Monthly Review

November 1955 Volume XXXVII Number 11

The Urban Residential Mortgage Market

. . . Recent Experience

FEDERALLY UNDERWRITTEN MORTGAGES provide many families the only way to home ownership, but they are offered on widely varying terms as interest rates rise and fall. During the late 1940's FNMA action offset interest-rate changes, but limited FNMA authority prevented such an offset from 1951 to 1953. Fixed interest rates on FHA and VA mortgages and rising Treasury bond yields led to severe stringency in the mortgage market for most of 1953, and the problem of discounts had to be resolved. Since mid-1953, builder and seller absorption of discounts has been legal.

Beginning late in the fall of 1953, VA-guaranteed loans furnished a strong upward thrust to mortgage activity, but the very liberal terms prevailing since mid-1954 have recently been restricted by administrative regulation. FHA terms were liberalized by the Housing Act of 1954, but a recent regulation has tightened them also.

During the twelve-month period ending June 30, 1954, FNMA regained some influence on the mortgage market. On November 1, 1954, Fanny May began operations on a new basis with three separate functions. Of chief interest to mortgage lenders are the Secondary Market Operations, which provide a minimum takeout for lenders owning eligible mortgages. In addition, the Special Assistance Functions and the Management and Liquidation Functions will be carefully analyzed and evaluated as FNMA gains experience in these operations.

Other actual and potential influences on the mortgage market are significant, but changing interest rates inescapably affect both the cost of housing and the level of mortgage lending.

Federal Reserve Bank of St. Louis

Survey of Current Conditions—p. 130

The Urban Residential Mortgage Market

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Federally underwritten mortgages provide many families the only way to home ownership, . . .

THERE is a misapprehension on the part of some people regarding the relative importance of Federally underwritten and conventional mortgage loans. Whether measured in terms of mortgage debt outstanding or as a per cent of total recordings, Federally underwritten mortgages are less important than conventional mortgages. Nevertheless, FHA-insured and VA-guaranteed loans make impressive totals, and they are about as important as conventionals in financing the sale of new houses.

At the end of 1954 the estimated mortgage debt outstanding on one- to four-family residences was a little more than $75 billion, of which $32 billion or about 42 per cent was Federally underwritten. In 1950 and 1951, home loans insured and guaranteed amounted to about one-third of total recordings, and for the next three years the proportion stood at something over one-fourth. In recent months, however, the proportion has risen again to about one-third. It now appears that last year's record total of $6.2 billion of insured and guaranteed loans will be exceeded in 1955. What is perhaps more significant, FHA and VA starts have accounted for more than one-half of private residential housing starts for over a year.

Although conventional loans continue to be greater in total volume than Federally underwritten loans, FHA and VA loans offer many families the only way to home ownership. Interest rates on conventional loans may in some cases be as low as those on FHA and VA loans, but they will usually range from one-quarter to one per cent per annum higher. Moreover, the down payment required by conventional lenders is seldom less than 25 per cent and may be as high as 40 per cent or more. Ordinarily, too, the term of a conventional loan is shorter than that of a Federally underwritten loan. Indeed, from the point of view of prospective borrowers, Government-underwritten mortgages have only one serious drawback. Whereas interest rates on conventional loans fluctuate with changes in the money and capital markets generally, rates on FHA and VA loans are fixed, or very nearly so, and the attractiveness of these loans to lenders varies with changes in capital market yields. The result has been, on VA loans particularly, that despite a wide compensating variance in terms other than interest charged, on at least one occasion the supply of funds available for Federally underwritten mortgages almost disappeared.

. . . but they are offered on widely varying terms as interest rates rise and fall.

Although both the VA and the FHA administrators have authority, as market conditions change, to change the rate charged borrowers, they have in practice been reluctant to increase the financing charges for housing under their control. For this reason, in times of rising rates in the money and capital markets generally, investors have found FHA and VA loans, with their fixed nominal interest rates, relatively less and less attractive. Along with other considerations influencing their investment in mortgages, institutional investors seek a minimum differential between the net yields on Federally underwritten mortgages and those on Government bonds in the the maturity range of ten to fifteen years and more. In practice the spread ordinarily desired by investors has been between 1.25 and 1.50 percentage points, the differential varying somewhat over time. In general, institutions with efficiently managed mortgage portfolios require a smaller spread than do marginal lenders, and for all lenders the necessary spread appears to be greater when there is a growing belief that the future course of interest rates will be upward.

