associations	189	33	17
Life insurance companies	138	32	23
TOTAL OR AVERAGE	1,021	134	13
Governmental lenders			
Farmers Home Administration	216	12	6
Federal Land Bank Associations	60	11	18
Production Credit Associations	68	10	15
Veterans Administration	4	4	100
TOTAL OR AVERAGE	348	37	11
TOTAL OR AVERAGE, ALL LENDERS	1,369	171	12

in the population. Table 1 indicates the types of lenders, the number of lenders in the population, and the number included in the random sample selected by list sampling methods.

A prepared questionnaire was used, but many of the answers were estimates made by the respondents. Opinion and attitude questions also made up a large part of the schedule. Answers to these questions were recorded and interpretations were made by trained field enumerators.

SOURCES of HOUSING CREDIT

The policies and practices of lenders engaged in home financing in the Southeast differed significantly. Most differences were associated with types of lenders. Nature of the business carried on by lenders and the legal framework within which they operated were the major determinants of lending policies. Some of the differences noted may be of assistance to individuals in determining the best sources of housing credit to meet their needs.[4]

The description of policies and practices common to each type of lender was based on averages and generalizations. Although the major differences were by types of lenders, there was con-

[4] This does not imply that there is one best source of housing credit for everyone but that there is a best source to fit the situation and needs of each individual.

siderable variation in policies and practices among similar types of lenders.

Commercial Banks

Commercial banks[5] were more uniformly distributed throughout the study area than were other types of lenders. In 1959, 1,055 national and state banks were operating in the four Southeastern States. More than 55 per cent of the sample banks were in rural areas (towns of 2,500 or less population) and made loans within their immediate trade areas (about a 10-mile radius).

Banks were a primary source of agricultural credit. There was no relationship between distribution of banks and percentage of commercial farms in the counties in which banks were located.

Commercial banks were primarily holders of demand deposits but they were permitted by law to hold time deposits. The inherent nature of holding funds that could be withdrawn on demand and the laws regulating banking operations compelled commercial banks to maintain relatively large reserves and high liquidity in investments.

Banks competed with other credit agencies in making several types of loans. They emphasized liquidity and had a relatively low proportion of their assets invested in long-term real estate mortgages. Banks in the sample had average assets of about 15 million dollars at the end of fiscal year 1959. An average of 18 per cent of their funds was invested in real estate mortgages.

Eighty-four per cent of the banks had made short- or intermediate-term loans and 32 per cent had made long-term loans to finance houses.

The average number of real estate loans made per bank in 1958-59 was 134. An average of 65 loans was for homes and about half of these were for rural homes. Seventy per cent of the banks had made rural home loans during the past fiscal year.

Banks made an average of 48 per cent of their loans on residential property. This average was below that for other types of lenders. However, the percentage that rural home loans were of total home loans was significantly larger than for other lenders.

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[5] Less than 0.5 per cent of all banks in the area were savings banks.

The large ratio of rural home loans to other types of loans made by banks was attributed to their location.

Ninety per cent of the banks reported making conventional home loans. Nine per cent reported making FHA-insured and 3 per cent made VA-guaranteed loans. The typical FHA-insured and VA-guaranteed loans were for 20 to 30 years. Since banks were committed to high liquidity, conventional loans of much shorter periods were better suited to their investment program.

Of the home loans made by banks, 42 per cent were for home construction, 30 per cent for purchase, and 28 per cent for improvement purposes. The high percentage of home construction loans was the result of a large number of interim loans made to finance construction until long-term financing could be obtained.

Life Insurance Companies

A total of 363 life insurance companies was listed as doing business in the four Southeastern States in 1959. Only 15 per cent had made rural home loans. Most of the companies that did not make home loans in the Southeast were those incorporated in states outside the area.

Over 80 per cent of the insurance companies' loan offices or loan correspondents were in cities of 50,000 population or more. These offices or loan correspondents generally made loans on selected residential properties and commercial farms throughout relatively large areas.

Insurance companies making real estate loans in the Southeast were incorporated in several states. Their lending practices were more variable than were those of other lenders because they were largely regulated by laws of the states in which they were incorporated.

Investment policies of insurance companies were highly flexible. Insurance companies, by the nature of their businesses, were in a position to invest a large percentage of their funds in mortgage loans. The bond market, however, competed favorably for their investments. In 1958-59, bond yields were especially favorable in relation to mortgage yields; consequently, investments in real estate loans were about 12 per cent below normal.

Insurance companies had average assets of $8,801,476 with an

average of 31 per cent of their assets invested in real estate loans.[6] Insurance companies made an average of 85 real estate loans per company in 1958-59, with an average of 90 per cent being for residential property. Only about 10 per cent of their residential loans were made on rural homes.

The general investment policies of insurance companies favored loans on better residential and better farm properties to assure safety as well as a reasonable yield. Since the obligations of an insurance company were paid uniformly over a long period, long-term investments were preferred. Insurance companies were an important source of long-term loans for home purchase and construction. Over 96 per cent of all insurance company loans were for construction or purchase in 1958-59.

Insurance companies favored FHA-insured and VA-guaranteed loans more than did other lenders. Because government-backed mortgages were highly standardized and negotiable, insurance companies could liquidate mortgages and invest in bonds when bond yields were more favorable than mortgage yields. About half of the companies invested in FHA-insured and a fourth in VA-guaranteed mortgages during the past fiscal year. Seventy-eight per cent had invested in conventional mortgages during the same period.

Companies investing in government-backed mortgages were generally large companies. They also made a larger number of loans than did other companies. The average number of FHA-insured and VA-guaranteed loans made was 101 and 42, respectively, compared with an average of 29 for conventional loans.

Savings and Loan Associations

Savings and loan associations were the only type of lender that specialized in making home loans. The primary functions of savings and loan associations were to hold savings or time deposits and invest in home mortgages. The nature of their business and legal requirements of savings and loan associations were responsible for their investing almost 90 per cent of their assets in real estate loans.

In 1959, 240 savings and loan associations were operating in the Southeast. Over 95 per cent of those in the sample were in

[6] This is based on reports from insurance companies incorporated in the Southeast. Total assets of companies incorporated outside the Southeast were not included since none or only a part of their assets was invested in real estate loans in the area.

towns of over 2,500 population. All of these associations made home loans; the average number made in 1958-59 was 261. About 80 per cent made rural home loans, but average number made was only 38.

All savings and loan associations made conventional home loans in 1958-59. A third had made FHA-insured and 12 per cent had made VA-guaranteed home loans. Over 95 per cent of the home loans made by savings and loan associations in 1958-59 were conventional loans.

Thirty per cent of all home loans made by savings and loan associations in 1958-59 were for financing new houses, 36 per cent for purchasing existing houses, and 34 per cent were for home improvement.

Federal Land Bank Associations

There were 60 Federal Land Bank Associations, local cooperative units of the Federal Land Banks of Columbia, South Carolina, and New Orleans, Louisiana, operating in the Southeast in 1959. The Federal Land Banks and their local units are under supervision and regulation of the Farm Credit Administration.

The Federal Land Banks were originally organized with capital supplied by the federal government. This capital has since been repaid and the banks are now owned by local associations that are made up of member-borrowers. The Federal Land Banks sell bonds to the investing public to obtain loan funds. Local associations borrow funds from the banks, using farm mortgages as security.

Member-borrowers of the local associations can borrow only on farm property and are required to purchase stock in the association equal to 5 per cent of the amount borrowed. Federal Land Bank Associations are primarily sources of long-term credit for financing complete farm units. In 1958-59, associations made an average of 96 loans on farms. Less than a third of the loans were made to construct or improve farm houses. About 8 per cent were made to purchase farms with dwelling units on them. Remaining loans were for purchasing farm land.

Production Credit Associations

Production Credit Associations are local cooperative associations composed of member-borrowers organized to provide farm production credit. The local associations are under supervision

and regulation of the Farm Credit Administration. They obtain loan funds by discounting notes and mortgages of member-borrowers with the Federal Intermediate Credit Banks, which sell debentures to the investing public.

In 1959, 68 Production Credit Associations were operating in the four Southeastern States. Most of their loans were secured by chattel or promissory notes, but they also made an average of 211 real estate loans in 1958-59. Most of these loans, however, were used to finance production enterprises. An average of only 40 loans per association was made for financing construction or improvement of farm homes.

Since Production Credit Associations do not make long-term loans, 80 per cent of their home loans were used for home improvement. Ten per cent were for construction and an equal percentage for purchase of homes.

Farmers Home Administration

A total of 216 Farmers Home Administration county offices was located in the study area of the Southeast in 1959. These offices were responsible for making loans to farmers and part-time farmers for financing farm ownership, farm housing, soil and water conservation practices, and farm production. In addition to making direct loans with government appropriated funds, these offices also insured farm ownership loans extended by commercial lenders.

An average of 15 real estate loans per office was made in 1958-59. Ninety-three per cent of these loans were for farm housing or for purchasing farms including homes. Most of these loans, 83 per cent, were made to finance construction of new farm homes.

Farmers Home Administration housing loans had favorable terms, but only farmers who could not readily obtain credit from other sources were eligible. The policies applicable to the use of housing credit from the Farmers Home Administration are altered by legislation and, therefore, are variable over long periods. Policies are made restrictive or liberal through changes in loan eligibility requirements as deemed necessary to help control inflationary or deflationary forces of the national economy.

Veterans Administration

The Veterans Administration was authorized in 1944 to guarantee the repayment of mortgage loans made to veterans for

building, buying, or improving homes. In addition to the guarantee program, under authority enacted by the Congress in 1950 the VA acts as a primary lender to make home loans to veterans in areas where they cannot obtain credit from other sources on reasonable terms.

The four regional VA offices in the Southeast made a total of 2,400 loans in 1958-59, all for financing homes. The majority of direct VA home loans, 1,320, was made to veterans in rural areas where housing credit was not available on reasonable terms.

Sixty per cent of all VA loans were used to finance construction of new houses, 37 per cent for purchasing existing houses, and only 3 per cent for home improvements.

Representatives of the VA reported lending activity only for direct loans made by them. VA-guaranteed loans were reported by commercial lenders since they made the loans from their own funds and the VA acted only as a guarantor of the loan.

COMPARISON of LENDING ACTIVITIES

The relative importance of various types of lenders as sources of housing credit for prospective borrowers can be based on a general description of lending practices and policies. An indication of the relative importance of various types of lenders, based on total number and dollar volume of various kinds of home loans, was necessary to complete the picture of credit sources.

Savings and loan associations made the largest number and accounted for the greatest dollar volume of home loans in the Southeast in 1958-59, Figure 1. Commercial banks, as a group, made more total loans than did insurance companies. However, loans made by insurance companies averaged larger in size than did those made by other lenders. Commercial lenders (banks, insurance companies, and savings and loan associations) made a much greater number and a larger total dollar volume of home loans than did governmental lenders.

