FOREIGN LENDERS

AND

MORTGAGE ACTIVITY IN HAWAII

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INTRODUCTION

House Resolution No. 109 of the 1968 Budget Session requested the Legislative Reference Bureau to study the provisions of House Bill No. 185 which recommends the amendment of Chapter 98L of the Revised Laws of Hawaii 1955 relating to Foreign Lenders. The proposal for amendment would include out-of-state federally chartered savings and loan associations within the definition of "foreign lender" to allow them to make mortgage loans in Hawaii. The term "foreign lender" as it is applied in the law refers to any bank or other lending institution chartered in another state which makes loans in Hawaii but does not maintain a place of business in the state.

Every state regulates its banks and banking activities, but the free flow of credit between states requires some sort of legislation to facilitate lending from areas of high capital concentration to areas where capital shortages exist. Hawaii has long been chronically short of mortgage funds, and the purpose of the present law, passed in 1961, was to encourage the making of mortgage investments by foreign lenders in Hawaii. In general, a foreign lenders law (or foreign bank loan law) allows out-of-state banks and other lending institutions to make loans without being subjected to regulation and taxation by the state where the loans are made. The state which enacts such a law gains certain advantages because funds for financing are made available for construction from other than local resources.

When Hawaii's foreign lenders law was passed in 1961, some twenty-one other states had parallel statutes, some of which restricted loans specifically to mortgage loans. In defining the category of foreign lenders, the legislators omitted several types of lending institutions, including federally chartered savings and loan associations. The federal savings and loan associations were excluded primarily because it was not clear whether state regulations could be applied to nationally chartered organizations. Furthermore, except in a few situations, a federal savings and loan association was prevented by the Federal Home Loan Bank Board regulations from making loans beyond its regular lending area which was limited to a 50-mile radius of its principal office, thus eliminating the possibility of a mainland association making a direct loan in Hawaii.

The present consideration for an amendment to include federal savings and loan associations in the definition of a foreign lender has come about because of two factors. First, construction activity in Hawaii since 1955 has risen to unprecedented heights and the need for mortgage investments to finance construction--residential (primarily multi-family units and condominiums) and commercial--has been acute. The Hawaiian market has often outstripped available local capital in these areas, and outside of single-family dwelling construction, it has been a postwar characteristic of building activity to be dependent upon investments of foreign lenders. To a great extent, the existing foreign lenders law has been instrumental in encouraging investment, but the construction needs of Hawaii are such that additional mortgage investment is welcomed and is regarded by many to be beneficial to the economy as a whole. Secondly, the restrictions placed on federal savings and loan associations in regard to the approved lending area which originally barred their inclusion in Chapter 98L have since been removed by the federal government. Despite this, some mainland federal savings and loan associations have been reluctant to purchase local mortgages because the law excludes them under the definition of a foreign lender.

Although a number of such associations have made mortgage investments in Hawaii since 1966, they have done so after private legal opinion was obtained that their activities probably do not violate the law. Other associations have preferred not to make loans or investments because of some doubt as to their status under Chapter 98L. The amendment in House Bill No. 185 would propose to correct this situation and include the federal savings and loan association as a foreign lender. At the same time, concern about the impact of this bill on the mortgage business in Hawaii and any inequities which might arise to local lending institutions and other foreign lenders resulted in House Resolution No. 109 calling for the Bureau to evaluate the proposed amendment.

The study is divided into three chapters. The first two chapters review the background of foreign lending in Hawaii and the economic impact of loan activities on the construction industry in the State. The third chapter discusses the possible inequities which arise from outside competition in the local savings and loan industry, which among the lending institutions in the mortgage market would be affected the most.

Chapter I

FOREIGN LENDING IN HAWAII

The scope of this report is delineated by House Resolution No. 109 in that we are concerned with only one type of foreign lender--the federally chartered savings and loan association--and one type of loan activity--mortgage loans. Nevertheless, in order to understand the problems involved, it is necessary to review briefly construction activity in Hawaii and the investment patterns in the mortgage loan business that have developed.

Postwar Construction and Mortgage Activity

The construction boom in Hawaii is a postwar development which began modestly. A virtual halt in civilian construction in Hawaii during World War II left an acute shortage in housing, hotels, commercial buildings and other structures, but a number of factors tended to further slow down construction activity after the war. Although there was a great expansion of new housing construction in the rest of the United States, construction and housing development in Hawaii between 1945 and 1950 were retarded by postwar cutbacks in defense activity and some negative aspects of major strikes.[1] Despite these generally depressive economic conditions, residential construction, financed through the accumulated wartime savings of individuals and through local institutions, did take place in Hawaii. Over 25,000 dwelling units were constructed between 1946 and 1952, and the mortgage debt in Hawaii rose from $40 million to over $160 million in approximately the same time period.[2]

Postwar construction activity did not pick up momentum until mortgage funds were made readily available. Because of a rapid rise in the volume of mainland investment, particularly from insurance companies, Hawaii entered a vigorous construction boom stage in the early 1950's. Increasing population growth and concentration on Oahu between 1955 and 1960 intensified the shortage of housing, but as funds for long-term financing became available, the dollar volume of construction jumped from $97 million in 1955 to $275.4 million in 1960. By 1961, the acute shortages in housing, hotels, and office buildings had been largely overcome, but construction activity has continued virtually uninterrupted, and mortgages outstanding similarly have been at very high levels.[3]

Mortgage lending for all categories of financial institutions (banks, savings and loan companies, trust companies, industrial loan companies, small loan companies, credit unions) totaled $809 million in 1967, or 54 per cent of all financial institution loans. If the $430 million held by insurance companies (domestic and foreign) is added, the total of all mortgage loans in Hawaii would be $1.239 billion. The value of mortgages expanded ten times from 1950 to 1967 with a rate of advance in Hawaii twice that of the national average for the same period. Between 1961 and 1967, the value of total mortgages outstanding has more than doubled with an average annual growth of 10.5 per cent. One of the strong points of Hawaii as an investment market is that it has the lowest rate of foreclosures of any state in the country, the 1967 level of foreclosures being one six-hundredths of one per cent, considerably below the national average.[4]

The value of total construction in Hawaii in 1967 was $367 million, representing a decline from $370.9 million in 1966. There was a decrease in single-family residential construction on Oahu in 1966 which reflected the shortage of mortgage money and rising interest rates, characteristics which were also true of the mainland. Since the level of construction is affected by the availability and terms of mortgage money both locally and on the mainland, the tight money market in 1966 led to a shortage of mortgage funds which caused residential construction to sink to near depression levels on the mainland. Monetary conditions did not ease until late 1966, which revived the flow of savings to mortgage-oriented institutions.[5] Hawaii, however, underwent a rapid recovery in construction activity and an overall increase for 1968 over 1967 is predicted with sharp gains in authorizations for single-family residences on Oahu and apartment units.[6]

Postwar Hawaii has been markedly dependent upon mortgage investments from the mainland. Two-thirds of the holdings are held by Hawaii-based mortgage lending institutions, while foreign (out-of-state) insurance companies, the Federal National Mortgage Association, and others hold approximately 32 per cent of the mortgages outstanding in Hawaii. The other institutions and their approximate share of mortgages are banks and trust companies 26 per cent, savings and loan associations 37 per cent, with industrial loan companies, pension funds, and other organizations accounting for the rest.[7]

Table 1

REAL ESTATE MORTGAGE LOANS OUTSTANDING BY TYPE
OF LENDING INSTITUTIONS IN HAWAII - 1966 AND 1967

Type of Lending Institution	December 31, 1966	December 31, 1967
All Types	$759,196,713	$799,693,878
Banks	$298,496,339	$317,619,955
Savings, building and loan associations	437,992,778	453,631,222
Trust companies (excluding mortgage loans held in trust and agency accounts)	1,807,753	2,795,230
Industrial loan companies	20,899,843	25,647,471

Sources: Hawaii Department of Regulatory Agencies, Bank Examination Division, May 14, 1968, and Honolulu (City and County), Redevelopment Agency, Redevelopment and Housing Research, No. 28, July, 1968, p. 26.

Foreign Lending Previous to Act 241 (1957)

The shortage of capital to finance construction and the need to attract funds from other than local sources were recognized long before the boom began in the 1950's, but in the early postwar years there were few advantages that the Hawaiian market could offer. The insurance companies, which were the only foreign lenders of note in Hawaii at the time, did not find the Territory to be a satisfactory investment outlet, and the total mortgage holdings of domestic (Hawaiian) and foreign insurance companies in Hawaii in 1948 amounted to only $326,580.[8] Moreover, it was estimated that in the period 1938-1948, approximately $189 million in terms of insurance premium earnings flowed out of the Territory to mainland companies which invested these funds elsewhere.[9]

By 1950, however, the attitude of most life insurance companies began to change appreciably, and there was an interest on their part to make investments in Hawaii whenever there were good opportunities. In several postwar legislative sessions, bills were considered which would give tax advantages to insurance companies investing a certain percentage of their annual premiums in Hawaii, but no general foreign lenders bill was passed. By 1954, foreign insurance company investments had grown to nearly $30 million, but they were practically the only institutions making mortgage loans other than purely local lending institutions.[10]

As interest in making mortgage investments in Hawaii grew, there was an accompanying demand for clearly defined laws which would attract out-of-state capital into Hawaii. The operations of insurance companies were regulated by Territorial laws governing both domestic and foreign insurance companies which did business in Hawaii, but the provisions for tax benefits applied only to insurance companies.[11] The taxation system which evolved in reference to insurance investments provided for the exemption from state taxation of the interest yields for the loans, only the premiums being taxed. Other foreign lenders did not share the same privileges.

The passage of Act 241 in the 1957 General Session of the Territorial Legislature was the first step in the direction of a comprehensive foreign lenders law. Under the 1957 Mortgage Loan Exemption Law (Chapter 127A, Revised Laws of Hawaii 1955), any income earned or received by a lender on a mortgage loan insured by the Federal Housing Administration (F.H.A.) or guaranteed by the Veterans Administration (V.A.) made within six years from June 3, 1957 was exempted from taxation. While the law covered only two types of government-insured loans made on residential construction, it was partially successful in attracting out-of-state capital from investors other than life insurance companies.

Prominent among the new group of foreign lenders were mutual savings (or savings) banks from the East Coast. Traditionally, these banks had followed a practice of supplying funds for the local mortgage market in their own states, but after World War II, state banking laws were amended to permit them to expand their operations beyond state borders. When the liberalization of lending conditions under the Mortgage Loan Exemption Law was put into effect in Hawaii, savings banks had already entered the field of national mortgage lending formerly dominated by life insurance companies and had begun to acquire out-of-state mortgages. Two factors accounted for a strong preference of savings banks to increase their holdings in mortgages--first was the generally higher yields on mortgages than other investments and secondly, F.H.A. and V.A. insured mortgages provided a high degree of safety for the investments.[12]

While a number of savings banks, particularly those located in Pennsylvania, were added to the roster of foreign lenders in Hawaii, other lending institutions were still reluctant to provide mortgage funds for lack of clarification of the category of foreign lenders and rights and immunities to loans other than government-insured ones. Since there were other attractive investment areas in the United States, many potential investors preferred to channel available funds there than in Hawaii. In view of the construction activity being undertaken in Hawaii by 1960, it was obvious that the lending capacity of local institutions was inadequate to meet all financing needs, and the necessity for a foreign lenders bill was recognized. Such a bill was passed in 1961.

Exclusion of Federal Savings and Loan Associations in Chapter 98L

In the preparation of a foreign lenders law, there were two major reasons why national banks, federal savings and loan associations, and other financial institutions chartered under the laws of the United States government were excluded. The first reason was to avoid any conflict between state and federal interests, the accepted opinion being that a state could neither authorize nor prohibit the making of loans by a federal institution. Even with this limitation, however, the definition of foreign lender could have been made broad enough to include federally chartered institutions as there was an existing guide for the law. The problem was recognized in the Model Foreign Bank Loan Act of the Council of State Governments[13] which made no reference either in terms of inclusion or exclusion of federal institutions in its definition of a foreign lender.

When Act 194 came up for consideration in Hawaii in the 1961 session, it excluded federal institutions from the definition of foreign lender through the specific reference in section 98L-8(b) that "the term 'foreign lender' does not include any similar organization organized under the laws of the United States...." There was apparently no intention of the legislature to be discriminatory toward the federal institutions, but rather the intent was to make it specific that the State was not imposing regulations on them.[14] The exclusion of federally chartered institutions was not regarded as particularly restrictive for a second and very important reason. In 1961, the federally chartered savings and loan associations themselves were prohibited from making direct loans beyond a regular lending area of 50 miles from the association's home office. Under the terms of the regulations, any lending between a radius of 50 and 100 miles from the principal office was subject to certain restrictions, including a limitation on the value of the loans to 20 per cent of the association's assets.[15] In effect, the areal limitation eliminated any possibility of their qualifying as foreign lenders in Hawaii for purely geographical reasons.

Even without the federal restrictions on out-of-state lending, savings and loan associations generally had restricted their lending activities to their own metropolitan areas. Prior to 1957, all associations insured by the Federal Savings and Loan Insurance Corporation (F.S.L.I.C.), which included all federal savings and loan associations, were allowed to do out-of-state lending only on F.H.A. insured and V.A. guaranteed home loans. In March 1957, associations were allowed to participate in conventional loans[16] beyond their regular lending area provided that at least 50 per cent of the loan was received by another F.S.L.I.C. insured institution which had a principal office within 50 miles of the security property.[17]

In a participation loan, one association, which has accumulated a surplus of funds which cannot be loaned locally, purchases mortgage loans through a partial interest in a loan secured by real estate and acquired by another association elsewhere. The association which sells a participation mortgage loan from its own portfolio to other associations does so in order to meet the needs of the community in which it is located by freeing more of its own funds for long-term financing of local construction activity. Since its inception, the participation program has expanded rapidly on a national scale. In 1958, participations amounted to $158 million, but this figure has increased by about 50 per cent annually so that by the end of 1963 about $3.3 billion of mortgage funds had been handled through participation. Thus, the federal savings and loan associations had been expanding their operations through participation into a nation-wide lending system despite the regulations which restricted extensive out-of-state lending.[18]

In order to supply additional funds to meet increasingly complex housing needs, new regulations to implement the provisions of the Housing Act of 1964 (Public Law 88-560) significantly broadened the investment and operational powers of the federal associations. Asset limitations were removed from loans on lending within a 100-mile area, and other changes to improve and extend the participation loan program were made.[19] Even before this, the Federal Home Loan Bank Board adopted a proposal on July 1, 1964, allowing insured associations to make loans, either participation or direct, in 219 metropolitan areas (one of which is the City and County of Honolulu) as defined in the Standard Metropolitan Statistical Areas published by the Bureau of the Budget.

Under these regulations, the amount invested by a federal savings and loan association beyond its regular lending area cannot exceed 5 per cent of its assets, and it may not make such loans if it has scheduled items of more than 2 per cent of specified assets. In addition, loans must be made and serviced by accredited types of lenders specified in the regulation.[20] Among other things, the Housing Act of 1964 increased the maximum limits of loans that can be made by a federal savings and loan association on a single-family home from $35,000 to $40,000. Associations are permitted to make loans secured by leaseholds if terms of the leasehold do not expire or are renewable so as not to expire for at least 15 years beyond the terminal date of the loan. Authority to make urban renewal and property and home improvement loans was also expanded.[21]

Restrictions for the most part, then, were removed from federal lending institutions in 1964-65, allowing them to make mortgage loans in Hawaii and elsewhere. They were, however, faced with the law under Chapter 98L in Hawaii which specifically excluded them from the category of foreign lenders. Despite this, a number of them expressed an interest in making mortgage investments in Hawaii and in 1967, about 25 federal savings and loan associations made investments or commitments, direct or otherwise, in Hawaii for a total of about $30 million. They have done so after receiving private legal opinions that they are probably exempt from taxation under the law.

Nevertheless, the indefiniteness of their position has discouraged some federal savings and loan associations from making mortgage loans in the State. The provisions of House Bill No. 185 would propose to make it specific by adding the words "a federally chartered savings and loan association" in the listing of foreign lenders in item (i) and deleting the words "any similar organization organized under the laws of the United States" appearing in item (iii) of subsection 98L-8(b). The rest of the law would stand as is. If the revision were adopted, subsection 98L-8(b) would read as follows:

"Foreign lender" means (i) a member bank of the Federal Reserve System, an "insured bank" as defined in the Federal Deposit Insurance Act, an "insured institution," as defined in the Federal Savings and Loan Insurance Corporation Act, a federally chartered savings and loan association, or an insurance company, the principal office of which is in another state, whether incorporated or unincorporated and whether acting in its individual capacity or in a fiduciary capacity, (ii) the trustee or trustees from time to time in office of any employee benefit plan, and (iii) any corporation all of the capital stock of which (except directors' qualifying shares) is owned by one or more foreign lenders of the classes specified in clauses (i) and (ii) of this subsection, but the term "foreign lender" does not include any small loan or industrial loan company of the general character covered by chapters 194 and 195.

Chapter II

ECONOMIC IMPACT OF THE PROPOSED AMENDMENT

A study of the economic impact of an amendment to Chapter 98L is largely an exercise in conjecture. There is no way of estimating how many federal savings and loan associations have been discouraged from making loans in the past two or three years after studying the law which excludes them from the definition of foreign lender.[1] It was mentioned previously that some 25 federal savings and loan associations did make investments or commitments worth about $30 million during 1967, the law notwithstanding. This indicates that they have a definite potential to acquire a share of the mortgage market in Hawaii. Nevertheless, there is little indication of the amount of new mortgage funds which will flow into Hawaii if restrictions were lifted. This is so because Hawaii competes for mainland mortgage funds with other parts of the country where construction booms are also under way. Proponents of the amendment have not argued that it would be a panacea for Hawaii's capital shortage, but only that federal savings and loan associations might make additional funds available for long-term financing for construction purposes.[2]

In the absence of specific information concerning potential investment from federal savings and loan associations, a discussion of the impact on the economy of the State is limited to several general factors which will reflect any changes should they occur. One of the means to gauge the trend of mortgage lending is to analyze the state of the construction industry in Hawaii, since the need for additional sources of long-term financing is tied to the needs and demands for housing. In addition to this primary consideration, the comparative impact of the amendment on Oahu and the Neighbor Islands, the effect on interest rates on mortgage loans, and the effect on other foreign lenders require some attention.

Construction Trends in Hawaii

The demand for mortgage money is largely determined by the trend in housing demands. In the postwar period, home construction in the United States has been an important economic stabilizer, for as demands in other areas declined and interest rates fell, mortgage demand continued because of the desire for home ownership at the end of World War II. The bulk of funds (3/4) going into mortgages in the country went for one- to four-family dwellings and other residential construction.[3] Although this demand has declined somewhat in many parts of the mainland, the demand has continued unabated in Hawaii.

The strong construction activity has had marked effects on the Hawaiian employment picture. This has been especially apparent in employment in the construction industry, both commercial and residential, which has increased according to construction activity but fell off after 1966, reflecting the downturn in construction. Table 2 indicates the development, but the distinction should be made that the vast bulk of the growth in employment has been in commercial construction. Hawaii probably can use more skilled construction workers as the boom picks up again.

Table 2

CONSTRUCTION EMPLOYMENT AND TOTAL UNEMPLOYMENT
OAHU - 1963 TO 1967

Year	Civilian Labor Force	Unemployed		Employment	Contract Construction	
		Number	Per Cent		Number	Per Cent
1963, Annual	199,140	9,330	4.7	189,640	12,930	6.8
1964, Annual	205,080	7,700	3.8	197,360	13,550	6.9
1965, Annual	214,610	7,090	3.3	207,450	15,090	7.3
1966, Annual	225,900	6,950	3.1	218,920	16,370	7.5
1967, Annual	234,280	7,880	3.4	226,150	14,960	6.6
1968, March	236,800	6,900	2.9	226,450	16,050	7.1

Sources: Hawaii Department of Labor and Industrial Relations, Labor Force Estimate, monthly and annual, and Honolulu (City and County), Redevelopment Agency, Redevelopment and Housing Research, No. 28, July, 1968, p. 32.

On the basis of past and present trends, there is every indication that the heavy demand for commercial and multi-family units (apartments and condominiums) in Hawaii will continue for some time. Despite increasing employment levels in construction, the demand for single-family units is decreasing due to the high costs of construction and limits on available land. The forecasts for single-family homes for 1968 and 1969, however, are above the 2,950 units recorded in 1966. The construction boom in the State is limited primarily to Oahu because of the disproportionate concentration of population and economic activity there than elsewhere in Hawaii. In 1967, for example, Oahu's share of residential construction in the State was 77 per cent of all single-family residential authorizations and 94 per cent of the State's privately authorized apartment units.[4]

By any measure of construction activity, the growth in Hawaii since 1955 has been impressive. Total construction volume on Oahu, as measured by building permits issued for both single- and multi-family units, increased from an annual average of approximately 5,500 units in the 1955-1959 period to an annual average of 7,225 in the 1960-1964 period. Considered separately, single-family units authorized hit a peak in 1960 and have declined somewhat through 1967. Multi-family units, including condominiums, have fluctuated from year to year, but there has been a general upward trend. Although a new high was recorded in total residential volume in 1965, with authorization of 10,800 single- and multi-family residential units, the number fell off in 1966 and 1967, reflecting the tight money conditions in 1966 existing both locally and on the mainland, which resulted in a shortage of mortgage funds to finance housing.[5]

Another measure of the housing conditions on Oahu is the estimate of housing units after allowances have been made for units demolished, converted, or abandoned during the year. As of April 1, 1968, it was estimated that there were 180,603 housing units on Oahu, a net gain of 7,686 housing units compared with 9,268 units in 1966-1967, and 9,986 units in 1965-1966. Although the 1967-1968 total was below the highs of the two previous years, the net addition was still above the annual averages from 1960 to 1965. Between April 1, 1960 and September 1, 1965, the number of housing units on Oahu increased from 125,800 to 157,000, an average annual increment of 5,750 annually. The annual increment between September 1965 to April 1967 was almost 3,000 units more than between 1960 and 1965, mostly due to the completion of a large number of apartment units in that period. Most of the net increase on Oahu, as well as the State as a whole, was in private rather than in public housing, and it is significant to note that the rate of inventory growth lagged behind the population growth in every county but Kauai in 1967-1968. For the State as a whole, the number of housing units rose 3.9 per cent while de facto civilian population increased 6.9 per cent; on Oahu, housing increased 4.4 per cent and population increased 7.3 per cent.[6]

With the heavy demand for housing, it was expected that the supply of mortgage funds especially for multi-family residential construction would be sorely taxed, even if funds were generally adequate for financing single-family units. This concern has led to the proposal supported by representatives in real estate, mortgage banking, and the building trade to seek out additional sources of mortgage funds.

Residential Construction Costs in Hawaii

There is an interlocking relationship between housing demands and the cost of borrowing, but there is yet a largely undetermined area that needs further study concerning the high cost of housing and home ownership in Hawaii and its effects on the cost of financing. The broad nature of the subject requires a more comprehensive treatment than can be attempted in this report, but is mentioned here because the shortage of mortgage funds to finance construction and the high interest rates on mortgage loans may be partly attributable to the large expense involved in building or purchasing a home in Hawaii.

The Hawaii resident pays approximately 50 per cent more than the mainland resident for an average single-family home ($27,000 compared to $18,000). During 1967, the cost of home ownership increased by 7.9 per cent on Oahu while it was 3.4 per cent for the entire nation. The growing gap between housing costs in Hawaii and the mainland is attributable to a number of factors, including high land prices, cost of materials, and construction and site costs, but the fact remains that despite the high prices, the average home in Hawaii is far below mainland averages in terms of lot size, calculated area of the dwelling, and the number of rooms. The Honolulu Redevelopment Agency reports that if the rise of island prices on its home ownership index continues for the next ten years, home ownership costs will be 400 per cent above their current level.[7]

Without delving further into the complex factors which make Hawaii a high-cost area for housing, it is obvious that the prospective homeowner must borrow more in Hawaii in order to finance a house. Whether an increase in available mortgage funds will alleviate the condition depends on whether the additional funds will be provided for residential rather than commercial construction. In this connection, it should be pointed out that loans for residential (including condominiums) construction are the primary type of mortgage in which the foreign federal savings and loan associations will deal. This specialization distinguishes all savings and loan associations from other mortgage lending institutions since associations limit their investments by law, regulations, and custom to loans largely secured by residential real estate. In 1967, for example, 99 per cent of the loans made by savings and loan associations in the United States was secured by real estate, and they provided more than two-fifths of all home mortgage credit in the country. As a general rule, savings and loan associations do not stray from this sort of investment since they have had the least difficulty with loans on owner-occupied homes. They ordinarily give attention to loans in the following order of preference: single-family dwellings, two- to four-family dwellings, small properties combining business and residential uses, residential real estate consisting of more than four-family units, large business property, and special purpose real estate.[8]

It was noted previously that the liberalization of federal regulations for lending allows federal savings and loan associations to make loans in the 219 standard metropolitan areas. In Hawaii, this will limit foreign federal savings and loan association lending on conventional mortgages to Oahu, but this does not mean the Neighbor Islands will not be affected in any way. Federal limitations on the making of loans to metropolitan areas apply only to conventional-type loans. F.H.A.-V.A. loans can be made by federal savings and loan associations on Neighbor Islands for home construction without similar geographic limitations. Moreover, there is another side effect since the availability of funds through federal savings and loan associations for mortgages on Oahu could theoretically free local funds for investments to be channeled to the Neighbor Islands. These secondary effects, however, are difficult to predict and may be of little consequence since the construction level on the Neighbor Islands hardly compares to the boom situation on Oahu.

