

Currie

July 13, 1939

PROPOSED REDUCTION IN MAXIMUM RATE ON FEDERAL
HOUSING ADMINISTRATION MORTGAGES

In the interests of recovery, it is suggested that the Federal Housing Administrator reduce the maximum interest rate on Federal Housing Administration mortgages by one-half of one per cent from 5 per cent to 4 1/2 per cent and that the Reconstruction Finance Corporation lower its buying rate for Federal Housing Administration mortgages to 3 1/2 per cent.

Reasons for the recommendation

1. The reduction in rates secured in the 1938 amendments to the National Housing Act, together with other provisions giving more favorable terms to borrowers, produced a large new demand for home construction under the Federal Housing Administration plan. The effect of a reduction of one-half of one per cent in the effective rate to borrowers at the present time, therefore, seems likely to result in a substantial increase in applications from people who are now deterred because there is not a sufficient differential between the cost of constructing a new home and the level of rents. It is important to tap a new group of borrowers if residential construction is to continue to expand.

2. Since Federal Housing Administration rates were reduced in February 1938 there has been a further decline in other interest rates. Long-term U. S. Treasury bonds, for example, have declined 5/8 of one per cent to an average yield of only a little over 2 per cent. High-grade municipal bonds have declined 3/8 of one per cent and high-grade corporate bonds have declined 1/4 of one per cent and these yields are now at record low levels.

3. Rates on long-term home mortgages in foreign countries are substantially below the Federal Housing Administration maximum, despite the fact that lenders are not protected by any similar type of insurance. The building societies of England now charge 4 1/2 per cent. In Sweden it is possible to obtain a first mortgage up to 60 per cent of the value for 60 years at about 3 per cent.

4. The competition among lenders, at least in certain areas, has resulted in a reduction of actual rates below the Federal Housing Administration maximum. This is particularly true in the New York area where 53 per cent of the new home Federal Housing Administration mortgages are being placed at less than 5 per cent.

5. Under the terms of the recent amendments to the Housing Act, the insurance premium on homes costing \$6,000 and less increased from 1/4 per cent per annum on the declining balance to 1/2 per cent.

If the effect of this increased cost to the borrowers is not to result in a reduced demand for housing, it appears necessary that administrative action should be taken to reduce the maximum interest charge.

6. The importance to borrowers of a reduction of one-half of one per cent in the effective rates, that is, from $5\frac{1}{2}$ to 5 per cent, is indicated by the fact that it is the equivalent of a reduction of about $5\frac{1}{2}$ per cent in the total construction cost on a small home, or of about $15\frac{1}{2}$ per cent of the direct labor costs.

Possible objection to reducing the maximum rate

The reduction would make banks reluctant to lend.

Answer

In view of the decline in yields on high-grade securities which are now the principal outlet for banking funds, and the need for earnings, the proposed maximum rates would still seem extremely attractive to the great majority of banks. In fact, some banks have voluntarily lowered their rates below the permitted maximum. In any case, the lower rate can be made effective by having the Reconstruction Finance Corporation lower the rate at which it will purchase Federal Housing Administration mortgages from the present $4\frac{1}{4}$ per cent rate to $3\frac{1}{2}$ per cent. Competition of agencies which will make Federal Housing Administration mortgages at $4\frac{1}{2}$ per cent and sell them to the National Mortgage Association at $3\frac{1}{2}$ per cent for the sake of the one per cent servicing fee will force banks into line.

General comment

No legislation would be necessary to reduce these rates. It would require only administrative action by the Federal Housing Administration and the Reconstruction Finance Corporation.

July 12, 1939

Mr. Currie

Henry Edmiston

The information you wanted on the Federal Housing Administration and the Federal National Mortgage Association is shown below:

FEDERAL HOUSING ADMINISTRATION

	<u>1939 law</u> (Per cent per annum)	<u>1938 law</u> (Per cent per annum)
<u>Maximum interest rates and insurance premiums:</u>		
Section 203 - covering mortgages up to \$16,000 on new or old property.....	5 on declining balance	5 on declining balance
Insurance premium (1/2 to 1 per cent - law).....	$\frac{1}{2}$ " " "	$\frac{1}{2}$ " " "
Total.....	$\frac{5}{2}$ " " "	$\frac{5}{2}$ " " "
Section 207 - covering obligations up to \$5,000,000 of new large-scale projects...	$4\frac{1}{2}$ " " "	5 " " "
Insurance premium (no statutory amount).....	$\frac{1}{2}$ " " "	$\frac{1}{2}$ " " "
Total.....	$5\frac{1}{2}$ " " "	$5\frac{1}{2}$ " " "
Section 210 - covering mortgages of \$16,000 to \$200,-000 on new construction....	(Repealed)	5 " " "
Insurance premium (no statutory amount).....		$\frac{1}{2}$ " " "
Total.....		$5\frac{1}{2}$ " " "

* January 1938 to July 1939 - Premium fixed at 1/4 per cent of declining balance on new small homes up to \$5,400.

Maximum maturity

Section 203

New small homes up to \$5,400 mortgage..... 25 years

25 years

Other new homes and existing properties up to \$16,000..... 20 years

20 years

Section 207 - large-scale (no statutory limit) in practice generally 20-30 years.....

$26\frac{1}{2}$ years average

$26\frac{1}{2}$ years average

Section 210 - \$16,000 to \$200,000.....

(Repealed)

21 years

FEDERAL NATIONAL MORTGAGE ASSOCIATION

In practice they only buy Federal Housing Administration mortgages on new homes (built after January 1, 1936). No statutory minimum on rate but in practice mortgages are purchased to yield 4 1/4 per cent.

Types

Section 203 - regular

	<u>Bought to yield</u>
If interest rate is 5 per cent - no service charge.....	4 1/4 %
" " " 5 per cent plus 1/2 per cent service charge.....	4 1/2
" " " less than 5 per cent but not less than 4 3/4 per cent - no service charge.....	4 1/4
" " " less than 4 3/4 per cent Federal National Mortgage Association will not purchase	

Section 207 - large-scale

(Purchased through May 31, 1939, only 9 totaling \$3,789,000.. 4 1/4)