Figure 2 indicates the importance of rural and urban home loans relative to all home loans made by major lenders. For the three types of commercial lenders that made 92 per cent of all home loans in 1958-59, only 26 per cent of their loans were on homes in rural areas.

Insurance companies were an important source of residential

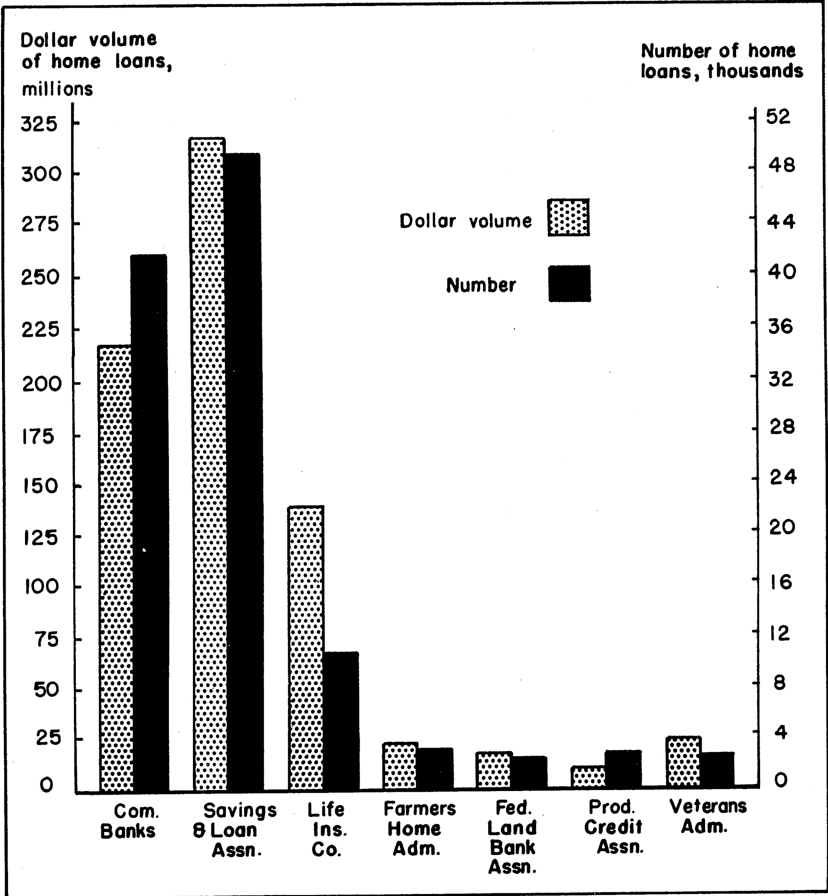

FIG. 1. Total number and dollar volume of home loans made by different type lenders during 1958-59 in the Southeast are shown in the above graph.

loans in urban areas but a relatively unimportant source of rural home loans. Savings and loan associations made the most home loans in 1958-59, but they made significantly fewer rural home loans than did banks.

Based on total number of rural home loans or rural loans as a proportion of total home loans, commercial banks were the most important source of credit for financing rural homes. All governmental lenders except the VA confined home financing to rural homes and a majority of the VA loans were for rural homes.

The kinds of loans (FHA-insured, VA-guaranteed, and con-

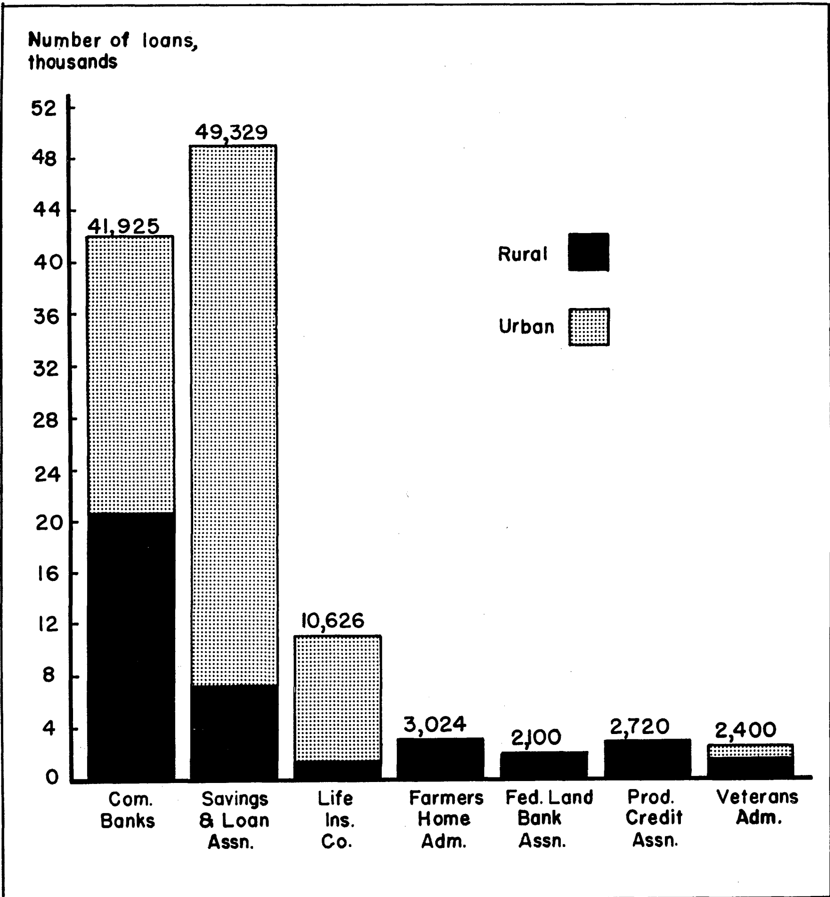

FIG. 2. Shown above are total numbers of rural and urban home loans that were made by different type lenders during 1958-59 in the Southeastern States.

ventional) varied considerably by types of lenders, Figure 3. Insurance companies and savings and loan associations made a significantly larger number and proportion of FHA-insured and VA-guaranteed loans than did banks. Governmental or quasi-governmental lenders do not make FHA-insured or VA-guaranteed loans.

