



Availability of rural housing credit in Montana
by Robert L Sargent

A thesis submitted to the Graduate Faculty in partial fulfillment of the requirements for the degree of
MASTER OF SCIENCE in Agricultural Economics
Montana State University
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Abstract:

The primary objective of this research was to determine terms, conditions, and sources of housing credit available to people living in rural areas in Montana.

Lake, Rosebud, and Chouteau Counties were the areas of concentrated study. Lenders whose service areas included these counties were interviewed as well as a sample of individuals within the counties.

Commercial banks and savings and loan associations were found to be the principal sources of housing loan funds in rural areas. Both preferred conventional loans. This was the only type of loan granted by savings and loan associations, and it was the predominant type granted by small town banks. City banks relied mostly on FHA insured loans for purchase or construction of homes in rural areas. They used conventional loans for improvement and refinancing. Repayment terms were shortest and interest rates highest of any loan type considered.

No VA guaranteed loans had been made in the areas surveyed in the twelve months preceding the interviews. VA direct loans are an important source of housing credit, but the agency often encounters difficulties as a result of inadequate funds.

The Farmers Home Administration has assisted in supplying credit for farm housing. Recently (October, 1961) it was authorized to extend its Rural Housing loans to eligible individuals in small towns and on rural nonfarm tracts. Demands for the loans in the first year were heavy. Through its Senior Citizens loans the agency also makes long term, low interest credit available to persons over 65 who wish to reside in rural areas.

Individuals were found to be important sources of home purchase credit and, to a limited degree, credit for construction and home improvement.

Proposals that can be suggested as a result of this study include: 1. Increase the effectiveness of VHMCP; 2. Cooperative working agreements between small town banks and savings and loan associations; 3. Extension of correspondent relationships between small town and city banks to include housing credit; 4. Utilization of insured lenders and increased interest rates on Rural Housing loans by the Farmers Home Administration; 5. A slight increase in FHA-VA interest rates in outlying areas.

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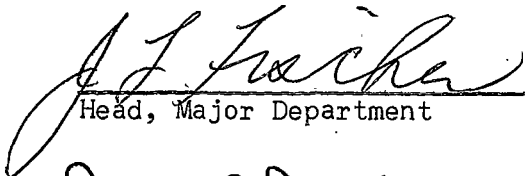
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Any errors or omissions in this study are the responsibility of the author.

TABLE OF CONTENTS

Chapter	Page
I. INTRODUCTION	1
Review of Literature	1
The Research Problem	1
Objectives	5
Hypothesis	6
The Procedure	7
II. PRACTICES AND EXPERIENCE OF LENDERS	9
Banks	9
Conventional Loans	13
FHA-Insured and VA-Guaranteed Loans	15
Comparison of Bank Policies Toward Housing Loans	18
Home Loan Volume	23
Construction Loans	23
Loans in Participation with Other Lenders	23
Reasons for Loan Rejections	26
Review of Loans Made	27
Summary of Bank Lending for Housing in Small Towns and Rural Areas	30
Savings and Loan Associations	31
The Sample	32
Lending Activities	32
Conventional Loans	32
FHA-VA Loans	35
General Rural Lending Experiences	36
Considerations in Refusing Loans	38
Other Lenders	39
Insurance Companies	39
Lumber Yards and Real Estate Offices	40
Production Credit Associations and Federal Land Bank Associations	41
Veterans Administration	42
Farmers Home Administration	42
Summary of Other Lenders	45
Individuals	46

Chapter	Page
III. EXPERIENCE OF INDIVIDUALS	47
The Small Town Sample	47
Tenancy Status	47
Housing Facilities Available	48
Remodeling, Purchase, or Construction in the Past Ten Years	50
Repayment Rates and Terms by Loan Types	53
Methods of Repayment	57
Plans to Remodel, Construct, or Purchase	57
Age and Education Levels, Gross Income, and Net Worth	58
Summary of Small Town Sample	62
The Farm Sample	63
Housing Facilities Available	63
Remodeling, Purchase, or Construction in the Past Ten Years	66
Plans to Remodel, Construct, or Purchase	68
Age, Education Levels, Gross Income, and Net Worth	68
Summary of Farm Sample	70
IV. SUMMARY AND RECOMMENDATIONS	72
Research Resume	72
Construction Loans	72
Purchase Loans	73
Remodeling Loans	74
Problems Encountered by Rural Residents	75
Problems Encountered by Lenders in Rural Areas	76
Recommendations	77
Proposal 1 - An Increase in the Effectiveness of the Voluntary Home Mortgage Credit Program	77
Proposal 2 - A Cooperative Working Agreement Between Small Town Banks and Savings and Loan Associations	78
Proposal 3 - Extension of Correspondent Relationships Between Small Town and City Banks to Include Housing Credit	78
Proposal 4 - Utilization of Insured Lenders and Increased Interest Rates on Rural Housing Loans by the Farmers Home Administration	79

Chapter

Page

Proposal 5 - A Slight Increase in FHA-VA Interest Rates In Outlying Areas	80
APPENDIX	81
LITERATURE CITED	86

LIST OF TABLES

Table	Page
1. Bankers Responses on Availability of Conventional Home Mortgage Credit in Small Towns and Rural Areas in Montana at Current Interest Rate, 1962-63	14
2. Characteristics of Conventional Home Mortgage Loans Made By Banks in Small Towns and Cities by Type of Area in Which Loans Are Made	19
3. Percent of Time Deposits Invested in Conventional and FHA-VA Loans for Housing, Selected Banks, Montana, 1962-63	20
4. Selected Characteristics of a Sample of Various Type Loans Made by 21 Commercial Banks in Montana in a 12-Month Period, 1962-63	28
5. General Characteristics of Conventional Loans by Savings and Loan Associations in Montana	34
6. Selected Characteristics of Respondents Relating to Facilities Available and Age of Homes of Small Town Housing Sample in Montana	49
7. Home Purchases and Improvements and Use of Credit by Residents of Rural Towns During 1953-62 Period, Selected Counties, Montana	51
8. Average Years to Repay and Interest Rate Charged by Various Lenders by Counties and by Total Sample, Small Towns in Montana	54
9. Ages and Education Levels of Household Heads and Spouses and Net Worth of Families (Small Towns) Sample Counties, Montana, 1962-63	59
10. Selected Characteristics Relating to Facilities Available and Age of Homes, Farm Sample, Montana, 1962-63	65
11. Numbers of Farmers Who Had Remodeled, Purchased, or Constructed Homes in Montana in Past Ten Years, 1953-62	67
12. Ages and Education Levels of Household Heads and Spouses and Net Worth of Families (Farm Sample) Montana, 1962-63	69

Table		Page
13	Tenure, Vacancy Status, and Condition and Plumbing Facilities, for the State of Montana, Urban and Rural: 1960	82
14	Tenure, Vacancy Status, and Condition and Plumbing Facilities, for the County of Rosebud, 1960	83
15	Tenure, Vacancy Status, and Condition and Plumbing Facilities, for the County of Chouteau, 1960	84
16	Tenure, Vacancy Status, and Condition and Plumbing Facilities, for the County of Lake, 1960	85

LIST OF FIGURES

Figure	Page
1. The Proportion of Deposits and of Loans and Discounts Carried by 28 Large City Banks, 29 Small City Banks, and 65 Small Town Banks in Montana	10
2. Location of Banks Included in Study in Relation to Survey Counties	12
3. Comparison of Housing Loans Made in Small Towns and Rural Areas by 8 Small Town and 13 City Banks in the Twelve Months Preceding Interviews (1962-63)	13
4. Percentage of Time Deposits Invested in Conventional and FHA-VA Loans by City Banks and Small Town Banks in the Sample	20
5. Ratio of Housing Loans to Total Loans for All Banks in Montana and for Those Serving the Sample Counties (December, 1962)	22
6. Ratio of Conventional Loans to Total Housing Loans for All Banks in Sample Counties	22
7. Location of Associations Included in Study in Relation to Survey Counties	33
8. Comparison of How Associations Feel About Current Volume of FHA-VA Loans in Urban and in Rural Areas	36
9. Length of Time Residents of Small Towns in Sample Counties Had Lived in House They Were Living in at Time of Interview, 1962-63	48
10. Comparison of How Long Farm and Small Town Families Had Lived in Their Present Houses, Montana, 1962	64

ABSTRACT

The primary objective of this research was to determine terms, conditions, and sources of housing credit available to people living in rural areas in Montana.

Lake, Rosebud, and Chouteau Counties were the areas of concentrated study. Lenders whose service areas included these counties were interviewed as well as a sample of individuals within the counties.

Commercial banks and savings and loan associations were found to be the principal sources of housing loan funds in rural areas. Both preferred conventional loans. This was the only type of loan granted by savings and loan associations, and it was the predominant type granted by small town banks. City banks relied mostly on FHA insured loans for purchase or construction of homes in rural areas. They used conventional loans for improvement and refinancing. Repayment terms were shortest and interest rates highest of any loan type considered.

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Proposals that can be suggested as a result of this study include:

1. Increase the effectiveness of VHMCP;
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4. Utilization of insured lenders and increased interest rates on Rural Housing loans by the Farmers Home Administration;
5. A slight increase in FHA-VA interest rates in outlying areas.

ABBREVIATIONS USED

FHA	Federal Housing Administration
HHFA	Housing and Home Finance Agency
VHMCP	Voluntary Home Mortgage Credit Program
PHA	Public Housing Administration
FNMA	Federal National Mortgage Administration
VA	Veterans Administration
FHADA	Farmers Home Administration, Department of Agriculture
PCA	Production Credit Association
FLBA	Federal Land Bank Association
BIA	Bureau of Indian Affairs
S&LA	Savings and Loan Association

CHAPTER I
INTRODUCTION

The National Housing Policy of the United States, as stated in the Housing Act of 1949, has as one of its major goals "a decent home and a suitable living environment for every American family." It also states that "private enterprise shall be encouraged to serve as large a part of the total need as it can" and that "governmental assistance shall be utilized where feasible to enable private enterprise to serve more of the total need."¹ This paper assumes the foregoing as an acceptable goal.

Review of Literature

A study which provided background information for this project was made in the Southeastern Cotton Belt region by Auburn University. The area included in the Auburn study comprised a sample universe from the four states of Mississippi, Alabama, Georgia, and South Carolina. It also included a "control" sample of three counties in Eastern Colorado and three counties in Northwestern Missouri.²

The findings of the Auburn study are

1. Individuals placed purchase of non-housing, non-business items ahead of housing improvements. Credit was also more readily available for these items.

¹Housing and Home Finance Agency, Capital Funds for Housing in the United States, p. 1.

²Yeager, J.H., Rural Housing Situation, Needs, and Financing, Agricultural Experiment Station, Auburn University, Auburn, Alabama, May, 1962.

2. There is a more highly developed framework for financing urban than rural housing, and various governmental housing programs have had little effect on housing in rural areas. Home financing in the rural sectors is done primarily with conventional loans requiring relatively high down payments and short repayment periods.
3. Many rural residents are not aware of housing needs and how to meet these needs effectively through use of credit.

Prior to 1934, all institutional housing credit was handled through conventional loans, loans not made by or insured by the Government. These loans were advanced predominantly by savings and loan associations and life insurance companies. Commercial banks and mutual savings banks also handled some housing credit. Conventional loans, at that time, were usually made in amounts of not more than 50 percent to 60 percent of the appraised value of the property.³ The term of the loans varied from three to twenty-five years. State statutes and lenders' policies tended to restrict the amount of loans. Most states have amended their laws so that the present statutory limits fall in the 70 to 80 percent range.⁴ (Montana's limit is 70 percent.)⁵

The government entered the housing picture with the National Housing Act of June 27, 1934.⁶ This act created the Federal Housing Administration (FHA). This legislation was designed to serve the two-fold purpose of

³Federal Housing Administration, First Annual Report, 74th Congress, 1st. Session, House Document No. 88.

⁴Boehmler, Erwin W. (ed.), Financial Institutions, Rev. Ed., pp. 355 and 453.

⁵Information obtained from Empire Savings and Loan Association, Bozeman Branch, Bozeman, Montana.

