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# THE MORTGAGE BANK

A STUDY IN INVESTMENT BANKING

BY

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## PREFACE

THERE are fashions in economic taste, and any one who writes on one of the prevailing popular topics need not want for an audience. There are, it is true, also a few standard lines, and here there is greater difficulty in winning a hearing. There is competition of producers for the attention of the limited number of readers. For some subjects there is no audience at all and very little chance of finding one. They have been branded as dull or insignificant decades ago, and that attitude has remained even when conditions have changed and they have grown important. It is customary to relegate the mortgage bank and the mortgage bond to footnotes; the charitable might concede them an appendix; the generous may allow them a chapter in a work on modern banking. But many will say that it is putting a strain on charity and patience to ask for a hearing for a whole book, albeit a moderate sized one.

And yet the subject has become of such importance in recent years that a study on it may well be thought to have become an urgent necessity. Before the war mortgage banks were highly developed in some countries, rudimentary in others, and non-existent in the remainder. In the last decade there has been a great out-cropping of them in almost all parts of the world. There is a real movement afoot for the extension and perfection of this branch of investment banking. Nor is it confined merely to Europe. The same tendencies are seen elsewhere. The fluidity of ideas in the banking world, the close relation between various markets, and the mobility of capital have brought about parallel developments in different continents.

The great growth in mortgage credit which is so significant a feature in present-day social organization is due to two factors: to the striking alterations in the wealth and status of

former groups of property holders, and other transformations brought about by the War—and to the eagerness for a more rapid exploitation of resources. The subject merits attention on account of its own importance, but it may also claim separate treatment because of the new interest in that branch of banking which deals with the direction and the flow of capital. Numerous changes have occurred recently in the organization of long term credit facilities. The development of mortgage banking is an effect of those changes and is producing others. No sound theory of banking as a whole can be worked out which ignores it.

It is proposed in this study to give a brief, but comprehensive, account of the mortgage bond as an investment and of the mortgage bond market; to direct interest to this special form of financing all types of real estate credit with a view to deciding what are its advantages and disadvantages. Its scope is thus limited to a small part of the capital market. It is, perhaps, the first attempt yet made to examine the questions involved primarily from the angle of the lender, and not, as is usual in discussing real estate credit, from the borrower's viewpoint. It is, however, impossible to deal with the mortgage bond as an investment without inquiring into the security behind it, and this involves an examination of the nature and organization of the mortgage bank. This point is dealt with briefly, and only so far as is necessary for elucidating the main subject.

The growth of the use of the mortgage bond since the War, and, above all, the change whereby instead of remaining a purely local concern, a security interesting only a restricted district, it has become marketable internationally, are tendencies which are of great, though as yet not sufficiently recognized, importance. Agriculture in Canada or coffee-growing in Brazil may be financed by London, cotton in Egypt by Paris, a new residential quarter in Budapest or in Buenos Ayres by New York or Amsterdam. But these tendencies are as yet in their infancy. The merits of this type of investment are not properly appreciated in many countries, whilst in some

they are considerably under-valued. This is due to a reason which may soon disappear. The market in this type of security is narrow. The organization is not yet properly developed. With better machinery it will be possible to finance the development of real estate undertakings at a lower rate, whilst investments in them will become even more attractive.

Although American writers have recently devoted some attention to this subject, there is no comprehensive detailed study on it in the English language. Indeed, in the article on "Bonds" in the *Encyclopaedia of the Social Sciences*, published in 1930, an American writer does not deem it necessary to refer specifically to mortgage bonds. It is doubtful whether any such study exists in any language. The numerous German publications which seem to deal with it are of the nature of juridic and historic studies; none stress the wide economic aspects. Moreover, they rarely show any knowledge of what other countries are doing in this field.

The temptation has been strong to discuss two contentious problems closely related to the subject treated, but it has been resolutely resisted. There is a growing literature dealing with the question at which stage in the trade cycle it is desirable to buy and to sell bonds, and a much smaller amount of discussion of the question whether, say for the next few decades, we are to expect a rising or a falling rate of interest. These subjects are sufficiently important in themselves to be treated independently and not as footnotes to a brief institutional study. This publication will have justified itself if it stimulates someone to attempt a larger work.

Thanks for information is due amongst others to Messrs. Lazard Frères of Paris, Messrs. Schröder of London, Mr. Proehl of Amsterdam, the Dresdner Bank, Berlin, the Swiss Bank Corporation, London, and to the Financial Committee of the League of Nations. Gratitude is due also to Dr. E. Wolfgang of Frankfurt, to Professor T. H. Gray of Washington, and to H. D. Dickinson, M.A., for valuable suggestions.

This book is based on a series of lectures delivered at the Institut Universitaire de Hautes Études Internationales in Geneva in December, 1930. The author takes this opportunity of expressing his gratitude to the students and staff for their friendly reception and helpful criticism.

CAMBRIDGE.

*May, 1931.*



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