Insurance company representatives explained that their preferences for government-backed loans were because of their high liquidity. FHA-insured and VA-guaranteed mortgages have become highly standardized and can readily be sold at market

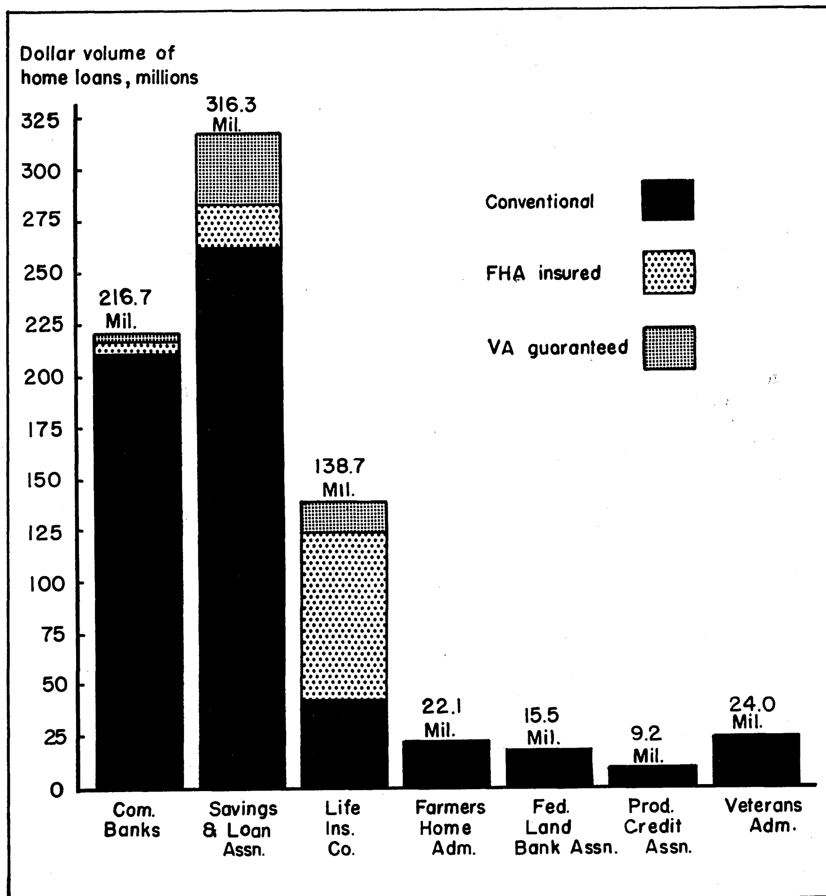

FIG. 3. Total dollar volume of different type loans made in the Southeastern States in 1958-59 is shown here by type of lender. Conventional loans include direct loans from governmental or quasi-governmental agencies.

prices in the secondary mortgage market. FHA-insured and VA-guaranteed mortgages permitted more flexibility in investments. Through market sales and purchases, government-backed mortgages could be converted to bonds and bonds to mortgages depending on their relative yields.

A third of the savings and loan associations and almost half of the life insurance companies reported investing in FHA-insured loans in 1958-59, Table 2. Only 12 per cent of the savings and loan associations and 25 per cent of the life insurance companies made VA-guaranteed loans during this period. Life in-

TABLE 2. PERCENTAGE OF COMMERCIAL LENDERS REPORTING AND AVERAGE NUMBER, SIZE, AND PERCENTAGE OF TOTAL HOME LOANS, BY KINDS OF LOANS, SOUTHEASTERN U.S., 1958-59

Item	Commercial banks	Savings and loan associations	Life insurance companies	Average for commercial lenders
Conventional home loans				
Proportion reporting, pct.	93	100	78	91
Average number	65	242	29	101
Average size, dol.	5,060	5,740	13,290	7,300
Average percentage of home loans, pct.	95	95	67	92
FHA-insured home loans				
Proportion reporting, pct.	9	33	47	24
Average number	23	35	101[1]	64
Average size, dol.	7,350	9,400	12,340	10,620
Average percentage of home loans, pct.	36	8	73	43
VA-guaranteed home loans				
Proportion reporting, pct.	3	12	25	10
Average number	8	101	42[2]	57
Average size, dol.	3,950	14,370	11,280	10,740
Average percentage of home loans, pct.	28	14	25	22

[1] Excludes one insurance company that bought 875 FHA-insured mortgages in a block.
[2] Excludes one insurance company that bought 875 VA-guaranteed mortgages in a block.

surance companies had the largest average size conventional and FHA-insured loans. Savings and loan associations had the largest average size for VA-guaranteed home loans.

Government-backed loans lowered the risks to lenders and permitted them to make more total home loans. The VA-guaranteed and FHA-insured loans were for a maximum of 100 and 97 per cent of appraised value. These loans reached a market made up of borrowers who did not have a fourth to a third of the appraised value as equity or as a down payment, which is normally required on conventional home loans.