Interest Rates and Types of Mortgage Loans

Interest rates are primarily the result of the relationship between supply and demand. When money is the commodity in demand and only a limited supply is available, the price of money (or the cost of borrowing money) is the rate of interest.[9] Contrary to popular belief among some borrowers, interest rates are not controlled by the lender. A lender may refuse to make a loan below a certain interest rate, but unless he is in a position to dominate a particular geographic region in the mortgage market, rates are generally beyond his control.[10]

Mortgage lending and borrowing is the largest single component of the long-term capital market. At a given time, general economic conditions play a major part in setting the lending pattern which is sensitive to the availability of funds and the level of interest rates. The fundamental difference between rates on mortgages and other capital market rates is that mortgages are primarily local while other capital market securities are national in scope. This local or regional nature of mortgages results in definite geographic variations in rates. In most cases, interest rates in a given locality evolve out of the operation of economic laws.[11]

Interest rates are also affected by a number of other variables, including governmental regulations. In this regard, F.H.A. and V.A. interest rate requirements are significant since they are often compared with conventional mortgage interest rates. Under the F.H.A. program, long-term, low-interest home loans are obtained from private lending institutions and homes are built in conformance with minimum property standards by private contractors. F.H.A. loans are open to all qualified borrowers while V.A. loans are available only to qualifying veterans. F.H.A. insures the private lender against loss in the event of failure of the borrower to repay the loan in full. By being insured against loss, lenders have been willing to accept smaller down payments and to lend their money over a longer period of time and under circumstances which otherwise might have been less attractive for investment. To finance its operations, F.H.A. charges an insurance premium of one-half per cent per annum on the average scheduled mortgage loan balance outstanding during the year which is included in the borrower's monthly payment.

The attraction of F.H.A.-V.A. loans for the borrower are the limits placed on interest rates and other charges. The rate of interest that lenders can charge on mortgages insured by the F.H.A. is currently 6-3/4 per cent per annum on the loan balance outstanding each month. Under its regular program (section 203b), F.H.A. insures mortgages in amounts up to $30,000 on individual loans, although special provisions are made for Hawaii, Alaska, and Guam because of higher costs. In Hawaii, the limit is $37,500 for individual homes.[12]

At times, as is the case in Hawaii, the rate of interest that lenders are allowed to charge on mortgages insured by F.H.A. is lower than the yield (net return on investment of interest rate adjusted for loan costs) required by lenders in the market. When money is scarce, the lender has an advantage and he may not want to issue the kind of low-interest, long-term mortgages approved by the government. For this reason, lenders sometimes discount F.H.A. mortgages, i.e., they charge a certain number of points, a point being a dollar per hundred dollars of mortgage amount, to make up the difference between the F.H.A. interest rate and the required yield on the market. The number of points charged varies in different places at different times among different lenders. F.H.A. regulations prohibit the home buyer from paying a discount but cannot control the charges that a lender collects from anyone other than the buyer.[13] The builder of the house of the person selling it may be required to pay the amount, but the cost may be disguised and passed on to the buyer. Conventional mortgages, on the other hand, can be adjusted to suit the needs of the borrower as well as the lender allowing special considerations. In Hawaii, the majority of mortgage loans are conventional mortgages with current interest rates averaging about one per cent higher than F.H.A. standards. After adjustments based on the one-half of one per cent insurance premium charge and discounts are paid; however, the F.H.A. mortgage may really cost only one-fourth to one-half of one per cent less than a conventional loan.

The problem of mobility of mortgage funds and the marketability of mortgages has been alleviated somewhat through the buying and selling activities of the Federal National Mortgage Association and the Federal Home Loan Bank System. These agencies have improved the flow of funds in one segment of the market, but in conventional mortgages, local and regional variations in interest rates have persisted and are expected to do so.[14]

Not only does the interest rate differ between F.H.A.-V.A. loans and conventional loans, but it also varies for the type of housing to be financed. Mainland investors are willing to put money into Hawaii mortgages secured by single-family residence or commercial projects but appear to be reluctant to invest in mortgages for individual condominiums, causing the rates for condominium loans to be a quarter to one-half per cent higher than they are for single-family residences. This added inducement of a higher interest rate is necessary to attract an investor into the condominium mortgage market. The reason for the reluctance is primarily because condominiums have not been successful in most areas of the mainland. Most institutional lenders also are reluctant to lend for buildings designed for hotel operation or for rental apartment operation and require owner-occupancy.[15]

An attempt to predict the future course of interest rates might be foolhardy since interest rates fluctuate for a number of reasons, but if avenues are open for more investors, it is argued by some in the mortgage lending business that interest rates will be lowered. This argument has several aspects to it. There is little doubt that after the passage of Act 194 in 1961, the exemptions and immunities granted in the foreign lenders law helped to attract more investment funds to Hawaii from out of state. Foreign insurance company investments in mortgage loans grew from $171.7 million in 1961 to $363 million in 1966. Approximately 100 foreign life insurance companies make mortgage investments in Hawaii currently.[16] In addition, out-of-state savings banks have invested close to $100 million in the mortgage market since 1961. Theoretically, the effect of this flow of funds is to lower interest rates on loans, and this may be the path interest rates will take; but high interest rates, it should be added, are what attract foreign lenders in the first place. Lower interest rates, if they do come about, would make investment less attractive and would probably discourage mainland investment. The nature of the housing demands and the state of the construction industry in Hawaii are such that despite increasing flow of funds, interest rates are still fairly high. How significant the amount of mortgage funds will be with the amendment is still unknown, but the impact on interest rates may not be immediate nor great.

Impact on Other Foreign Lenders

It has been pointed out that there will probably be an increase in funds for multi-family residential construction through the inclusion of federal savings and loan associations as foreign lenders. This is important since other large sources of mortgage funds appear to be moving more and more out of residential construction financing into hotel and commercial construction financing. Mainland life insurance companies, which are among the most important in the lending field and account for the most rapidly increasing segment of mortgage investment in Hawaii, have become the prime source of financing for projects which exceed $1 million. The announcement in August 1968 of a multi-million dollar development project proposed at Kahuku Point by the Prudential Insurance Company and the Del W. Webb Corporation is an example of the large-scale investments of insurance companies.[17]

The operations of life insurance companies are regulated by the laws of the state in which they are incorporated, and the great majority of states allow insurance companies to make both conventional loans and fixed rate F.H.A.-V.A. loans on a nationwide basis.[18] Mortgages as an investment outlet have always been important to life insurance companies because of high yields and the opportunity they provide of spreading investments over a wide geographic area. In most cases, insurance companies do not make loans directly, but purchase a loan outright from a savings or other lending institution, which needs the funds derived from the sale to make more loans. Of the $58.7 billion in mortgages on property in the United States at the end of 1965, the heaviest concentration of $10.6 billion was in the Pacific region which covers the West Coast and Hawaii. Other capital-short areas competing for insurance company investment funds are the southwestern and southeastern regions of the United States.[19]

It was noted earlier that mutual savings banks were among the foreign lending institutions to enter the mortgage market in Hawaii under the foreign lenders law. The movement of funds from this source has been somewhat similar to that of the insurance companies. Mutual savings banks are state chartered institutions, and state laws controlling the mortgage investments of mutual savings banks vary considerably. They are peculiar to only 17 states primarily on the East Coast, which has traditionally been a capital-rich area compared to the West Coast where the demand for funds for home financing has far outstripped the supply. Close to 75 per cent of their number holding 90 per cent of the assets of savings banks are concentrated in New York, Connecticut, and Massachusetts.[20]

The majority of mutual savings banks are engaged in out-of-state mortgage programs with savings banks in New York continuing to be the most active participants in the field followed by banks in Massachusetts, Pennsylvania, and Rhode Island. In out-of-state mortgage lending, funds from mutual savings banks have been placed in capital-short areas where yield on mortgage loans are attractive. Out-of-state loans made by savings banks are purchased largely from mortgage companies which retain the servicing of the mortgage.[21]

Under most state regulations, savings banks may make a loan anywhere in the United States on F.H.A.-V.A. type loans. In terms of conventional loans, however, more stringent geographic restrictions applied by state laws limit conventional loans primarily to states adjoining the state in which the mutual savings bank is located.[22] Recently, more eastern mutual savings banks have indicated an interest in making conventional loans in Hawaii.[23] Savings banks are a good source of money for direct loans at competitive market rates, although the rates in particular cases have sometimes been steep at 8 to 8-1/2 per cent for 75 per cent financing over 25 years. Savings banks do not deal in participation loans at the present time.[24] There are indications, however, that mutual savings banks may move in the same direction of life insurance companies by investing in income-producing property such as resorts.

