INVESTMENT OF LIFE INSURANCE COMPANIES' FUNDS

VI.

Points to be Considered in Investments

BY M. P. LANGSTAFF, A.I.A., F.A.S.

Having considered the advisability of investing in the various classes of securities, I will now deal with certain points to be kept in view when the merits of investments are being considered. Firstly, then, as to mortgages on real estate whatever class, whether city, town, village or farm:

1. Law usually limits the amount of the loan to, say, 60 per cent. of the value of the property. This value should be determined by an experienced appraiser.

2. The character and financial position of the borrower are always of prime importance.

3. The instalment feature stipulating for an annual repayment on account of the principal is often introduced, as any decrease which may take place in the value of the security is thus more or less counteracted.

4. In view of a possible foreclosure, determine the rental value of the property, in order that the company may know what revenue it could derive therefrom. This rental value should be sufficient to provide for payment of the interest and principal of the loan.

5. In case of foreclosure dispose of the property at the first favorable opportunity. Difficulty of managing the property, and possible depreciation are thus avoided as well as the forced and hurried sale necessary as the time limit allowed by the law approaches.

6. It is not a good policy to encourage progressive loans, i.e., when building is in progress of construction.

Question of Renewals.

7. Constant watchfulness and periodical inspection should be maintained not merely when a renewal is asked for, but throughout the whole period of the loan.

8. When a renewal is asked for, the whole question of the loan should be reconsidered.

9. See that the loan is a first mortgage on the property, free of all other liens and encumbrances, that the title is clear, all taxes paid, and that no judgments are registered against the owner.

10. Adequate fire insurance protection must be provided.

11. See that taxes are paid promptly as they fall due.

12. Certain states and provinces tax interest on investments, and this fact should be taken into account when arranging for the rate of interest.

13. A company should not grant loans for amounts so large that they would be seriously crippled or hampered in case of loss. Cyclones will happen in other places besides Regina; and earthquakes sometimes occur outside of San Francisco.

14. Investments of this kind often require constant supervision, and the company must determine whether they can be made as well at a distance from head office as they can under the eyes of the management.

15. It is of particular importance that loans by way of mortgages on real estate should be well distributed, otherwise depreciation of values in a particular section would cause serious loss.

16. The borrower should not be allowed to fall into arrears in respect to interest payments.

City Mortgages.

Now as to city mortgages: A pamphlet by Parsons, entitled "Elements of Safety in City Mortgages," deals witn this subject. A brief synopsis of his paper follows:—

(1) Avoid those states whose laws are distinctly unfavorable to the lender.

(2) Select carefully from the standpoint of location and natural resources, the cities in which loans are to be made.

(3) Avoid "boom" towns. Do not invest in a city until it has a fair population and a reasonably accurate forecast of future growth may be obtained.

(4) Exclude such sections of a city as are retrograding in value and locations which, owing to topographical defects or nuisances, are undesirable.

(5) Avoid vacant land and all property devoted to special uses.

(6) Broadly speaking, loans should be confined—in cities of moderate size at least—to those classes of property in general demand; such as retail business property, office buildings, and detached rental property, with exceptions in the case of loans, for a reasonable percentage of the value, upon modern and well-located wholesale property, and substantially built and well-arranged flat or apartment houses in the larger cities, provided, however, the disproportion between land and building values is not too great.

(7) Keep in personal contact with the cities in which loans are to be made. Frequent visits to the field of operations are essential and a systematic recording of the real estate and mortgage transactions therein, is necessary.

(8) A comparative study of rentals and values in similarly situated cities of equal size is of the utmost importance in order that tendencies towards inflation in individual cases may be made apparent and avoided.

(9) Intelligent and responsible local representatives are a necessity; men who have lived for a number of years in their respective localities, and who have kept themselves informed upon real estate values and mortgage conditions.

Net Income Over Period of Years.

(10) The question of the net income over a period of years is one of the greatest importance. While there are exceptions to the rule, in all cities there is usually an agreed income basis upon which all improved property aside from high-priced residences, is sold. So that with the income basis in mind upon which a given class of property changes hands, the value ascribed to it should not exceed a figure upon which the net rentals have paid such a return over a period of years. The return which a purchaser is willing to accept is affected of course, by the anticipated appreciation or depreciation of the neighborhood.

(11) The mistake should not be made of assuming that, because a certain amount of money has been paid for or expended upon a property, the value is equal to that sum, or that a property having at one time been worth a certain amount is worth that sum at the present time, or will be so necessarily in the future. For safety, a property should reasonably approximate the character and value of its surroundings; for loaning purposes, an expensive residence in a neighborhood of small cottages is of but slightly more value than its humbler neighbors, and a retail store on a quiet residence street may be almost valueless. With the growth of a city, constant shifts and changes are taking place, which, while enhancing the value of certain sections, depreciate and render undesirable other locations. It is true that, aside from times of great activity, or of unusual depression, the price paid for a property is the best indication of its value. Moreover, the great majority of buildings are suited to their surroundings. It is the exceptional conditions, however, under which losses occur, that must be guarded against.

(12) In all but the largest cities, it is not considered conservative to lend higher than 50 per cent. of a careful valuation of the property.

(13) The instalment principle of repayment of loans is recommended.

(14) The moral hazard is an important factor in this as in other forms of business. The physical security for a mortgage loan, however, should at all times be adequate aside from the personal bond.

(15) A constant and intelligent watchfulness is imperative.

He concludes by saying "To those whose loans are confined to a moderate percentage of the value of property in universal demand. located in improving sections of growing cities. and who will observe the other fundamental principles of business herein briefly set forth. the changing conditions need be less matters of concern than in any other field of investment.

Farm Mortgages.

In considering farm mortgages the following points must be borne in mind:

(1) Good farm property in a favorable section fluctuates very little in value, but crop failures must be guarded against. See that there is proper rotation of crops, and up-to-date methods of farming.

(2) Reliable and experienced agents must be selected.

(3) Consider the nature of the soil, the climate, the class of crops raised, the nearness to market, churches, schools, transportation facilities, and sufficiency of farm tools.

(4) The moral hazard. What is the farmer's past record as a producer and a saver, and the reason for his needing the loan?

(5) It is of the utmost importance to ascertain the ready market value—not in boom times—of similar lands in the same locality.

(6) Although buildings may add materially to the value of the farm, yet that is not where the earning capacity lies, and this fact should be taken into account in determining the proportion of the whole value which should be lent.

(7) Unimproved land should not be lent upon. A farm in a productive state is always readily marketable, and a conservative valuation of such, which ignores local and unjustified rises in market value, leaves an ample margin of safety as a protection to the investor.