FACTORS AFFECTING AVAILABILITY and COST of HOUSING CREDIT

The total volume of mortgage funds is affected by private and public monetary and fiscal policy. There are indirect or external factors that affect both lenders and borrowers; however, these were beyond the scope of this study. The factors of concern in

this study were the policies and practices of lenders that affect the allocation of funds at the primary lender level.

Willingness to Make Home Loans

Apart from general mortgage market conditions, willingness of lenders to make certain kinds of home loans largely determined the availability of housing credit. Percentage of lenders that were willing to make certain kinds of loans varied widely by types of lenders, Table 3. Based on willingness to lend in their respective areas, rural residents had a higher probability of obtaining home loans from banks and savings and loan associations than from insurance companies. Urban residents had a relatively high probability of obtaining loans from all three commercial lenders.

The policies of Federal Land Bank Associations, Production Credit Associations, and the Farmers Home Administration were to make loans to farmers only. The Veterans Administration made home loans to veterans only but did not differentiate by types of loans or occupational groups.

TABLE 3. PERCENTAGE OF LENDERS THAT MAKE HOME LOANS FOR CONSTRUCTION, PURCHASE, OR IMPROVEMENT TO VARIOUS GROUPS, SOUTHEASTERN U.S., 1958-59

Group and purpose of home loan	Proportion making different type loans			
	Commercial banks	Insurance companies	Savings and loan associations	All firms
	Per cent	*Per cent*	*Per cent*	*Per cent*
Farmers				
Purchase	74	28	67	61
Construction	75	25	64	60
Improvement	84	22	64	64
Part-time farmers				
Purchase	70	25	76	60
Construction	71	25	73	60
Improvement	80	19	73	63
Non-farm rural residents				
Purchase	71	38	91	68
Construction	72	38	88	68
Improvement	84	31	88	72
Urban residents				
Purchase	56	88	97	74
Construction	58	88	94	74
Improvement	61	59	94	74

Terms of FHA-Insured and VA-Guaranteed Loans

After a lender indicates he is willing to make the type of loan desired, terms of the loan will determine total cost and whether an individual can utilize the loan.

Most FHA-insured home loans[7] were made on a maximum term basis. Title II FHA loans in 1958-59 were made for 97 per cent of appraised value up to $13,500 at 5¼ per cent interest amortized over a 20- to 30-year period. In addition to the interest paid, borrowers were required to pay FHA 0.5 per cent for insuring the loans. All FHA loans required monthly payments.

Title I FHA-insured loans were made for a period of 3 or 5 years for alterations, repairs, and improvements on existing homes. The maximum financing charge was 5 per cent discounted in advance. Maximum amount for insurable loans was $3,500.

In 1958-59, VA-guaranteed loans were made to veterans for a maximum of 100 per cent of appraised value at 4¾ per cent interest amortized for a period of 20 to 30 years. Most VA-guaranteed loans in 1958-59, however, were obtained at a 3 to 10 per cent discount. This meant that borrowers had to pay from $405 to $1,350 to obtain VA-guaranteed loans of $13,500.

Discounts were in the form of cash to lenders. The discount was either part of the down payment or a charge paid by builders. In both cases payments were finally made by borrowers. This meant that they did not receive loans for 100 per cent of appraised value or that they paid effective interest rates of more than 4¾ per cent.[8]

Terms of Conventional Home Loans

Terms of FHA-insured and VA-guaranteed loans were more standardized than were those for conventional loans. Commercial lenders were reluctant to make loans for rural homes and the additional security of government backing was relatively inef-

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[7] Title II of the National Housing Act, originally enacted in 1934, authorized FHA to insure mortgage loans for the construction or purchase of a home. Title I authorized FHA to insure loans made on an unsecured basis for home improvement.

[8] See also a report by Robert E. Scott, "Suggested Modifications of the FHA, VA, and FNMA Programs to Improve the Supply and Distribution of Mortgage Credit Available for Home Financing," in *Study of Mortgage Credit,* U.S. Government Printing Office, Washington, D.C., 1958, p. 320.

TABLE 4. AVERAGE TERMS OF CONVENTIONAL HOME LOANS AND DIRECT GOVERNMENT LOANS, BY TYPES OF LENDERS, SOUTHEASTERN U.S., 1958-59

Type of lender	Terms of loans to urban and rural borrowers					
	Loan to value		Interest rate		Length of loan	
	Urban	Rural	Urban	Rural	Urban	Rural
	Pct.	*Pct.*	*Pct.*	*Pct.*	*Years*	*Years*
Commercial banks	62	60	6.0	6.1	7	4
Savings and loan associations	74	69	6.1	6.1	15	14
Life insurance companies	66	64	5.7	5.8	19	16
Farmers Home Administration	----	97	----	4.0	----	33
Federal Land Bank Associations	----	65	----	5.4	----	24
Production Credit Associations	----	65	----	6.1	----	4
Veterans Administration	100	100	4.8	4.8	25	25
AVERAGE	68	67	5.9	5.8	13	12

fective in inducing them to make such loans. In fact, lenders who made rural loans apparently preferred less standardized conventional loans that permitted higher interest rates to cover what they believed to be more risk.

DOWN PAYMENT. The down payment was the largest single cash cost item to a borrower obtaining a conventional home loan. The average percentage of appraised value loaned on rural homes was 60, 64, and 69 for banks, insurance companies, and savings and loan associations, Table 4. These three types of lenders loaned an average of 62, 66, and 74 per cent of appraised value, respectively, on urban homes. The average percentage of appraised value loaned by savings and loan associations was significantly lower for rural than for urban home loans.[9]

The lower average percentage loaned by savings and loan associations reflected the belief that rural homes would have a lower resale potential in the event of mortgage foreclosure. The same opinion about resale of rural homes was expressed by representatives of banks and insurance companies, but most said they adjusted appraised value rather than the percentage of appraised value loaned. It was not determined how much appraisals were lowered below current prices on rural property to reflect a lower resale potential.