⁶Federal Housing Administration, op. cit.

giving a seriously depressed economy a "shot in the arm," and of improving housing needs of the citizenry. It received broad acceptance from the start as evidenced by the fact that 72,658 loans in the amount of \$30,450,583 were approved in its first six months of operation.⁷ The FHA then, as now, did not advance cash for the loan, but instead insured loans made by private lending institutions. The FHA was unique in establishing the practice of insuring "character" loans, i.e., little or no down payment required if the applicant was approved as a good credit risk. A large share of the mortgages insured by FHA are in urban areas. This is where funds are most readily available. Also, except in certain approved areas, loans (Section 203 i) in small towns or on the outskirts of larger towns are limited to not over \$9,000.⁸

The Congress has created other agencies to deal with specific housing needs since 1934. Some of these include the National Housing Agency, predecessor of the Housing and Home Finance Agency (HHFA), established in 1942;⁹ the Voluntary Home Mortgage Credit Program (VHMCP) in 1954;¹⁰ the Public Housing Administration (PHA) in 1937;¹¹ the Federal National Mortgage Administration (FNMA) in 1934;¹² the Veterans Administration (VA)

⁷Ibid.

⁸Massman, A.J., Montana Director, Federal Housing Administration, Address to Farmers Home Administration meeting, September, 1962.

⁹Housing and Home Finance Agency, 15th Annual Report, p. 24.

¹⁰Ibid., p. 34.

¹¹Ibid., p. 201.

¹²Ibid., p. 241.

in 1944.¹³ The Farmers Home Administration (FHADA) was created as a successor to the Farm Security Administration in 1946.¹⁴ It makes loans for farm housing as well as for non-farm housing in rural communities (towns of 2,500 or less population).

The HHFA is responsible for carrying out certain operating functions in the areas of (1) urban renewal coordination, (2) urban studies, (3) low-income housing demonstration, (4) urban mass transportation, (5) farm housing research, (6) community disposition, (7) defense planning, (8) international housing, and (9) inspections and investigations. The HHFA coordinates and directs the activities of the Federal Housing Administration, Public Housing Administration, Federal National Mortgage Association, Community Facilities Administration, and Urban Renewal Administration. It also provides some of the staff and machinery for operations of the VHMCP.¹⁵

The VHMCP is a joint industry-government endeavor which seeks to transfer credit from areas that have surplus funds to those areas that have a shortage of housing funds. The Auburn study indicates this program could prove the answer to the rural housing dilemma if it were more thoroughly understood by local credit agencies.¹⁶

The Veterans Administration makes direct and guaranteed loans to eligible veterans in all areas if funds are available. The direct loans

¹³Yeager, op. cit., p. 51.

¹⁴Information obtained from Montana State Office, Farmers Home Administration, Bozeman, Montana; Murray, William G. and Nelson, Aaron G., Agricultural Finance, p. 440.

¹⁵Housing and Home Finance Agency, 15th Annual Report, Index.

¹⁶Yeager, op. cit., p. 51.

are made from funds advanced by Congress. The guaranteed loans receive their funds from private lenders with the VA acting as guarantor.¹⁷

FNMA purchases FHA insured and VA guaranteed mortgages from primary holders as the market demands and then sells them to other holders as they become available.

To date there has been no systematic attempt to determine housing credit needs in small towns and rural areas of Montana. Experience of the Farmers Home Administration in 1961-62, however, indicates that there is a lack of adequate credit for non-farm housing in these areas. This agency was authorized to make loans for building of new houses or improvement of existing dwellings in these areas by the Housing Act of 1961. This became effective in the field October 15, 1961. From then until November 1, 1962, 253 applications for loans on non-farm tracts in Montana were received.¹⁸

The Research Problem

The areas of primary concern in this project are the small towns (2,500 or less population) and rural nonfarm tracts--all considered rural nonfarm--and the farms. Selected characteristics (Table 13) compiled from 1960 Housing Census indicate that these areas enjoy less of the comforts and conveniences of home living than do their urban neighbors. These statistics indicate that 54 percent of the urban homes in Montana are owned by their occupants, as compared with 49 percent of the rural nonfarm homes and 79 percent of the farm homes. Significantly, nearly 12 percent of the rural

¹⁷Housing and Home Finance Agency, 15th Annual Report, Index.

¹⁸Information obtained from Montana State Office, Farmers Home Administration, Bozeman, Montana.

nonfarm homes not occupied by owners are vacant year round as compared with about 7 percent of such urban homes. This is cause for considerable concern, but it was not investigated within the limitations of this study. Of the rural homes, 27 percent were listed as in dilapidated or deteriorating condition, as compared to 18 percent of such homes in the urban areas. Only 76 percent of the rural group have hot and cold water piped inside the structure as compared with 96 percent in the cities. Exclusive toilets and bathing facilities show similar ratios.