During the late 1940's FNMA action offset interest-rate changes, . . .

In view of the steady and persistent growth in the volume of Federally underwritten mortgages outstanding during the late '40's, it may be wondered why the effect of gently rising long rates was not more pronounced in the years just after World War II. The answer is, of course, that both FHA and VA loans would not have been made in such volume if the Government had not supported the secondary market. The Federal National Mortgage Association was authorized, beginning July 1, 1948, to purchase VA as well as FHA mortgages. Limited at first to the purchase of only a fraction of the eligible mortgages of a lender, FNMA after October 9, 1949, could purchase 100 per cent of a lender's eligible mortgages. Moreover, FNMA could issue advance commitments whereby lenders were permitted to make loans to builders knowing that the mortgages could be sold at par when construction was completed. These free takeouts at par were made until the end of March 1950; because FNMA during this period was in effect a primary supplier of funds—taking from originating lenders mortgages that the private, secondary buyers did not want—no stringency developed in the mortgage market.

. . . but limited FNMA authority prevented such an offset from 1951 to 1953.

As yields on long-term Treasury securities firmed after March 1951, the effect on Federally insured and guaranteed mortgages was much different than it had been in the immediate post-war years, for during the ensuing months the FNMA could play only a limited role. FNMA purchases of FHA and VA mortgages could not increase much because of a statutory limitation; and such purchases as were made were on an over-the-counter—i.e., noncommitment—basis and were in limited amounts from originating lenders only. When in the late spring of 1952 bond yields began a sharp and almost uninterrupted advance, prices of both FHA and VA mortgages fell below par in the secondary markets throughout the country. By late 1952 and early 1953 discounts had become substantial. FHA mortgages were selling at prices as low as 97 and VA mortgages, partly because of a lower rate of interest, at prices ranging down to 90 or below. In general, discounts tended to be greater on mortgages originating in parts of the country farthest removed from the eastern money market centers.

Editor's Note

SINCE the end of World War II the Federal Government has greatly stimulated the construction of urban residences. This is so because for most house buyers two considerations are paramount: the size of the down payment and the amount of the monthly payments. Before 1933 monthly payments were not ordinarily a problem to the house buyer because amortized first mortgages were much less common than they are today. Loan-to-value ratios ranged from one-half to two-thirds, and interest rates on first mortgage loans ranged from 6 to 8 per cent. Second mortgages were often used to reduce down payments, and interest rates on second mortgages were substantially greater than on firsts, not infrequently reaching 15 per cent when all charges were considered.

The Federal Government has made "easy terms" a reality in the housing market. What began under the old Home Owners Loan Corporation as a method of direct relief to borrowers had by the end of World War II become a multi-purpose program under the National Housing Agency. In 1947, the Housing and Home Finance Agency was created to coordinate the principal housing programs of the Government; besides the Office of the Administrator, the Agency included the Home Loan Bank Board, the Federal Housing Administration, and the Public Housing Administration. This year the Home Loan Bank Board became an independent agency and was renamed the Federal Home Loan Bank Board. Obviously, activities of each of these agencies affect the housing and mortgage market, and a full treatment can neglect none of them. But the Federal Housing Administration, which insures mortgages with high loan-to-value ratios, and the Federal National Mortgage Association, which over the years has provided a varying amount of support to the secondary market, play major roles. The Veterans Administration, which presently guarantees loans to veterans up to 60 per cent of the value of a property, with a maximum of $7,500, joins FHA and FNMA as the third major influence on the mortgage market.

During the past few years it has become apparent that the supply of mortgage money is extremely sensitive to changes in yields in the Treasury bond market. Two years ago, the *Monthly Review* of this Bank examined the reasons for this sensitivity and ascribed them to the structure and the institutions which had come to characterize the mortgage market. (See "Federal Influence on the Urban Residential Mortgage Market," *Monthly Review*, Federal Reserve Bank of St. Louis, September 1953.) It is the purpose of the present article to examine the structural and regulatory changes which have taken place in the mortgage market over the past two years.

Fixed interest rates on FHA and VA mortgages and rising Treasury bond yields led to severe stringency in the mortgage market for most of 1953, . . .

The cause of the difficulty has already been suggested. With yields on FHA and VA mortgages, after servicing, below 4 per cent and yields on the Victory 2½'s of 1972-67 approaching 3 per cent, insurance companies and mutual savings banks stayed out of the market for mortgages. They no longer found it profitable to shift out of securities which by then had fallen below par in order to purchase urban mortgages; or to put the matter the other way around, with the fall in prices of Treasury bonds and high-grade corporates, yields on these securities were more attractive than on mortgages. By administrative action during the first week of May 1953, permissible interest rates on VA loans were raised from 4 to 4½ per cent and on most FHA loans from 4¼ to 4½ per cent. Although it had been argued that such an increase in rates would bring Federally underwritten mortgages back to par, the effect of the change was less than had been anticipated because of the almost simultaneous sharp rise in market rates generally. As late as September of 1953 VA and FHA mortgages carrying the new rates were selling at discounts of 2 or 3 points (i.e., 2 or 3 per cent), and in some cases more.

. . . and the problem of discounts had to be resolved.

During the 1953 period of stringency in the mortgage market, builders, mortgage originators, mortgage brokers, interim financers, and investors—to say nothing of harried Government officials—learned to live with and work in a discount market. A good many, public officials and private investors alike, were uneasy about the appearance of discounts on Federally underwritten mortgages. There was never any question, of course, whether a lender could sell VA or FHA paper at a discount, for these mortgages have always been assignable. Both VA and FHA officials wished to prevent payment of discounts by purchasers, for if buyer-mortgagors were indirectly to assure investors higher yields the effective interest rates would, of course, be higher. The question then arose: was it legal to obtain from a builder or other seller a payment sufficient to compensate for the discount at which a mortgage was sold? Pursuant to the Housing Act of 1950, both the FHA and the VA had issued regulations which prohibited a charge on the builder of more than 2½ per cent of his construction loan plus 5 per cent simple interest on construction funds actually advanced. But despite the restrictions imposed various ways of extending VA-guaranteed loans were found; likewise, the authorized fees, plus commissions on insurance and the interest received by a lender for construction loans, enabled many lenders to absorb the somewhat smaller discounts at which FHA loans were selling. Apprehension grew that the added charges were in many cases being passed on to buyers.

Since mid-1953 builder and seller absorption of discounts has been legal.

The whole matter of the legality of discounts was clarified by one of the June 30, 1953, amendments to the Housing Act. With a minor exception, the rule established in mid-1953 has remained in force to the present time. It is this: the originating lender on either an FHA or a VA mortgage may get any number of points from a builder or seller to offset the discount at which the mortgage will sell.[1] The law provides that such charges paid by a builder (or seller) shall not be passed on to the mortgagor-buyer. Thus, if a lender originating loans to a builder can sell the mortgages to a permanent investor for only 97, he may under the present rules obtain from the builder the 3 points necessary to reimburse him for the discount on the mortgages. Moreover, if the originating lender had to pay a "takeout" commitment fee, that fee may be obtained from the builder. In the case of a seller of existing property, a seller may, if he wishes, pay any number of points necessary to obtain a loan and assure the consummation of his deal. In no case, however, can the buyer under the present law be required to pay directly more than one point of the discount.

Builder and seller absorption of secondary market discounts, by allowing whatever yields permanent investors demand, prevents a drying-up of the flow of funds to these mortgages. The discount system has an advantage of allowing geographic variance of yields and thus introducing a certain flexibility into the country-wide mortgage market. Meanwhile, in a tightening market, interest rates on conventional loans rise to the point where the supply of and the demand for such funds is equated.

Beginning late in the fall of 1953, VA-guaranteed loans furnished a strong upward thrust to mortgage activity, . . .

Since mid-1953 the forces of competition, a substantial piece of new legislation, and administrative

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[1] For a time the rule applied to the seller of *existing* property only in the case of VA loans; it now applies to the seller of existing property in the case of FHA loans as well.

decisions have modified the institutional framework of the mortgage market. Least affected by rules changes has been the program of the VA. An examination of the changing volume and characteristics of VA-guaranteed loans is instructive to whoever would assess the performance of the American mortgage market.

From the middle of 1953 on, interest rates generally fell. By the late fall of 1953, discounts on VA loans were disappearing, and as Treasury yields continued to drop through the first half of 1954, discounts vanished on paper which reached minimum quality standards of big investors. Between June 1953 and June 1954, VA loans showed no persistent tendency to increase as a per cent of total recordings, nor did the number of loans closed change much. In the spring of 1954, however, the number of loan applications received by the VA began a steep rise. Shortly thereafter the volume of loans closed began a steady increase, and in October 1954 VA loans exceeded $0.5 billion and constituted 20 per cent of total nonfarm recordings of $20,000 or less. In January 1955 VA loans reached an all-time peak of 31 per cent of nonfarm recordings. Since that time the figure has fallen to remain through mid-1955 at around 22 per cent of recordings. However, the monthly dollar volume of VA mortgages closed through June of 1955 was well in excess of $0.5 billion per month. Each month since June 1954 VA starts have accounted for at least one-fourth of total nonfarm starts; in several months the percentage has reached 30 or more, and in November 1954 VA starts hit a record high of 35 per cent of total nonfarm starts.