[9] The calculated "t" value for the difference between rural and urban average loan-to-value ratios for savings and loan associations was significant at the .05 probability level based on "Student's" distribution of "t" values.

The percentage of appraised value loaned on rural homes was significantly lower for banks than for savings and loan associations.[10] This differential was increased by the policies of banks to make appraisals below current market prices on rural homes.

Commercial lenders loaned a significantly smaller percentage of the current price for rural homes than for urban homes. Thus, the rural borrower was required to have a higher proportion of the cost of a home as down payment than was the urban resident.

CLOSING COSTS. The second largest cash cost met by the borrower in obtaining a conventional home loan was closing costs. The closing costs for VA-guaranteed loans and maximum FHA-insured loans were usually largest. There was a large variation in the dollar closing costs for loans from various types of lenders. There was also wide variation among similar types of lenders, especially among banks.

Such costs as recording fees for the mortgage and deed, appraisal fees, title search, and legal work were relatively fixed. Most banks charged only the so-called actual costs of these fixed expenses. Most insurance companies or their correspondents and savings and loan associations charged an additional service or origination fee, usually a percentage of the amount loaned.

Respondents were asked to estimate typical closing costs for a $10,000 home loan. Some attempted to itemize the closing costs, but most lenders said they charged a certain percentage of the amount loaned. Table 5 shows average closing costs charged by the various types of lenders for FHA-insured, VA-guaranteed, and conventional loans.

All commercial lenders said closing costs were lower for conventional loans than for government-backed loans. Commercial banks charged lower closing costs for all types of loans than did savings and loan associations or insurance companies.

The relatively high closing costs charged by Federal Land Bank Associations and Production Credit Associations were attributable to a provision that borrowers purchase association stock equal to 5 per cent of the amount borrowed. This amount is refunded when the loan is fully repaid, but it is a cost that must be paid in

[10] The calculated "t" value for the difference in average loan-to-value ratios between banks and savings and loan associations for rural home loans was significant at the .01 probability level based on "Student's" distribution of "t" values.

TABLE 5. AVERAGE CLOSING COSTS FOR A $10,000 FHA-INSURED, VA-GUARANTEED, AND CONVENTIONAL HOME LOAN, BY TYPE OF LENDER, SOUTHEASTERN U.S., 1958-59

Type of lender	Closing cost by type of loan		
	FHA-insured	VA-guaranteed	Conventional
	Dollars	*Dollars*	*Dollars*
Commercial banks	250	248	102
Savings and loan associations	354	300	188
Life insurance companies	333	290	214
Farmers Home Administration	------	------	100
Federal Land Bank Associations	------	------	640[1]
Production Credit Associations	------	------	583[1]
Veterans Administration	------	------	363
AVERAGE	317	284	230

[1] Closing costs include purchase of stock in association equal to 5 per cent of amount loaned.

cash or deducted from the face amount of the loan when the loan is negotiated.

INTEREST RATE. The interest rate charged on home loans is important because the typical home loan is for a long time. A difference of 1 per cent in interest rate on a 1-year loan is much less important than when applied to a 20-year to 30-year loan. An increase from 5 to 6 per cent interest on a $10,000 loan amortized with monthly payments for 20 years increases total interest paid by $1,356. In spite of the increase in total interest paid, extended loan maturities lower total monthly payments and make home financing possible for many families who could not meet payments with shorter-term loans.

Although there was wide variation in interest rates charged among individual lenders and types of lenders, there was little indication that interest rates were higher for rural than for urban home loans. There was more variation in interest rates on rural than urban loans among individual lenders, but urban loans varied more by types of lenders. Average interest rates on rural and urban home loans according to types of lenders are shown in Table 4.

The method of charging interest can greatly affect cost of credit. Total interest charged is generally less for amortized loans in which interest is charged only on the outstanding balance than for other methods of charging interest.

Almost all savings and loan associations and insurance companies made amortized home loans on a monthly basis. About a

third of the banks charged interest on a straight-term or flat rate basis. Most of these loans, however, were made for 1 year and part of the loan could be renewed at the end of the year.

LENGTH OF LOAN. While down payment is one of the most important determinants of ability to obtain a loan, length of loan is the major factor that determines ability to repay. Extending the length of a loan lowers the amount of each payment. Since payments are largely determined on the basis of current income, longer term loans can be used by low income groups.

Most conventional home loans were made for shorter periods than FHA-insured and VA-guaranteed loans. Government-backed loans were made for 20 to 30 years, whereas conventional loans were for shorter periods. Thus, average payments were higher for rural than for urban borrowers because the former relied mainly on conventional loans. Average length of loan or maturity of loans made by conventional lenders is shown in Table 4.

Differences in average length of rural and urban conventional home loans made by the same types of lenders were not significant. The differences between types of lenders were highly significant for both rural and urban conventional home loans.[11]

Although length of conventional home loans on rural property was not significantly shorter than for urban property, rural borrowers were not able to obtain FHA-insured and VA-guaranteed loans as readily as could urban borrowers. The result was that, on the average, the rural borrower could not get as long to repay the loan as could the urban borrower; therefore, he had to have a greater repayment ability to obtain a comparable loan.

REJECTION OF HOME LOAN APPLICATIONS. In 1958-59, approximately 29 per cent of all home loan applications to all lenders were rejected, Table 6. Percentage rejected ranged from 18 per cent for Production Credit Associations to 42 per cent for Federal Land Bank Associations. Commercial lenders accepted a larger percentage of applications than did governmental lenders.

Assuming that the total volume of applications was an indication of the need for home financing, existing credit agencies were not meeting this need. The percentage of applications, however,

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[11] The calculated "t" values for differences in average length of loans for commercial lenders were statistically significant at the .01 probability level based on "Student's" distribution of "t" values.

TABLE 6. AVERAGE PERCENTAGE OF APPLICATIONS FOR HOUSING LOANS REJECTED AND MAJOR REASONS FOR REJECTION, BY TYPE OF LENDER, SOUTHEASTERN U.S., 1958-59

Type of lender	Firms reporting	Applications rejected	Percentage that were rejected for various reasons[1]					
			Low equity in property	Undesirable location or kind of property	Inadequate repayment ability	Poor credit rating	Too long a term desired	Other
	Number	*Per cent*	*Per cent*	*Per cent*	*Per cent*	*Per cent*	*Per cent*	*Per cent*
Commercial lenders								
Commercial banks	69	29	55	14	33	25	41	13
Savings and loan associations	33	30	91	24	30	58	0	18
Life insurance companies	32	20	41	38	47	50	3	19
TOTAL OR AVERAGE	134	28	60	22	36	39	22	16
Governmental lenders								
Farmers Home Administration	12	40	50	58	50	0	0	41
Federal Land Bank Associations	11	42	64	54	45	18	0	0
Production Credit Associations	10	18	0	10	40	10	70	20
Veterans Administration	3	27	0	67	67	100	0	33
TOTAL OR AVERAGE	36	35	39	44	47	17	19	22
TOTAL OR AVERAGE, ALL LENDERS	170	29	55	28	38	34	21	18

[1] In several cases more than one reason was reported for rejecting loans.

does not measure the exact need not being met. Many potential borrowers were discouraged from applying for housing credit. On the other hand, some of the applicants who were rejected by one lender were accepted by another.

"Low equity in property" was given as the most important reason for rejecting loans by banks, savings and loan associations, and Federal Land Bank Associations. This was attributed to their emphasis on conventional loans with low loan-to-value ratios.

The Farmers Home Administration and the Veterans Administration made direct loans, whereas insurance companies made a large proportion of FHA-insured and VA-guaranteed loans with higher loan-to-value ratios. Consequently, less equity was necessary to utilize FHA-insured and VA-guaranteed loans.

Lack of equity in property was by far the most important reason for rejecting applications for home loans in 1958-59. This was further evidence that the ability to meet the down payment was the major determinant of whether a person obtained housing credit.

"Too long a term loan desired" was the most important reason given by Production Credit Associations and the second most important reason given by banks for rejecting applications. Both of these types of lenders made primarily short-term loans. Thus, the large amount of funds generally necessary for buying or building a house could not be paid in a short time by the average borrower.

"Inadequate repayment ability" was relatively important for all types of lenders as a reason for rejecting loans. This was closely connected with length of loan. As length of loan was increased, payments were less and could more nearly be met by low income groups.

"Undesirable location or kind of property" was the most important reason for rejection by the Farmers Home Administration. This was explained by the fact that, in many cases, rural property offered as security did not meet requirements for being classified as a farm. This was also a relatively important reason given by Federal Land Bank Associations for rejecting applications.

"Poor credit rating" was the reason given by half the savings and loan associations for rejecting loans. Also, more than half the insurance companies and all Veterans Administration offices reported poor credit ratings of applicants as reasons for rejecting

loans. Most cases of poor credit ratings were believed to be the result of character and personal traits of applicants rather than their economic inability to repay loans.

Generally, lenders expressed a preference for loans on property with a high resale potential. This preference existed even though loans on low resale potential property might have had a greater probability of being repaid. More weight was given to what would happen in the event of foreclosure than to whether the loan would be repaid.

This general policy appears to be in conflict with the Federal Housing Administration's policy on mortgage credit analysis.[12] In the process of approving loans for FHA mortgage insurance, FHA credit analysts do not contemplate forced sale of the mortgaged property to accomplish liquidation or to avoid loss.

Since lenders generally believed that future resale potential for rural housing was lower than for urban housing, they employed an appraisal technique that reflected this in appraised value. Appraisal of most rural houses was based on factors other than current market price. This prevented rural people from obtaining loans covering as large a percentage of the market price of houses as could urban people. Therefore, rural people who could make relatively small down payments were often left with the alternative of purchasing a home in urban areas or of sacrificing needed housing in order to live in rural areas.

ABILITY and DESIRE of RURAL RESIDENTS to UTILIZE HOUSING CREDIT

Fifty-eight per cent of the rural resident families included in phase I of the study had non-farm occupations or were part-time farmers with regular off-farm income. Only 17 per cent were full-time farmers and 9 per cent were farm laborers. Sixteen per cent were retired, disabled, or otherwise unemployed.

The percentage of rural resident families with income from off-farm employment was significantly higher in 1959 than during earlier years. This percentage will likely increase still more in the future. The increase in off-farm work has resulted in higher incomes for rural people — particularly for those with non-farm employment. For farm families, total farm income has remained

[12] See Part V, Section 19 of *FHA Underwriting Handbook*, Volume VII, Book 1, FHA Manual.

at about the same level or slightly lower during recent years. However, since there are fewer people sharing this income, average farm family incomes are higher than in earlier years.