The plan of this study was to determine the role of credit, or lack of it, in influencing these apparent deficiencies. It seemed reasonable to assume that rural residents would have as much desire to own a home of their own equipped with such conveniences as hot and cold running water and bathrooms as would their city cousins.

Objectives

The objectives of this study were as follows:

1. To determine availability of credit for housing in rural areas of Montana. Rural areas are considered as including farms and towns of 2,500 population or less as determined by the 1960 census.
2. To find the sources to which people in these areas go to secure their credit needs.
3. To try to find the factors lenders consider in granting or refusing credit for housing wants and needs in Montana's rural areas.
4. To appraise the effectiveness of our present credit system in meeting housing credit needs in Montana's rural areas.

Hypothesis

The primary hypothesis was that credit for housing is not as readily available in comparable amounts, rates, and terms in rural areas as it is in urban areas.

It was further hypothesized that this disparity was due to (a) lack of interest in and use of the various federal programs by private lenders, and (b) failure of the agencies charged with meeting housing needs to recognize the nature of rural housing problems and to adapt programs to fit repayment ability of rural residents.

The Procedure

As a means of determining the extent that credit or the lack of it influences the apparent housing deficiencies in Montana, three counties were selected in which study would be concentrated. These counties were Rosebud, Chouteau, and Lake. They were judged as quite representative of the sections of Montana in which they are located. For data on the housing situation in these counties and the state see Tables 14-17.

Rosebud County, in southeastern Montana, is primarily devoted to raising of livestock, but a substantial amount of income comes from irrigated farms in the Yellowstone Valley where the principal cash crop is sugar beets. Credit is available in the larger cities of Miles City and Billings in nearby counties, as well as in Forsyth, the county seat of Rosebud.

The north central portion of the state was represented in this sample by Chouteau County. The economy here depends heavily on dryland wheat and barley. Some cattle are also raised. Fort Benton, the county seat, is the largest town in the county, but additional sources of credit for housing are in Great Falls and Havre, located in adjoining counties.

Lumbering, irrigated farming, and recreational activities are the principal enterprises in Lake County, in the northwestern section of Montana. Three banks in the three principal towns of the county are available as

sources of credit. Other home mortgage lenders are located in Missoula and Kalispell.

Gallatin County was used for the testing of lender schedules. Data from these schedules is included in the discussion of lenders in Chapter II.

Schedules were prepared by the Farm Production Economics Division of the Economic Research Service for contacting lenders. These schedules were revised to fit local conditions after pretesting in Gallatin County. Included among the lenders were banks serving the sample counties, representatives of life insurance companies, savings and loan associations, Federal land bank associations, production credit associations, and Farmers Home Administration. Real estate agents and lumber yards in the survey areas were also contacted. They were asked, among other things, who are some of the sources of credit in their areas. In addition, representative lenders outside the sample counties were contacted to determine the extent of the credit they extended on a statewide basis as well as in the survey areas.

Individuals also extend some housing credit, but there was no attempt to contact them.

Approximately a 2.2 percent sample of household units in the survey areas was taken as a further check on availability of housing credit. Personal interviews were used to determine the tenure status, financial position, and efforts that householders had made to obtain credit.

CHAPTER II

PRACTICES AND EXPERIENCE OF LENDERS

The principal sources of residential housing credit in Montana are its 122 commercial banks and 18 savings and loan (sometimes called building and loan) associations. Other lenders which contribute to housing credit include about 15 life insurance companies, 23 local offices of the Farmers Home Administration, 11 production credit associations, 11 Federal land bank associations, and numerous individuals. The Public Employees' Retirement Fund and the Teachers' Retirement Fund serve as further sources of money for residential housing, but they rely on other institutional lenders including banks and real estate agencies to originate and service the loans that they buy. The above lenders are the possible sources of residential home mortgage credit in the small towns and rural areas in Montana to which this study was confined. The contributions of the various lenders are considered in this and subsequent sections.

Banks

Twenty-eight of the banks that serve Montana are located in nine cities with a population in excess of 10,000. These 28 banks, out of the total of 122 for the state, carried slightly less than 61 percent of the deposits and 61 percent of the total loans and discounts as of December 31, 1962.¹ They are situated in nine counties.

¹Abstract of reports of Condition of Montana State Banks, National Banks, Trust Companies, December 28, 1962, No. 187; and information from the Federal Reserve Branch Bank, Helena, Montana.

In addition, 29 banks are located in cities of 2,500 to 10,000 population. They are in 17 additional counties. These 29 banks carry 24 percent of the total state bank deposits and 23 percent of the loans and discounts. Since they are located in the principal trading centers in their respective areas, these and the larger city banks actually serve customers in several counties surrounding their respective cities.

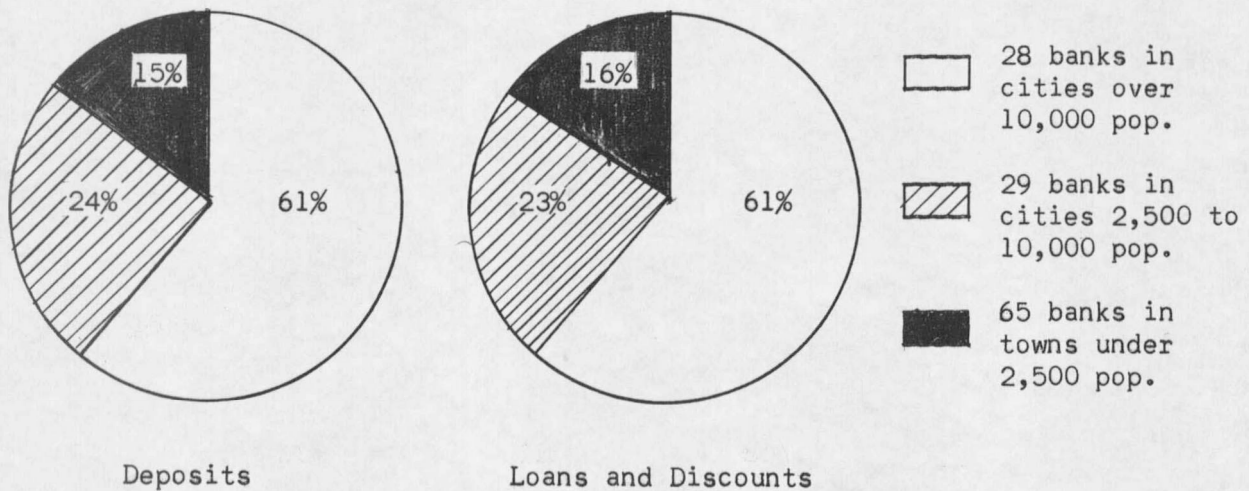


Figure 1. The Proportion of Deposits and of Loans and Discounts Carried by 28 Large City Banks, 29 Small City Banks, and 65 Small Town Banks in Montana

The remaining 65 banks are located in small towns (under 2,500 population) scattered throughout the state. They carry a little over 15 percent of the deposits and about 16 percent of the loans and discounts in the state banking system. The small town banks usually confine their lending to the county in which the bank is located. Two of Montana's 56 counties have no banks within their borders.

In this study, 26 of the banks in Montana were contacted (Figure 2). They included ten of thirteen banks in the sample counties (seven of these banks were in small towns). One other small town bank in an adjoining county was included in the sample. The remaining fifteen banks were located outside the sample counties in cities of over 2,500 population that serve as trade centers.

The banks sampled included some of the smallest in the state as well as the largest ones. Five of the 18 city banks contacted were found to make no residential loans in the sample counties nor in rural areas in their immediate proximity, so interviews were terminated at this point. These banks are not considered in any of the following discussions.

Of those from whom schedules were taken, five more city banks were found which did not make loans in small towns, but they indicated they do make loans outside the incorporated city limits. These banks considered areas outside suburban boundaries which included small acreages with the dwelling units as being in rural areas. Thirteen schedules then were taken from city banks and eight from small town banks. These were all included in the sample and the following discussion. Other small town banks in adjoining counties have little effect on the housing loan situation in the sample counties.

The banks surveyed made a total of 1,848 housing loans in the past twelve months. Of these, 288 were made in small towns and rural areas, mostly but not entirely in the sample counties (Figure 3). Of the latter, 197 (65%) were made in small towns. Eighty-four (42%) of the loans made in the small towns were FHA-insured or VA-guaranteed. Of the total of 288 loans, 204 were conventional loans.