During the latter half of 1954 and the first two months of 1955, VA-guaranteed loans furnished a strong upward thrust to mortgage activity and thus to residential construction. Why did VA loans become so attractive to borrowers? Because lenders, competing vigorously with each other for the business, made terms other than the rate of interest charged even more liberal. Since the interest rate on a GI loan was held at 4½ per cent, competition among lenders took the form of lower and lower down payments and longer and longer maturities. No-down-payment, 30-year loans, became increasingly common, as the accompanying table shows.

. . . but the very liberal terms prevailing since mid-1954 . . .

Indeed, once yields on long Treasury bonds had fallen to the point that even marginal lenders found the difference between mortgage yields and bond yields greater than the 1.5 spread discussed previously, terms more favorable than no down payment and 30-year maturities were common in several large cities. In some cases, though the VA loan did not exceed 100 per cent of the Certificate of Reasonable Value, a part or all of the closing costs were paid by the builder and not by the veteran purchaser. In other instances, the closing costs were added to the loan, so that the Veterans Administration was actually guaranteeing a mortgage which exceeded its Certificate of Reasonable Value by the amount of the closing costs.

. . . have recently been restricted by administrative regulation.

Within the past few months, by administrative ruling, two steps have been taken to make the terms of VA loans less liberal. Effective April 28, 1955, veteran purchasers could no longer include closing costs in their loans but had to pay them in cash.[2] A VA regulation published July 30, 1955, placed maturity and down payment limitations on veterans' loans "... pending possible changes in economic conditions and until further legal changes (regulatory or statutory)." On any properties for which a request for appraisal was received on or after July 30, 1955, the veteran purchaser would have to make a cash payment in addition to closing costs of 2 per cent of the selling price and the loan could not have a maturity in excess of 25 years and 32 days.

TABLE I

SELECTED CHARACTERISTICS OF VA-GUARANTEED LOANS

	Per Cent of Total Number of Loans			Per Cent of Total Number of Loans	
Year and month	with 26-30 years maturity	with no down payment	Year and month	with 26-30 years maturity	with no down payment
1953 June	2.4	7.4	1954 July	22.5	27.0
July	4.0	8.7	August	24.1	28.2
August	6.2	8.3	September	28.4	34.1
September	6.7	9.5			
October	10.0	10.1	October	31.5	34.7
November	10.4	11.4	November	34.6	37.9
December	12.4	12.8	December	37.4	37.2
1954 January	10.6	13.0	1955 January	40.6	39.1
February	13.3	15.2	February	43.6	40.3
March	13.8	18.5	March	46.3*	44.8
April	15.5	19.6	April	45.3	44.7
May	16.2	24.4	May	43.7	43.2
June	20.8	25.2	June	44.8	41.9

* All-time high.

Source: *Housing Statistics*, June, 1955.

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[2] The regulation was not applicable to those cases where the Certificate of Reasonable Value was issued before the effective date or where a contract to purchase had been executed before the effective date.

FHA terms were liberalized by the Housing Act of 1954, . . .

In the late fall of 1953 discounts on FHA-insured mortgages, like those on VA-guaranteed mortgages, began to decrease, and by the spring of 1954 FHA mortgages were generally back to par. At that time, however, the maximum maturity permitted by law on existing homes was 20 years, and on new homes 25 years. Moreover, down payments were set by a schedule which required a 20 per cent cash payment, plus closing costs, on properties with an FHA valuation of $12,000 or more, and the maximum loan that could be obtained was $16,000. Hence, as the mortgage market eased, veteran purchasers could get much more favorable terms by applying for a VA loan.

The Housing Act of 1954, which was signed on August 9 and became effective October 1, 1954, made FHA terms substantially more liberal than they had been under the old law. The maximum maturity was increased on new construction from 25 to 30 years and on existing properties from 20 to 30 years.[3] Required down payments were lowered substantially, and for both old and new housing the amount of the maximum mortgage was raised to $20,000.

Despite the liberalization of FHA terms in August of 1954, there was no great increase in FHA's share of total mortgage lending. However, the dollar volume of FHA mortgages recorded rose from about $150 million monthly in the summer of 1954 to about $250 million per month in 1955. After the passage of the Housing Act of 1954, FHA starts varied, as they had during the previous year, at between 20 and 25 per cent of total nonfarm starts.

. . . but a recent regulation has tightened them also.

By a regulation of July 30, 1955, terms on FHA-insured loans were restricted somewhat. As in the case of VA loans, the maximum permissible amortization period was reduced to 25 years and 32 days. The down payment schedule on both existing and new property was changed to require an additional down payment of 2 per cent of FHA valuation. Thus, for example, the required down payment on a new $12,000 house is now $1,200 plus 2 per cent of $12,000 or $1,440. (See Table II for the basic schedule of down payments.) However, FHA terms are still more liberal than conventional lenders are, with rare exceptions, willing to grant; with a maximum loan of $20,000 still possible, FHA mortgages are in demand by a large group of buyers not eligible for a VA-guaranteed loan.

TABLE II.

FHA DOWN PAYMENT SCHEDULE

(1-2 Family)

(Established by the Housing Act of 1954)

Appraised Value	New Housing	Existing Housing	Appraised Value	New Housing	Existing Housing
$ 4,000	$ 200	$ 400	$15,000	$1,950	$2,400
5,000	250	500	16,000	2,200	2,650
6,000	300	600	17,000	2,450	2,900
7,000	350	700	18,000	2,700	3,150
8,000	400	800	19,000	2,950	3,400
9,000	450	900	20,000	3,200	3,650
10,000	700	1,150	21,000	3,450	3,900
11,000	950	1,400	22,000	3,700	4,150
12,000	1,200	1,650	23,000	3,950	4,400
13,000	1,450	1,900	24,000	4,200	4,650
14,000	1,700	2,150	25,000	5,000	5,000

Note: As noted above an administrative ruling, effective July 30, 1955, increased down payment requirements by 2 per cent of FHA valuation. Since this regulation is subject to administrative change, readers are asked to make their own calculation of present required down payments.

During the twelve-month period ending June 30, 1954, FNMA regained some influence on the mortgage market.

During the twelve-month period ending June 30, 1954, the Federal National Mortgage Association regained some of the influence on the mortgage market which had been lost in the immediately preceding years. By an amendment to the Housing Act passed on June 30, 1953, Fanny May was given a new role as commitments to purchase VA and FHA mortgages were authorized for a year under a one-for-one purchase and sale provision. By this plan FNMA could sell mortgages from its portfolio at prices ranging from 96 to par, at the same time issuing a commitment to the purchaser to buy, within a year and at par, an equivalent dollar amount of FHA and VA mortgages bearing the higher interest rates which had been authorized only two months previously. Purchasers taking advantage of FNMA forward commitments were charged a one per cent commitment fee and an additional one-half of one per cent service charge when the new mortgages were later sold to FNMA. FNMA was further authorized to purchase mortgages on defense, disaster, and military housing both on an over-the-counter and on a commitment basis.

The one-for-one purchase and sale plan in effect assured a takeout at par for lenders who advanced funds to builders. The nominal cost of the takeout was 1½ points, but if the mortgages purchased from FNMA were sold at a further discount the cost of the takeout was actually greater. In practice, lenders were at first reluctant to use the one-for-one plan because in the existing state of the market they had to take a loss of several points on the mortgages

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[3] Although a 30-year term is permissible for existing property, the maturity cannot exceed three-fourths of the remaining life of the structure as estimated by FHA.

bought from FNMA. However, as mortgage prices improved during the year the FNMA takeout became progressively less expensive, and when the last commitment was made late in June 1954, the $500 million one-for-one purchase and sale authority was very nearly exhausted.

On November 1, 1954, Fanny May began operations on a new basis . . .

Rechartered under the Federal Housing Act of 1954, FNMA began operations on November 1, 1954, on an altogether new basis. For many years there had been objections that the Association was actually serving as a source of primary funds to the mortgage market. Moreover, it had operated as a wholly owned Government corporation and had obtained funds by borrowing from the Treasury. Although FNMA had operated profitably in every year save two of its history, there was considerable sentiment for making it a true secondary mortgage facility which would ultimately be privately owned.

. . . with three separate functions.

Under the new charter FNMA was reorganized to undertake three separate and distinct functions. The Association was to continue to provide a secondary market for Federally underwritten residential mortgages, it was to furnish special assistance for the financing of mortgages originating under regular and special housing programs, and it was to manage and liquidate the portfolio acquired under its previous charter. The Association was directed to maintain separate accountability for each of the three types of operation.

Of chief interest to mortgage lenders are the secondary market operations . . .

After less than a year of FNMA operation under the new charter, it is still too early to conclude what will be the ultimate impact of the reorganized agency on the residential mortgage market. It is the secondary market operations which elicit the chief interest of mortgage lenders, but only in the past few months have general market conditions given rise to a measurable volume of transactions. There are signs, however, that in a discount market the new FNMA may come to perform a genuine secondary function.

The rules, of course, have been greatly changed. FNMA is directed to purchase and sell only such mortgages as are of a quality to meet the purchase standards required by private investors. Eligible mortgages are to be purchased over-the-counter only and at prices which vary according to area and market terms.[4] In order to prevent excessive use of FNMA facilities, a Purchase and Marketing Fee of one-half of one per cent of the unpaid principal balance is charged in connection with the purchase of a readily marketable mortgage; a fee of one per cent is charged in connection with a purchase of lesser marketability. Finally, sellers of mortgages to FNMA are required to subscribe for common stock of the Association in an amount equal to not less than 3 per cent of the unpaid principal amount of the mortgages sold.

. . which provide a minimum takeout for lenders owning eligible mortgages.

It will be apparent that FNMA thus provides a minimum takeout for lenders owning eligible mortgages. At the same time, FNMA no longer furnishes a par market for any paper which a lender happens to have, nor does the Association make advance commitments under the Secondary Market Operations.[5] Furthermore, the amount of FNMA's common stock issued to date has been so small and transactions in the stock have been so few that a definite market for it has not yet been established. Scattered reports from the market place indicate that the stock is selling at approximately 65 cents on the dollar, and this would mean, of course, that a seller disposing of his stock at such a price would be paying an additional point for the privilege of selling to FNMA. As a definite market for FNMA stock becomes established, any improvement in the price of the stock will lessen, of course, the amount paid for the privilege of selling to FNMA.[6]

In addition, the Special Assistance Functions . . .

Under the program of Special Assistance Functions FNMA may purchase, or make commitments to purchase, such mortgages as the President of the United

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[4] Recently published Purchase Price Schedules for different states indicate that prices vary according to the ratio of the outstanding principal value of the mortgage to the original mortgagor's purchase price of the property and to the length of the remaining term of the loan. In the last Purchase Price Schedule of the Chicago Agency, which includes ten midwestern states, the lowest current price was 95 and the highest 99½.

[5] The FNMA Charter Act authorizes the Association to issue Purchase Contracts (one-for-one commitments) when and under such conditions as its Board of Directors may determine. It is not now contemplated that FNMA will in the immediate future undertake such a program.

[6] Initial capital for the secondary mortgage operations totals $93 million, the sum of the capital of the former Association plus accumulated surplus, reserves, and undistributed earnings held on November 1, 1950. Preferred stock in this sum was issued to the Secretary of the Treasury and will be repurchased with funds acquired from the sale of common stock and from earnings. Common stock may earn dividends not to exceed 5 per cent per year, but the rate may not exceed that paid to the Secretary of the Treasury on preferred stock. With the approval of the Secretary of the Treasury, FNMA may issue debentures for the Secondary Mortgage Operation up to ten times its capital, surplus, reserves, and undistributed earnings, or in an amount equal to approximately $930 million. To date no debentures have been issued to finance Secondary Mortgage Operations.

States shall determine to be in the public interest. The mortgages so purchased are to meet the quality standards of private investors, though at the time they are offered to FNMA private investors may not be in a financial position to buy them. Before authorizing such purchases the President is to take into consideration conditions affecting the national economy, the building industry, and the home mortgage investment market. A limit of $300 million is placed on the total of mortgages held under the program plus commitments to purchase, and Government funds, borrowed from the Treasury, are to be used in financing the program.

. . . and the Management and Liquidation Functions . . .

The new FNMA charter requires the Association to manage and liquidate the portfôlio acquired before November 1, 1954, including mortgages acquired after that date under previous commitment contracts. Mortgages owned on the starting date amounted to about $2.4 billion and commitments were then outstanding in excess of $600 million. Through its five regional offices and a New York sales office, FNMA issues Mortgage Sales Price Schedules for the Management and Liquidating Portfolio. Prices vary according to the type of mortgage offered, and all prices are subject to change without notice. Funds required for the Management and Liquidation Functions are obtained by borrowing from the Secretary of the Treasury and through sale to private investors of FNMA debentures (not guaranteed by the United States).[7] These debentures are not to be confused with "Secondary Market Debentures," which have not yet been issued.

. . . will be carefully analyzed and evaluated as FNMA gains experience in these operations.

How will the new Fanny May develop as a secondary market institution? It is still too soon to tell, of course, but recent experience suggests the possible course of operations. In general, FNMA will be approached by sellers as the mortgage market tightens in response to rising interest rates; conversely sellers will show less interest as the private secondary market loosens in response to falling interest rates.

Thus, interest on the part of lenders and other mortgage sellers in FNMA Secondary Market Operations has been modestly but steadily increasing since the program became operative on November 1, 1954. (See Table III.)

TABLE III.

NUMBER OF MORTGAGES OFFERED TO FNMA FOR PURCHASE, BY MONTHS

	Month	Number
1954		
	November	2
	December	35
1955		
	January	46
	February	226
	March	315
	April	427
	May	569
	June	1,096
	July	899
	August	1,495
	September	2,008
	Total	7,118

Source: Federal National Mortgage Association.

In part the increase is attributable to the fact that prospective participants are becoming familiar with the secondary market facility. More important as an influence toward greater participation has been the tightening mortgage market with the reappearance of discounts on good loans as early as the spring of 1955. Table IV shows clearly the steady rise in the volume of Secondary Market Operations.

As late as the middle of October 1955, no purchases had been made by the Association under its Special Assistance Functions. At the end of September, however, commitment contracts amounting to about $3.5 million were outstanding, providing for the future purchase by FNMA of special assistance mortgages originating in defense and military types of housing.

Table IV shows purchases and sales under the Management and Liquidation Functions since the commencement of activity in November. Purchases, which remained fairly high for several months, have dwindled as commitments under the old one-for-one program have nearly been fulfilled. The volume of liquidation has fallen, too, as the mortgage market has weakened. In general, it is to be expected that liquidation will be slowed as discounts appear and lenders have difficulty in disposing of newly originated paper.

Other actual and potential influences on the mortgage market are significant, . . .

The actual and potential influences on the mortgage market which have been discussed in the foregoing paragraphs are by no means the only ones which the careful observer must keep in mind. Other bodies within the Housing and Home Finance Agency can affect the cost and availability of mortgage funds.

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[7] The aggregate amount of debentures which may be issued under this program cannot exceed FNMA's holdings of cash, mortgages, and Treasury obligations, or $3,350 million, whichever is smaller. An issue of $570 million of FNMA Management and Liquidation Debentures was marketed in January of this year to acquire funds with which to fulfill purchase commitments made under the old charter.

TABLE IV

FEDERAL NATIONAL MORTGAGE ASSOCIATION ACTIVITIES

(Dollar Amounts in Thousands)

	Purchases		Liquidations (By repayments only)		Purchases		Liquidation (All Types)	
1954	**No.**	**Amount**	**No.**	**Amount**	**No.**	**Amount**	**No.**	**Amount**
November	1	$ 13		$	5,185	$ 50,023	2,326	$ 22,168
December	1	11			6,625	64,352	2,747	26,352
1955								
January	16	142			4,934	48,207	2,112	20,158
February	14	103			4,027	47,480	2,026	21,491
March	117	805	—	1	5,836	53,588	3,266	31,064
April	180	1,257	—	3	5,233	56,777	2,598	24,575
May	313	2,537	—	5	3,626	36,525	2,245	22,300
June	533	4,599	—	12	1,017	16,430	1,186	16,778
July	600	5,177	—	17	629	10,199	917	15,518
August	835	7,338	—	30	773	11,165	1,048	13,333
September	877	7,769	—	42	237	2,747	1,296	18,590
Total	3,487	$29,751	—	$110	38,122	$397,493	21,767	$232,327

Source: Federal National Mortgage Association.

Furthermore, the Federal Home Loan Bank Board can materially affect the lending activity of member savings and loan associations by changing the terms on which the eleven Federal Home Loan Banks may make advances to member institutions. For example, early in September of this year the several Home Loan Banks requested that for the time being member associations limit their new commitments to such amounts as could be met from current savings plus loan repayments. Applications for renewal of existing advances were to be accompanied by a payment on the principal outstanding, and new advances, to be applied for only in cases of definitely established need, were to be retired on an amortization basis over a period of five years.