If both life insurance and savings banks move into other areas of construction financing, it could be beneficial to have an additional source of funds for multi-family residential construction through foreign federal savings and loan associations. Although other foreign lenders will be in competition with foreign federal savings and loan associations, this would not appear to have adverse effects on the lenders or the economy as there would be different emphases on the type of mortgage investments by each type of foreign lender.

Chapter III

THE IMPACT ON THE LOCAL SAVINGS AND LOAN ASSOCIATIONS

At the time the amendment in H. B. No. 185 was under consideration, the question of possible inequities was raised by the local savings and loan associations through their organization, the Savings and Loan League of Hawaii. In the face of what appeared to be favorable reaction on the part of other mortgage lenders and general arguments that the economy of the State would benefit from more mortgage investment, the efforts of the savings and loan associations seemed at best an exercise in futility. Although the reasons for the League's opposition were not readily apparent to the proponents of the amendment, the position of the savings and loan associations cannot be dismissed as being entirely one of self-interest. An understanding of the special nature of savings and loan associations in the mortgage lending field may give some balance to the general arguments that the amendment in H. B. No. 185 will be beneficial to the economy as a whole, but the difficulty still remains when a judgment must be made for or against the amendment.[1]

Mortgage Lenders in Hawaii

In terms of lending authority, financial institutions can be classified into two types. One is a specialized mortgage lender like the savings and loan association whose lending authority is limited by law and regulation and invests practically all available funds in mortgages. Savings and loan associations are privately owned and managed savings and home-financing institutions. They accept the savings of individuals and organizations and use these funds to make long-term loans in the community for purchasing, constructing or repairing homes. From the interest derived on the loans, associations pay their operating expenses, pay earnings to savers for the use of their funds, and set aside reserves for protection against possible losses.[2]

Associations are regulated either by the state government[3] or by the federal government in the form of a charter. In the case of federally chartered savings and loan associations, the examination, supervision, and regulation of activities are handled by the Federal Home Loan Bank Board. An association which receives a federal charter must carry the term "federal" in its official corporate title and is required by law to be a member of the Federal Home Loan Bank System and to carry insurance on its savings account through the Federal Savings and Loan Insurance Corporation.[4] Federal savings and loan associations with offices located in the State are subject to the same taxes and entitled to the same privileges as state-chartered associations.[5]

As they operate in Hawaii, there are no significant differences between the two federal savings and loan associations and the twelve state-chartered savings and loan associations which maintain places of business in the State.[6] They limit their loans to within the state lending area, primarily on first mortgages on single-family, owner-occupied homes. They also make mortgage loans for residential condominiums which are considered to be single-family homes for lending purposes. The vast bulk of their assets is in real estate mortgage loans.[7]

In contrast, the other type of financial institution has a diversified lending authority and can allocate available funds among different types of investments on the basis of attractiveness of returns and other economic considerations. With less of its assets tied up in long-term mortgages, the diversified lender does not have the same liquidity problem that savings and loan associations do. In Hawaii, the primary competition for savings and loan associations in the field of mortgage lending comes from commercial banks. In practice, commercial banks prefer business loans as an outlet for funds and have moved into mortgage lending when business demands declined. This has led to charges in the past that commercial banks are eager to make profitable, high-rate mortgage loans when money is easy and other loan demand is slack, but abandon the mortgage market when money is tight, preferring business and consumer lending instead. This view is not entirely correct for Hawaii since commercial bank holdings in mortgages constitute a much more significant part of total banking activities than in other localities. However, it is true that much of commercial bank activity in real estate lending is in the nonresidential category going to commercial or industrial properties.[8]

One other type of mortgage lender should be mentioned, which belongs in neither category. These are mortgage companies, which are largely privately owned stock corporations representing the investment of a significant amount of capital funds by one or a few individuals. Although their home mortgage lending function is similar to the savings and loan associations, their financial size is more limited by their private nature while savings and loan associations draw on savings of the entire community for funds to lend.[9] Essentially, mortgage companies act as middlemen, originating mortgage loans from those who construct or acquire properties and selling these loans to institutional investors such as insurance companies. In the case of foreign lenders, the mortgage companies usually service the mortgages that they sell.[10] Since they sell directly to an outside institution and seek such investments, their position on the question of expanding the list of foreign lenders is at odds with the savings and loan associations because of the additional mortgage funds these foreign lenders can provide.

Supply of Local Mortgage Funds

Unlike the operations of the mortgage companies, both savings and loan associations and commercial banks look to personal savings as the primary source of residential mortgage credit. Although the level of personal savings generally determines the supply of residential mortgage credit, a high level of personal savings does not necessarily mean that a large supply of funds will be available for mortgage lending. If personal savings are channeled into the stock market or if a large share of savings is placed in the commercial banks rather than savings and loan associations, the residential mortgage market generally does not fare well.[11]

The primary factor determining whether the bulk of deposit type savings go into savings and loan associations or into commercial bank time deposits is the relative interest rates paid by these two types of institutions. Formerly, the commercial bank rates were under limits imposed by the Federal Reserve Board, but since the introduction of high-yielding certificate deposits in the 1960's, the spread between interest rates on savings between banks and savings and loan associations has narrowed. The ability of a savings and loan association to keep its deposit rates above that of competing banks depends on the effective mortgage rate in the lending area. So long as the mortgage rate is high, the savings and loan associations are able to raise the deposit rate up to the limit set by law to keep it above the bank rate in order to insure a sufficient flow of funds.[12]

Although the contention has never been proved, it is generally felt that, all things being equal, savers prefer bank time deposits to savings and loan accounts for reasons of convenience. To be competitive with bank time deposits, the savings and loan accounts must pay about one-half of one per cent more than banks do on savings accounts.[13] Hawaii's savings and loan associations currently pay interest to savers at the rate of 5 per cent on a regular savings account and lend on mortgage loans with rates ranging from 7-1/4 per cent to 8 per cent, a yield which is considered profitable even after rates are adjusted for costs. Nevertheless, a number of local savings and loan associations have had to resort to gifts and premiums and large advertising outlays in order to attract savings. To the extent that banks bid more aggressively for savings, fewer savings dollars will be available for mortgage investments since the banks limit the amount they put into mortgages by their own policies. This, say the local savings and loan associations, is one of the reasons why banks desire more funds for mortgages from foreign lenders, so that they can lend their own funds in other more profitable channels. While it would be easy to interpret the opposite stands of both types of lending institutions on the basis of their own interests, it should be noted that prudent banking policy generally limits the amount of mortgages held, and banks cannot be called to account for following traditional practice. Table 3 shows the proportion of savings/time deposits in mortgages of commercial banks and savings and loan associations in Hawaii, and illustrates the difference between the two types of institutions.

