Form No. 131

# Office Correspondence

FEDERAL RESERVE BOARD

Date November 18, 1935.

To Governor Eccles

From J. M. Daiger

Subject: Reduction in Federal Housing Administration Interest Rate.

16—852

Following the White House conference about which I wired you on Thursday, I suggested to Mr. McDonald that the President's statement to the newspaper men about mortgage interest rates would afford an appropriate background against which to announce another reduction by the Federal Housing Administration. In accordance with this suggestion, I prepared a memorandum in the form of a press release for Mr. McDonald to consider.

As you know, I ~~am~~ expected to be in New York today, but I remained over at Mr. McDonald's suggestion to attend a meeting at his office this morning to discuss the proposed reduction in interest rate. It was decided at this meeting to put the reduction into effect. The public announcement will therefore probably be made sometime this week.

I am attaching a copy of the revised memorandum as the basis of the discussion this morning.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Preliminary and confidential.
Suggested press release.
Revised draft (JMD) 11/18/35

## REDUCTION OF INTEREST RATE ON MORTGAGES INSURED BY THE FEDERAL HOUSING ADMINISTRATION

Effective at the opening of business tomorrow morning, the maximum interest rate authorized on mortgages to be insured by the Federal Housing Administration will be reduced to 4½ per cent per annum, plus a maximum service charge of one-half of 1 per cent per annum, on decreasing balances.

This will be a reduction of one-half of 1 per cent in the maximum authorized interest rate, which is now 5 per cent plus a service charge of one-half of 1 per cent. A similar reduction of one-half of 1 per cent was made on June 24, 1935. The mortgage-insurance premium, which was reduced on June 24, 1935 to a flat rate of one-half of 1 per cent per annum on the original face amount of the mortgage remains unchanged at that rate.

Lending institutions may, in their discretion, elect to charge a lower rate of interest than 4½ per cent or to eliminate the one-half of 1 per cent service charge, according to local competitive conditions in the mortgage market or in keeping with the circumstances of any particular loan transaction. The Federal Housing Administration prescribes the maximum rate of interest that

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

may be borne by mortgages which it finds acceptable for insurance. It does not, however, make that rate mandatory, nor does it wish to discourage lending at a lower rate on either insured or uninsured mortgages.

Applications for mortgage insurance filed with any office of the Federal Housing Administration prior to this date and now pending will be acted upon in the usual manner and in accordance with the terms under which such applications are already drawn. Applications filed after this date and found acceptable will be approved subject to the condition that the mortgage shall not bear interest at a rate in excess of 4½ per cent, plus one-half of 1 per cent service charge.

In making a further reduction at this time in the maximum rate of interest to be charged on mortgages which it accepts for insurance, the Federal Housing Administration is simply giving recognition to a condition that has already come about in the mortgage market. The trend of charges for mortgage loans has been continuously downward ever since a reopening of the mortgage market became evident in the early part of this year.

For some months now loans have been freely offered and advertised at rates below the maximum permitted by the Federal Housing Administration on mortgages which it insures. Many loans insured by the Federal Housing Administration have been made at

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

lower rates, and a still larger number of loans have been made at lower rates even without the protection afforded by mortgage insurance under the provisions of the National Housing Act.

~~In fact, a number of institutions, notably life insurance companies, trust companies, building and loan associations, and mortgage bankers, have given as a reason for not insuring loans with the Federal Housing Administration their willingness to lend on long term and at a low rate of interest without such insurance. It is to be noted, though, in this connection that these institutions would be able to lend at a still lower rate if they insured their eligible loans, for the insurance would relieve them of the necessity and expense of building up reserves against losses on these loans.~~

Manifestly, mortgages that conform to the appraisal standards of the Federal Housing Administration and that carry provisions whereby the full amount of any unpaid principal, plus interest at 3 per cent per annum, is guaranteed by the United States Government, should not carry as high a rate of interest as mortgages not insured by the Federal Housing Administration. Another factor to be taken into account by lending institutions is the status that mortgages so insured would have as collateral for advances by the Federal reserve banks under the provisions of the Banking Act of 1935.

A factor which mortgage borrowers should take into account, furthermore, is that the annual premium paid to the Federal Housing Administration covers the cost of insuring a mortgage up to twenty years,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

without renewal fees of any kind, and up to 80 per cent of the appraisal value of the property. This premium is not to be regarded wholly as an expense, but as covering both the cost of the mortgage insurance and the accumulation, in a mutual insurance fund, of a sum to be applied in the later years of the mortgage toward the unpaid balance of the principal.

The further reduction in the maximum interest rate authorized by the Federal Housing Administration is made at this time for several reasons. In the first place, it is in accordance not only with the trend of mortgage interest rates generally, but also with the tendences that have characterized the yields on the several types of investment usually carried in the portfolios of financial institutions. In the second place, it is designed to induce home-builders and home-buyers to seek funds more freely from private lending institutions, which now have in the aggregate a great surplus of funds available for mortgage lending. This should have the effect of diminishing the pressure for governmental lending in the urban-mortgage field.

In the third place, the reduction is expected to encourage materially the planning of new construction during the winter months, and thus give a strong impetus to further recovery of residential construction during the next building season. The reduction should therefore operate not only to the advantage of home-builders and

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

and home-buyers, but to the advantage of the construction industry, which is still lagging far behind the recovery experienced by business generally, and also to the advantage of the country's lending institutions, which have been experiencing great difficulty in finding an outlet for their surplus funds.

The new maximum interest rate of 4½ per cent, plus a service charge of one-half of 1 per cent still affords to lending institutions a higher return than is available on any comparable type of investment. According to the compilation made by the Board of Governors of the Federal Reserve System, the current average yield on a selected list of corporate bonds rated Aaa is approximately 3.77 per cent, on corporate bonds rated Aa 4.08 per cent, and on corporate bonds rated A 4.55 per cent. The same source gives the current average yield on a selected list of municipal bonds as 3.10 per cent, and on United States Treasury bonds as 2.75 per cent.

Mortgages insured by the Federal Housing Administration are in many respects comparable to the government-guaranteed bonds of the Home Owners' Loan Corporation and the Federal Farm Mortgage Corporation. The longer maturities of these issues currently yield approximately 2.89 per cent, which is equivalent, after making allowance for tax-exemption provisions, to a yield of approximately 3.40 per cent to corporate lenders. The longer maturities of Federal Land Bank bonds currently yield approximately 3.02 per cent, which to corporate lenders, is equivalent to approximately 3.50 per cent after account is taken of the tax-exemption provisions.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis