

CHANGING ATTITUDES TOWARD PROPERTY OWNERSHIP AND MORTGAGE FINANCE

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Throughout the history of real estate ownership and real estate finance, there has been a remarkable continuity and constancy in the legal foundations upon which governmental action has been based. Yet within the framework of a fixed legal tradition, two revolutions in the policy and objective of state intervention have occurred.

The first revolution began with the breakup of the feudal system which paralleled the growth of commercial and industrial enterprise in Great Britain. This development placed the state more and more in the background as it gave increasing outlet to individual initiative, and reached its peak in the founding of the American republic and in the land policies under which this nation so rapidly expanded.

In the United States the ownership of property became more than a legal and economic circumstance. It became the supreme symbol of individual freedom and of the protection of the individual in his freedom. The nation's land policy as it ultimately developed was primarily concerned with making this freedom available to the greatest possible number of persons. The effect of this policy gave its tone to the whole body politic, since even for those who did not care to undertake the hardship of seeking new land, the possibility of doing so was always present.

In its encouragement of a wide distribution of property the federal government gave little attention to the use of the land that was settled and almost none to the fate of the individual who entered his claim. The obligation of government was fulfilled when opportunity was granted; and the individual was left to pursue his happiness in his own way and according to his own abilities. If his luck and judgment were good and his toil great, whatever reward he reaped was his; if he failed, his misjudgments and mistakes were no responsibility of the government.

The only exceptions in the exercise of this policy came in periods of general distress. Then the federal government generously modified the terms of its own land contracts and the states intervened to impede the process of foreclosure. Even these exceptions were not contradictory to the underlying policy. They were aimed not only at salvaging individual but at preventing the accumulation of land in the hands of a moneyed class and in preserving the concept of individual freeholds.

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The second revolution began with the closing of the frontier and the awakened concern with the wastage of natural resources and the decrease in individual opportunity. Government gradually developed new objectives which in many ways, were in sharp contrast to those that prevailed in the era of expansion. The conservation and restoration of its wealth in soil and forest when land was no longer there for the taking and the creation of security for its people to whom opportunity (at least within the old pattern) no longer existed—these were the goals to which government now turned attention. The movement was at first slow in developing. Its real momentum came from the impact of the Great Depression; and its apogee is not yet in sight.

Under the new dispensation, the free individual ownership of property is of less importance than the just use of property, as defined by government. The encouragement of individual initiative has less emphasis than the safeguarding of individual welfare. The assuring of a hygienic occupancy (as distant from an unqualified ownership) of property from the physical, economic, and social point of view becomes the root of governmental policy.

As the policy has evolved, regulation of property for social ends has been greatly extended through both state and federal instrumentalities. The first manifestations were in the vast expansion of the police power to create the now generally accepted controls of physical planning and land use as embodied in numerous state and local building, zoning, and planning laws, and in the conservation measures of the federal government. But so indirect an approach did not satisfy the new demands.

The federal government, reaching into the realm of traditional state jurisdiction, took on responsibilities for individual welfare and security which the states for the most part were indisposed or unable to assume. In the area of real property, however, what the states might undertake directly the federal government had to approach indirectly. Because of constitutional limitations, the federal government, for instance, could not directly exercise the police power to improve housing conditions, nor, as it soon discovered, could it exercise the power of eminent domain for housing purposes.¹ The federal government, therefore, was required to enter the arena of the social direction of real property largely through the avenue of credit, in which constitutional development had given it wide powers.

This limitation did not prove restrictive. Credit devices were found to offer an almost unimpeded freeway to the goal. By their use, the over-all supply of housing might be increased, and the number of farm owners might be increased. Special aid could be granted to this group or that—insolvent debtors, farm tenants, urban slum dwellers, families of low income, veterans. Interest rates could be specialized to meet the needs of certain classes. The lending policies of private institutions could be influenced to follow desired directions. Cities could be cajoled into accepting and promoting federal policies. Builders, at the peril of restriction of credit, could be required to observe designated standards. And through the same means, the char-

¹ U. S. v. Certain Lands in the City of Louisville, 78 F. (2d) 684 (1935).

acteristics of the new dwellings that were made available to the market could be subjected to governmental influence.

The mortgage insurance system of the Federal Housing Administration offers perhaps the most revealing example of the growth of the idea of the social direction of realty credit. The system was initiated as a means for bringing a greater volume of funds into the residential mortgage market than was possible under restrictive state legislation. It was particularly aimed at tapping liquid funds where they existed in greatest quantity at the time—in the commercial banks, which otherwise would have been largely kept out of the field. It was hoped that through this device residential construction would be increased and an important contribution would be made to the general economic recovery.

Initially FHA had no further objective than this. It established a careful appraisal method and a system of property standards; but these were only for the purposes of gauging risk and protecting the solvency of the insurance fund (for FHA from the start was intended to be a self-supporting business proposition). The service that FHA directly rendered the community lay solely in the ability to make credit more generally available for any who cared to make use of it. FHA was entirely impersonal in concept and undiscriminating among persons except in so far as ability to repay a loan was or was not evident.

For these reasons FHA lacked favor both with certain established home financing institutions who disliked its competition and with those who deplored its absence of social consciousness. Once, however, the device had demonstrated its effectiveness, the possibilities of its use for the advancement of selected social objectives became evident.

If easy terms could expand credit, easier terms, so the argument ran, could bring new homes to those unable otherwise to have them and to the special groups which government found reason to favor from time to time. If property standards could serve to protect an insurance fund, they could also be turned to the improvement of city planning and the protection of the home buyer. If the insurance device could be used to force builders to follow certain standards of construction it could also be employed to force them to pay standard wages.

Thus from a purely financial instrumentality, FHA has found itself more and more a device for directing and policing house construction and for making houses available on the basis of need rather than strictly within the limits of ability to pay. In the process the traditional concepts of credit tended to be lost. Special terms were made for special groups according to their special needs; and, instead of the most favorable terms going to the best risks, the tendency was exactly the reverse. In the process all but the appearance of homeownership was also lost, for, with the mortgage stretched to cover all but a nominal downpayment, and the amortization period extended to cover the probable duration of the utility of the property, an unencumbered freehold was rarely to be anticipated.

Other devices followed, with less circumvolution, the same objectives. The farm

tenant-purchase loans, under the Bankhead-Jones Act, which permit some control of farm management to be made a condition of easy credit, and the guarantee of loans to veterans under the Servicemen's Readjustment Act which reduced the down-payment to zero, are in the same trend. The loans and subsidies to local authorities for city-owned housing go much farther along the road of social control of real estate through the use of credit. The new vistas opened by extension of subsidized financing to provide an instrument for nominal ownership, as proposed in the farm housing sections of the General Housing Bill of 1946, indicate that the end of the road is still in the distance.

In the course of this development there is more than a mere subordination of the principle that property ownership is in itself a protection of individual freedom and initiative to the principle that individual freedom and initiative must not stand in the way of broader social objectives as determined by the state. The new attitude, moreover, tends to deny that property ownership is a source of freedom and initiative. On the contrary, it asserts, with increasing emphasis, that the individual is more likely to be enslaved than he is to be freed by owning property; that he is kept immobile in a fluid economy and his investment is put at the mercy of economic forces beyond his control; and that he is better off without the shackles of ownership in the strict legal sense.

In the new sense, the acquisition of ownership is largely bereft of its old responsibilities. With the original stake of the owner reduced in some cases to zero and the time of payment extended almost to the probable economic life of the property, free ownership becomes a fiction. What really exists is a new form of tenancy. With the government standing by (as it widely is assumed to do) to protect and salvage in time of distress, the mortgagor-mortgagee relationship tends to be considered as not involving a fixed and final obligation, but rather one that will be modified as needs arise.

The new conception of credit reduces the responsibility of the lender along with that of the borrower. In order to bring about lower interest rates and longer periods for amortization, greater safeguards for the borrower, and increased control over the character of his property, the government found it necessary to improve the quality of its guarantee and remove from the lender the cost as well as the risk of doing business. But in accepting this bargain, the lender finds himself a factor of constantly decreasing importance in the determination of his business policies.

We find the beginnings of this process in FHA where not only is a major part of the risk removed, but the task of appraisal is largely assumed by the government. It goes farther in respect to loans under the Servicemen's Readjustment Act, where the payment of the guarantee is made more immediate and where, through a provision for the assignment of a defaulted mortgage to the Veterans Administration, an automatic HOLC is set up. What would appear to be a final step is found in the 1946 amendments to the Bankhead-Jones Farm Tenant Act effectuated by the Farmers' Home Administration Act of 1946,² also known as the Cooley Act which

² P. L. 731, 79th Cong., 2nd Sess., Aug. 14, 1946, §5, amending 7 U. S. C. §§1001-1006.

creates a system of insurance on farm mortgage loans to special classes of borrowers. Here the transaction is wholly conducted by the government, collections are made by the government, delinquencies are immediately paid by the government, and defaulted loans are assigned to the government with full compensation to the lender. The lender's cost of doing business is no greater than that in connection with bond purchases and his risk is even less since his outstanding investment is guaranteed at par.

When the risk traditionally borne by the individual owner of property and the private lender on property is shifted to the government, there is brought about a profound change in the concept of real property and property rights, for the substance of property rights is gone when risk is eliminated. The rights are bound, in one way or another, to shift to the bearer of the risk. Carried beyond a certain point, therefore, the effort by the government to protect ends in the necessity of the government to control and, in effect, to own.

Both governmental protection and governmental control have increased at an accelerating rate during the past two decades. Even ignoring the presumably temporary controls of the war and post-war period, the shift from private to public initiative in real estate development and finance has been tremendous. Barring a major reaction of which there is yet no sign, it must be anticipated that this trend will continue.