Foreign and Local Lenders

All types of local lenders originate and sell loans from their own portfolio, but banks and mortgage companies are more actively engaged in this practice than savings and loan associations. The banks and mortgage companies often seek out foreign investors on the mainland to purchase the mortgage loans they make, retaining the servicing of the mortgage. One estimate is that at least one-third of the loans owned by out-of-state institutional investors were originated and are presently serviced by banking institutions. The fees for the servicing vary with the size of the loan and are negotiated between the foreign lender and the local lender. Generally, the foreign lender will pay a servicing fee of three-eighths of one per cent which comes out of the interest yield levied on the loan. The yield, then, will have to be attractive enough for the foreign lender to make a loan in spite of the servicing costs.[14]

While local savings and loan associations agree that Hawaii is a capital-short area, the amendment of Chapter 98L is opposed because the legislation, it is contended, works well when money is needed, but has adverse effects on all mortgage lenders when the demand for funds decrease.[15] Since the only requirement of the amendment is the registration of foreign federal savings and loan associations, some of the opposition

Table 3

PROPORTION OF SAVINGS/TIME DEPOSITS IN MORTGAGES

	Commercial Banks			Savings and Loan Associations		
Year	Mortgage Balance	Savings/Time Deposits	Ratio	Mortgage Balance	Savings Balance	Ratio
1958	$152,829,133	$196,577,674	77.7%	$136,917,421	$137,366,746	99.7%
1959	186,960,794	214,526,623	87.1	161,636,742	158,831,159	101.8[a]
1960	203,143,502	233,419,379	87.0	185,034,096	175,316,967	105.5
1961	203,635,669	266,766,057	76.0	208,958,944	206,150,954	101.4
1962	220,877,324	305,594,281	72.3	252,650,753	242,376,441	104.2
1963	226,341,873	331,209,719	68.3	312,752,061	299,148,337	104.5
1964	249,340,381	349,745,658	71.3	377,192,642	346,211,783	108.9
1965	259,377,476	394,392,852	65.8	423,602,931	378,069,889	112.0
1966	298,496,339	427,665,708	69.8	437,992,773	399,458,526	109.6
1967	317,619,955	495,419,483	64.1	453,631,222	450,181,275	100.8

Taken from: State of Hawaii, Department of Regulatory Agencies, Bank Examination Division, Comparative Statement of Condition of Savings and Loan Associations and Comparative Statement of Condition of Banks for years 1958-1967.

[a]Percentages exceed 100 per cent because of retained earnings (reserves) and F.H.L.B. advances in mortgages.

is based on the savings and loan associations' fear of unregulated loan competition, and a number of the concerns are genuine and should not be overlooked. While a savings and loan association might find it desirable to lend in a distant and higher yielding market if it could not lend profitably locally, not many associations would favor having to compete in their own areas with distant associations who would have a tax exemption in their favor. Considering the attractions of the Hawaiian mortgage market and the fact that there are a number of federal savings and loan associations on the mainland whose assets are considerably larger than local firms and can make several million dollars available in loans, the discomfort of the local savings and loan associations is understandable.

Present Outlets for Foreign Federal Savings and Loan Associations

Under existing regulations, there are two ways through which a foreign federal savings and loan association can invest in mortgages in Hawaii other than under Chapter 98L. The first method was mentioned earlier and is through the participation loan. This is the primary method by which local and foreign associations now cooperate. A foreign savings and loan association with excess cash may buy a partial ownership or interest in the mortgage of a local association which may need more cash to meet other loan requests. In this case, the income derived from the share of the local savings and loan association on the loan is taxable, providing a source of state revenue.[16] On the other hand, the income of the foreign lender derived through its share in the participation loan is tax exempt.[17] Through the participation program, the local savings and loan associations estimate that some 75 mainland savings and loan associations have invested more than $100 million in Hawaii. As can be seen in Table 4, investment funds from this mainland source have averaged about 25 per cent of the value of mortgages made by local savings and loan associations in the period 1963-1967.

Table 4

INFLOW OF MAINLAND PARTICIPATION MONEY

Year	Mortgages Recorded by Hawaii S&L	Participation by Mainland S&L	Ratio
1963	$118,113,000	$25,000,000	21.2%
1964	145,653,000	40,000,000	27.4
1965	145,403,000	50,000,000	34.4
1966	78,750,000	14,000,000	17.8
1967	89,507,000	24,000,000	26.8

Source: Savings and Loan League of Hawaii.

Foreign lenders (and presumably foreign federal savings and loan associations) also can invest through the outright purchase of mortgages originated by a local lender.[18] In the purchase of mortgages, it was pointed out earlier, the local lender usually retains the servicing of the loan. Since the law authorizes local savings and loan associations to sell these loans which it originates within prescribed limits, it has been the contention of the local savings and loan associations that the present system already works well since substantial amounts of out-of-state savings and loan money (80 per cent of which is from foreign federal associations) have been invested under the existing arrangements. Nevertheless, even if the present setup is maintained, the position of foreign federal associations is still vague as to when their activities are regarded as "doing business" and whether tax exemptions should apply to the frequent and regular purchasing of loans.

State Government Regulations and the Foreign Lenders

The amendment as recommended in H. B. No. 185 is basically a clarification of the status of the foreign federal savings and loan association and envisions no changes in the subsequent sections of the law dealing with the exemptions, privileges, and activities presently extended to foreign lenders. Under Chapter 98L, a foreign lender who wishes to make any of the permitted investments must file a statement with the Director of Regulatory Agencies concerning its incorporation and principal activities. Upon the filing of the statement and its approval by the Director of Regulatory Agencies, the immunities provided by the law will be operative.[19]

The inclusion of foreign federal associations in the category of foreign lenders would subject them to the same regulations. At present, there are no regulations governing activities of foreign federal associations should they make direct loans in Hawaii. Those which are mainland-based and which are making commitments which are not participation loans or outright purchases,as covered elsewhere by state law, do not register with the Department of Regulatory Agencies. Information on which foreign federal savings and loan associations are currently making loans is known only to the associations themselves and those who are involved in the negotiation for the loans. Such associations have operated here on the assumption that their activities do not violate the law, although those federal savings and loan associations which did apply to conduct loan activities under Chapter 98L were turned down by the Department of Regulatory Agencies because the law clearly states they do not come under the category of a foreign lender.

In citing the unfair competitive conditions which may arise from the amendments, the savings and loan associations in Hawaii are not attacking the exemption clause. The tax exemption is the core of any foreign lenders law and is a major feature in attracting investment. What the local savings and loan associations would like to see is a change in the permitted activities of foreign lenders and a closer regulation of these activities. Should foreign federal associations be included under the amendment, the League proposes to amend one of the present permitted activities of foreign lenders from "making loans" to "purchasing loans".[20]

The difference in wording is important because by limiting foreign lenders to "purchasing" rather than "making" loans, direct loans would be prevented between borrower and lender. Implicit in the arguments of the local savings and loan associations is the concern that the foreign federal savings and loan associations, should they qualify as foreign lenders, would bypass the participation technique entirely, cutting off local savings and loan associations from servicing fees and other earnings. They contend that potential problems exist under this type of arrangement with the elimination of the middleman. Thus, a condominium developer, for example, may seek a direct loan from a foreign federal savings and loan association, arranging for his own loan without any state regulation and free from taxation of any sort. Although on the surface this substitution appears to be motivated by self-interest, such an amendment does allow a certain degree of indirect regulation by the state government through regulations of the local agency which would hold the servicing in the case of the purchase of the loan.[21]

The situation of unrestricted direct loans may, in effect, occur, but the exact arrangements which would take place cannot be predicted definitively. The banks and mortgage companies as originators and servicers of mortgages are eager to have a new source of funds to purchase their mortgages and doubt that there will be much difference in the lending arrangements, since foreign federal savings and loan associations are not likely to originate their own loans in Hawaii but would probably prefer to use mortgage bankers who know the local conditions intimately. In this regard, the Department of Regulatory Agencies records show that the majority of foreign lenders operating under Chapter 98L in Hawaii do work through local agents rather than directly, and the pattern will probably be maintained.[22]

A large part of the concern of the local savings and loan associations covers the entire field of mortgage lending and the need for more regulation in order to protect domestic-chartered institutions like themselves and the public interest as well. What provisions should be reviewed and revised are not within the scope of this report, but steps such as the passage of Act 228 in the 1967 General Session regulating mortgage brokers and mortgage solicitors have been in the right direction.[23]

SUMMARY

It has been indicated in the previous chapters that the amendment of section 98L-8(b) should have favorable effects on the economy as a whole. The action would probably make more mainland funds available to finance further residential construction and may eventually lower interest rates on mortgages. The economic impact, however, is likely to be limited because the amendment involves the addition of only one type of foreign lender, the mainland federal savings and loan association. In the face of continuing demands for mortgage funds and the boom conditions of the construction industry in Hawaii, there seems to be good reason for an amendment of this sort.

The opposition of the local savings and loan associations is based on two factors. First, they contend that as specialized mortgage lenders, they are likely to be affected adversely by such an amendment. It is their argument that present practices such as participation, where a mainland association holds a joint interest in a mortgage with a local association, are adequate as investment outlets for mainland-based federal savings and loan associations. Secondly, there is a concern by local associations that unrestricted lending activity by foreign lenders, which may well increase in the future, will cause problems if more stringent state regulations are not imposed.

While the concerns of the local savings and loan associations are justified, further restrictive measures on the foreign lending field in Hawaii are not under consideration in this amendment. The issue is primarily one of clarification of the status of the mainland federal savings and loan associations as a foreign lender. Even if economic arguments reviewed in this report as to the expected benefits and inequities are largely conjectural in nature, there is still a compelling reason for some action to be taken because of the vagueness of the law.

Under Chapter 98L, mainland federal savings and loan associations are not foreign lenders, yet it is apparent that several such associations did make loan commitments in 1967 despite the law. If these loans were made directly, it has not been resolved whether this was in violation of Chapter 98L or other laws. They have not been prosecuted, and the Department of Regulatory Agencies has no record of which associations are making loans since they do not qualify as foreign lenders under Chapter 98L and the Department thus has no jurisdiction over them. The passage of the amendment may seem like an attempt to legalize existing practice, but it would at least require mainland federal associations to register with the Department of Regulatory Agencies if they intend to operate under Chapter 98L. If the amendment is not passed, then some decision on whether the direct lending activities now carried on by foreign federal savings and loan associations are in violation of the law should be made. In either case, a clearer definition of the permitted activities of foreign federal savings and loan associations is necessary.

In the interests of the economy and to establish at least some regulation over the lending practices of foreign federal savings and loan associations, the present amendment is probably the simplest action required to clarify their status. If the amendment is adopted, some problems may arise. While there are no conclusive data at present which would establish what real adverse effects the amendment would have on the local savings and loan industry, the legislature should be aware of its responsibilities to provide the necessary corrective measures to erase inequities once the effects of this amendment are clearly demonstrated.

FOOTNOTES

Chapter I

1. Annual Economic Report 1963, Bank of Hawaii (Honolulu: 1963), p. 21.

2. Annual Mid-Year Report 1953, Bank of Hawaii (Honolulu: 1953), pp. 6, 14.

3. Annual Economic Report 1963, Bank of Hawaii, p. 21. It should be noted that there is a high correlation between residential construction activity and mortgage credit. Housing starts, the value of new construction, and net increases in mortgages outstanding all move up and down together. The direction of causation, however, is still not conclusive. See: U. S., Congress, Senate, Subcommittee on Housing and Urban Affairs of the Committee on Banking and Currency, A Study of Mortgage Credit, 90th Cong., 1st Sess., 1967, pp. 369-381.

4. Construction in Hawaii 1968, Bank of Hawaii (Honolulu: 1968), p. 5 and Annual Economic Review 1968, Bank of Hawaii (Honolulu: 1968), p. 36.

5. Construction in Hawaii 1968, Bank of Hawaii, p. 5 and United States Savings and Loan League, Savings and Loan Fact Book 1968 (Chicago: 1968), pp. 18-19.

6. Honolulu Star-Bulletin, September 19, 1968, p. B-2.

7. Construction in Hawaii 1968, Bank of Hawaii, p. 5.

8. Insurance Commissioner's Report 1954, Territory of Hawaii; Summary of Insurance Business in Hawaii for the Year 1953 (Honolulu: 1954), p. 14.

9. Insurance Commissioner's Report 1949, Territory of Hawaii; Summary of Insurance Business in Hawaii for the Year 1948 (Honolulu: 1949), p. 18.

10. Insurance Commissioner's Report 1956, Territory of Hawaii; Summary of Insurance Business in Hawaii for the Year 1955 (Honolulu: 1956), p. 14.

11. Rev. Laws of Hawaii, sec. 181-313 (1955).

12. Robert Pease and Lewis Kerwood, Mortgage Banking (New York: McGraw-Hill Book Company, 1965), pp. 95-96.

13. Council of State Governments, Program for 1960 (Chicago: Council of State Governments, 1960), pp. 91-93. This model law was passed by the Alaska state legislature in 1960. See: Alaska Stat., Title 6, ch. 10.

14. See: Hawaii, Legislature, Senate, Committee on Ways and Means, 1st Legislature, General Sess., 1961, Standing Committee Report 1048 [on] H. B. 4 (H. D. No. 1, S. D. No. 1). Comment on the section of the act concerning foreign lenders makes no mention of federal savings and loan associations and speaks only of "certain carefully defined classes of out-of-State lenders" which would qualify for tax immunities.

15. Annual Economic Report 1964, Federal Home Loan Bank Board (Washington: Government Printing Office, 1965), p. 75.

16. "Conventional" mortgage loans are those which can be tailor-made to suit the needs of both the borrower and the lender. Credit can be extended to meet special considerations, but interest rates are adjusted accordingly to market demands rather than government approved levels such as in the F.H.A.-V.A. program.

17. Lawrence V. Conway, Savings and Loan Principles (Chicago: American Savings and Loan Institute Press, 1965), pp. 221-222.

18. Ibid., p. 223.

19. Annual Economic Report 1964, Federal Home Loan Bank Board, pp. 76-77.

20. 12 C.F.R. sec. 545.6-18(f) (1966).

21. Henry Hoagland and Leo Stone, Real Estate Finance (Homewood, Illinois: Richard D. Irwin, Inc., 1965), p. 221.

Chapter II

1. Records in the Department of Regulatory Agencies show that four foreign federal savings and loan associations officially applied to do business under Chapter 98L but were turned down.

2. A number of interviews were conducted with people in the mortgage lending field, and their general observations are incorporated in this chapter where there appeared to be (in the opinion of the researcher) substantial agreement on the subject.

In favor of the amendment were:

H. H. Stephenson	- Bank of Hawaii (July 17, 1968)
W. J. Huckins	- Bank of Hawaii (July 17, 1968)
Charles Wade	- First National Bank (July 22, 1968)
Stanley Baird	- Honolulu Mortgage Company (August 27, 1968)
H. Dickey Thacker	- Honolulu Board of Realtors (July 19, 1968)
Jack K. Palk	- Real Estate Commission (July 19, 1968)
Morris Taketa	- Central Pacific Bank (September 26, 1968)

3. Robert Pease and Lewis Kerwood, Mortgage Banking (New York: McGraw-Hill Book Company, 1965), pp. 125, 141.

4. Construction in Hawaii 1968, Bank of Hawaii (Honolulu: 1968), p. 8.

5. Honolulu (City and County), Redevelopment Agency, Redevelopment and Housing Research, No. 28, July, 1968, pp. 1-2 and U. S., Federal Housing Administration, Field Market Analysis Service, Analysis of the Honolulu, Hawaii Housing Market as of April 1, 1967 (Washington: 1967), p. 11.

6. Ibid., p. 11.

7. Honolulu (City and County), Redevelopment Agency, Redevelopment and Housing Research, Supplemental Research Notes, February, March 1968.

8. United States Savings and Loan League, Savings and Loan Fact Book 1968, p. 77 and Henry Hoagland and Leo Stone, Real Estate Finance (Homewood, Illinois: Richard D. Irwin, Inc., 1965), pp. 215-216. Mainland federal savings and loan associations are also playing important roles in financing condominiums. The announcement of the Kealani condominium is an example of this arrangement where primary financing is being provided by the First Federal Savings and Loan Association of Davenport, Iowa with mortgages being handled locally by Realty Mortgage Corporation. (Sunday Star-Bulletin and Advertiser, October 7, 1968, p. D-1).

9. Pease and Kerwood, p. 125.

10. Stanley McMichael and Paul T. O'Keefe, How to Finance Real Estate (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1967), p. 198.

11. Hoagland and Stone, p. 221.

12. U. S., Federal Housing Administration, Office of Public Information, F.H.A. Home Mortgage Insurance, F.H.A. No. 208 (Washington: Government Printing Office, 1963). Current figures from Honolulu F.H.A. office.

13. U. S., Department of Housing and Urban Development, Federal Housing Administration, F.H.A. Financing for Home Purchases and Home Improvements, F.H.A. No. 428 (Washington: Government Printing Office, 1966).

14. Pease and Kerwood, p. 142.

15. Honolulu Star-Bulletin, August 26, 1968, p. A-14.

16. Report of the Insurance Commissioner of Hawaii 1967; Summary of Insurance Business in Hawaii for the Year 1966 (Honolulu: 1967), p. 16.