Average annual net income of heads of households was $3,217 for non-farm residents, and $2,771 for part-time farmers in 1959. Full-time farmers had an average income of $1,810. Income for farm laborers and heads of households who were unemployed, disabled, or retired averaged $844 and $1,035, respectively.

Average net worth for full-time farmers was $10,801. Part-time farmers had an average net worth of $14,694 and non-farm rural resident heads of households averaged $7,369. Heads of households who were unemployed, disabled, or retired had an average net worth of $11,002 but for farm laborers it was only $259.

About half the heads of households living in rural areas had an annual net income of over $2,000. Based on the rule used by many lenders, that a family can afford a house costing 2½ times their annual net income, a majority of the rural resident families could afford a house in the $5,000 to $9,000 price range.

Findings of this study indicate, however, that rural resident families did not have the standard of housing that could have been justified by their incomes and net worth. Over half of the houses were deficient in water and bath facilities. More than 70 per cent of the rural residents reported housing deficiencies. Twenty per cent of these reported exterior conditions to be most serious and 40 per cent said additional space was the most needed housing improvement.

Almost three-fifths of the respondents owned their homes and nearly half of these had bought or built during the past 9 years. Slightly more than half who had bought or built since January 1, 1951, had borrowed funds to finance their homes.

Although a majority of respondents had housing deficiencies, only 31 per cent said housing was their most urgent need. Only 11 per cent planned to buy or build a house within 3 years.

SUMMARY and CONCLUSIONS

Financing of homes in rural areas of the Southeast has, until recent years, meant financing a farm with an existing home. Rural homes have been integral parts of farms and loans have been based on farms as production units. Rapid industrialization of rural areas has changed this situation and many rural homes today are basically rural residences for non-farm workers.

Incomes of rural residents have been increasing. More than half have non-farm jobs. In 1959, the average annual net income of non-farm rural resident heads of households was $3,217. This group had average net worth of $7,369.

The non-farm group of rural people is increasing as a percentage of the rural population. The expected trend is for their incomes to increase also. Thus, rural residents will be better able to pay for rural homes, for residences only, and their demand for homes will likely increase. This increase in demand and buying power is reflected in current prices.

Existing credit facilities for financing rural homes included the Farmers Home Administration, Federal Land Bank Associations, and Production Credit Associations, which made loans to farmers only. Commercial lenders (banks, life insurance companies, and savings and loan associations) were permitted to make loans in rural and urban areas, but generally preferred to make loans only on large commercial farms and urban residential properties.

Commercial banks made a larger number of home loans and a larger percentage of total home loans in rural areas than did any other group of lenders. Banks, however, made short- and intermediate-term loans that were used primarily by individuals to repair or remodel homes or by individuals or contractors to finance construction on a temporary basis.

The primary function of savings and loan associations was to make long-term loans on residential property. However, rural home loans comprised a relatively small proportion of their total business in 1959.

Life insurance companies were an important source of mortgage credit. Their investment policies were highly flexible. Bonds and government-insured mortgages on urban homes made up the largest portion of their investment. A relatively small proportion of their loans was made in rural areas and most of these were on commercial farms.

More than half of the direct loans made by the Veterans Administration were in rural areas. However, this was only a small percentage of total rural loans made by all lenders.

Average terms of conventional home loans (loan-to-value ratio, interest rate, and repayment period) did not vary significantly between rural and urban loans. The major differences were among types of lenders.

Government agencies and programs designed to aid the flow of mortgage funds appeared to have had little effect in providing more mortgage funds at favorable terms to rural residents. The major sources of home financing offered primarily conventional loans with relatively low loan-to-value ratios or short repayment periods, or both, to rural borrowers.

Findings from interviews with 665 rural residents indicated that housing needs were not being met, because of their reluctance to use credit and their inability to utilize available credit.

The spread between appraised values and current prices of rural houses required down payments so large that rural people with limited equity could not utilize conventional loans. Lenders explained that relatively low appraised values were based on a belief that the resale potential of rural houses would be low in the event of foreclosure.

Assuming that the resale potential for rural houses will be lower than that for urban houses, this study indicates that the differential in appraised values is often unrealistic. Relatively high down payments prevent rural residents (mostly non-farm) from obtaining home loans that could be economcially justified by their repayment ability.

In view of the present situation and problems that exist in financing homes in rural areas, the following are suggested as feasible corrective measures:

(1) Provision should be made for flexible interest rates on government-backed loans to reflect the additional risks involved in financing rural homes having a lower resale potential than urban homes. With government-backing and a higher yield resulting from higher interest rates, lenders would make more FHA-insured and VA-guaranteed loans to rural residents. FHA-insured and VA-guaranteed loans with lower down payments would also permit more rural residents to obtain housing loans.

(2) Emphasis should be given to more education of prospective borrowers in planning and accepting moderately priced houses that can be justified by their repayment abilities. Such houses can be adequate if suitably designed and well-constructed. This emphasis on housing education should be carried out by existing public and private agencies.

(3) Lenders should consider revision of present appraisal methods and practices to more closely reflect present market values. It is further recommended that lenders revise mortgage risk analysis to more nearly reflect repayment risks rather than risks in event of foreclosure.

(4) Rural development programs should be expanded and intensified to aid in occupational adjustments and to raise incomes, thereby increasing still further the ability of rural people to pay for better housing. Such programs should include the planning of land and other resources for residential, industrial, agricultural, and other uses that would help stabilize property values.