17. Honolulu Star-Bulletin, August 20, 1968, p. A-1, August 23, 1968, p. B-7.

18. McMichael and O'Keefe, p. 36.

19. Institute of Life Insurance, 1967 Life Insurance Fact Book (New York: 1967), p. 84.

20. McMichael and O'Keefe, pp. 42-44.

21. Pease and Kerwood, pp. 100-101, 105, 107. Department of Regulatory Agencies records list at least sixteen savings banks currently doing business under Chapter 98L, most of which work through a corresponding agent here in Honolulu rather than directly. Because of the unlikelihood that residential projects will be handled on a direct basis, the problem of direct lending may not arise. However, it could have adverse effects in lending on hotels. Many loans on major hotels have been "direct", and this could discourage lending in other fields.

22. McMichael and O'Keefe, pp. 45-47.

23. Construction in Hawaii 1967, Bank of Hawaii (Honolulu: 1967), p. 4.

24. Honolulu Star-Bulletin, August 23, 1968, p. B-7.

Chapter III

1. Interviews with those in the savings and loan field included: Clarence Taba, Savings and Loan League of Hawaii, September 25, 1968; George Cooke, First Federal Savings and Loan Association, July 25, 1968; J. Ralph Brown, State Savings and Loan Association, July 16, 1968.

2. American Savings and Loan Institute, Handbook of Savings and Loan (Chicago: 1965), pp. 4-5.

3. Rev. Laws of Hawaii, ch. 180 (1955).

4. U. S., Federal Home Loan Bank Board, Combined Financial Statements 1967 (Washington: Government Printing Office, 1968), p. 73.

5. Rev. Laws of Hawaii, sec. 180-15 (1955).

6. The savings and loan associations are: First Federal, Island Federal, American, First Financial, Hawaiian, Honolulu, International, Pacific, Pioneer, State, Territorial, Hilo-Kona, Kauai, and Maui.

7. "Comparative Statement of Condition of Savings and Loan Associations Operating in the State of Hawaii As at the Close of Business June 30, 1968, December 31, 1967, and June 30, 1967" (Bank Examination Division). (Mimeographed).

8. U. S., Congress, Senate, Subcommittee on Housing and Urban Affairs of the Committee on Banking and Currency, A Study of Mortgage Credit, 90th Cong., 1st Sess., 1967, pp. 144-45. Loans on residential property, particularly F.H.A.-V.A. loans, are made by commercial banks in considerable volume as compared to savings and loan associations which deal in conventional loans.

9. American Savings and Loan Institute, p. 68.

10. Act 228, Session Laws of Hawaii 1967, regulates activities of mortgage brokers.

11. U. S., Congress, Senate, Subcommittee on Housing and Urban Affairs of the Committee on Banking and Currency, A Study of Mortgage Credit, 90th Cong., 1st Sess., 1967, p. 371.

12. Ibid., pp. 372-374.

13. Ibid., p. 374.

14. If, for example, a foreign lender makes a loan at 8 per cent interest, he might pay a servicing fee of 3/8 per cent of this to the local firm; the remaining yield of 7-5/8 per cent must be profitable enough for the foreign lender to invest in Hawaii rather than elsewhere. Estimate of loan origination was from Stanley Baird, Honolulu Mortgage Company.

15. The Savings and Loan League, in fact, has argued that local savings funds have caught up substantially with the loan balance in 1967; borrowings to finance mortgage have been reduced considerably, thus giving local savings and loans more ability to expand and decreasing the need for out-of-state money.

RELATIONSHIP OF MORTGAGES TO SAVINGS, BORROWINGS AND ASSETS

Year	Savings Balance	Mortgage Balance	Ratio	Mortgage/Borrow Ratio	Mortgage/Assets Ratio
1963	$299,148,337	$312,752,061	104.5%	5.9%	87.5%
1964	346,211,782	377,192,642	108.9	8.3	87.7
1965	378,069,889	423,602,931	112.0	11.5	87.9
1966	399,458,526	437,992,778	109.6	11.6	86.3
1967	450,181,275	453,631,222	100.7	5.8	84.0

Source: Savings and Loan League of Hawaii.

16. Rev. Laws of Hawaii, ch. 127 (1955).

17. Ibid., sec. 180-52.5.

18. Ibid., sec. 180-52.

19. Rev. Laws of Hawaii, sec. 98L-11 (1965 Suppl.).

20. Ibid., sec. 98L-10(a).

21. Excerpts from the "Model Savings Association Act", which is recommended and endorsed by the United States Savings and Loan League, would define a foreign association and limit the business transaction to the "purchasing" of loans.

> SECTION _____. FOREIGN ASSOCIATIONS. (a) Defined. For the purposes of this section, the term "foreign association" shall include any person, firm, company, association, fiduciary, partnership or corporation, by whatever name called, actually engaged in the business of the savings association, which is not organized under the provisions of this Act or the Home Owners' Loan Act of 1933, as amended, the principal business office of which is located outside the territorial limits of this State.
>
> (b) Doing Business. No foreign association shall do any business of a savings association within this State or maintain an office in this State for the purpose of doing such business unless an application is made to the Commissioner for permission to do such business in this State which is approved by him.
>
> . . .
>
> (f) Transactions Which Are Not Considered "Doing Business." For the purposes of this section and any other law of this State prohibiting, limiting, regulating, charging or taxing the doing of business in this State by foreign associations or foreign corporations of any type, any federal association the principal office of which is located outside this State, and any foreign association which is subject to state or federal supervision, or both, which by law is subject to periodic examination by such supervisory authority and to a requirement of periodic audit, shall not be considered to be doing business or to have a tax situs in this State by reason of engaging in any of the following activities: (1) The purchase, acquisition, holding, sale, assignment, collecting and enforcement of obligations or any interest therein secured by real estate mortgages or other instruments in the nature of a mortgage, covering real property located in this State, or the foreclosure of such instruments, or the acquisition of title to such property by foreclosure, or otherwise, as a result of default under such instruments, or the holding, protection, rental, maintenance and operation of said property so acquired, or the disposition thereof; provided that such association shall not hold, own or operate said property for a period exceeding five (5) years without securing the Commissioner's approval.

22. Department of Regulatory Agencies records (March 1968) show that 9 out of 36 foreign lenders operating under Chapter 98L are doing so directly rather than through a local agent.

23. Potential problems are present if clearer definitions, restrictions, and minimum standards are not developed. The Savings and Loan League suggests that a review of mortgage lending be made which would provide new guidelines relating to:

    a. permitted loan expenses and charges;

    b. disclosure statements of costs and obligations incurred by the borrowers;

    c. such provisions as to payment methods, prepayments, defaults, escrowed funds, etc.;

    d. various maximum loan limits for various types of mortgages, leasehold collateral, property improvement loans, etc.*

*For insurance companies, a number of points have already been updated as in Act 112, 1967 Session Laws of Hawaii, which revised loan limits for investments.

(To be made one and eight copies)
FOURTH LEGISLATURE, 1968
STATE OF HAWAII

H.R. NO. 109

C O P Y

HOUSE RESOLUTION

REQUESTING THE LEGISLATIVE REFERENCE BUREAU TO STUDY THE PROVISIONS OF H. B. NO. 185, RELATING TO FOREIGN LENDERS.

WHEREAS, H. B. No. 185, introduced in the Fourth Legislature, Budget Session of 1968, would amend Section 98L-8(b), Revised Laws of Hawaii 1955 to include federally chartered savings and loan associations within the meaning of the term "foreign lender", enabling such associations to file statements with the Department of Regulatory Agencies and thereafter make mortgage loans in Hawaii; and

WHEREAS, it is not the intent of this bill to treat federally chartered savings and loan association making mortgage investments in Hawaii any different from other savings and loan associations and other lending institutions; and

WHEREAS, the provisions of this bill may result in certain inequitable treatment to lending institutions that are not foreign federal savings and loan associations; and

WHEREAS, there is concern about the economic impact of this bill on the mortgage business in Hawaii; now, therefore,

BE IT RESOLVED by the House of Representatives of the Fourth Legislature of the State of Hawaii, Budget Session of 1968, that it request the Legislative Reference Bureau to study the provisions of H. B. No. 185 with regard to any inequities which may result therefrom and with regard to the economic impact of said bill on the mortgage business in Hawaii; and

BE IT FURTHER RESOLVED that the Legislative Reference Bureau submit the report of its findings and recommendations to the House of Representatives thirty days prior to the convening of the 1969 General Session; and

BE IT FURTHER RESOLVED that a duly certified copy of this Resolution be transmitted to the Legislative Reference Bureau.