Perhaps more important as an influence on the market for mortgage loans is the apparatus of interim financing, including hedges in the form of private takeout commitments, which has emerged in response to market needs. Chiefly through the devices of collateral loans on the pledge of mortgage papers and purchase of mortgage loans under resale agreements, the commercial banks have become the most important interim lenders, their customers being mortgage bankers for the most part. But a significant new development has been the use of interim financing by large investing institutions which, for one reason or another, must postpone the final lodgement in their portfolios of mortgages for which they are committed.[8]

. . . but changing interest rates inescapably affect both the cost of housing and the level of mortgage lending.

Lenders and borrowers in today's mortgage market have learned to think in terms of discounts and premiums on Federally underwritten mortgages as well as in terms of changing interest rates on conventional loans. It is largely for this reason that as the mortgage market gradually tightened during 1955 there was no abrupt choking-off of funds as there was in 1953. Rates on conventional loans rose slowly, and discounts on Federally underwritten mortgages appeared, almost imperceptibly, as the year went on. The mortgage market mechanism, with some time lag, was keenly responsive to the shifting forces of supply and demand for long-term credit.

But no institutional changes can disguise a rise in interest rates, not even builder or seller absorption of discounts. The increasing cost of money must ultimately be paid by someone, and it is unrealistic to suppose that builders (or sellers) will pay discounts to lenders without eventually raising the price of the product. Contrariwise, when interest rates are falling, competition among lenders will assure lower-cost loans and thus lower-cost houses to prospective home owners.

Changing interest rates also affect the level of mortgage lending. It is important to builders and lenders, as well as to the American consumer, that changes in rates be transmitted smoothly and efficiently to the mortgage market mechanism so that it in turn does not move by fits and starts. There is reason to believe that the market for Federally underwritten mortgages has become more flexible in the past two years, in part as a consequence of the expanded role of commercial banks in the mortgage market. It seems fair to conclude that flexibility will be increased and risk and uncertainty reduced as private lenders and investors become increasingly aware of the impact of monetary policy on the supply of mortgage credit.

Ross M. Robertson

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[8] For statistics on the volume of credit extended under these types of "warehousing" loans, see "Credit Extended by Banks to Real Estate Mortgage Lenders," *Federal Reserve Bulletin*, September 1955, page 980.

Survey OF CURRENT CONDITIONS

BUSINESS ACTIVITY in the Eighth Federal Reserve District held to a high level during October. However, certain indicators suggested a leveling off in the rate of expansion. The rate of new construction contract awards dropped further, and agricultural prices continued to decline, adversely affecting farm income in this area. In addition, there appears to have been some at least temporary moderation in the optimism of investors and businessmen. Two major indicators were virtually unchanged after allowance for seasonal movements: department store sales and unemployment claims. But ,an important measure, industrial production, inched up.

Total activity in the construction field in the district continued at a high level in October, reflecting the large volume of contracts awarded so far this year. In the first nine months of 1955, contracts awarded in this district totaled $104 million, up 20 per cent from the corresponding period last year. Activity was at such a fast tempo in certain areas that the supply of some materials fell short of needs.

However, future activity may not be as high. The seasonally adjusted rate of contract awards in recent months has been below the rate in the first few months of the year. Most of the reduction resulted from a drop in the rate of residential contracts awarded. In the first half of October awards in the St. Louis territory of F. W. Dodge Corporation, which includes most but not all of the Eighth District, dropped substantially from the comparable period a year earlier and from the September rate.

Residential awards have been cut back more severely in the district than in the nation. In the third quarter, district awards were 50 per cent below the peak rate reached in the December-February period, after seasonal adjustment, whereas the decline was only 6 per cent from the first quarter peak in the 37 easternmost states. The sharper cutback here notwithstanding, the year-to-date totals for the district compare favorably with those for the 37 states. Residential awards for the first nine months were 27 per cent ahead of the corresponding period of 1954 in the district and 29 per cent larger in the 37 states. The increase in awards has been reported in all of the major metropolitan areas of the district except Little Rock.

RESIDENTIAL CONSTRUCTION CONTRACTS AWARDED
(VALUE IN MILLIONS OF DOLLARS)

Metropolitan Area	First Nine Months 1955	1954
St. Louis	140.0	127.4
Louisville	84.0	64.4
Memphis	51.3	38.8
Evansville	19.1	10.7
Little Rock	13.2	13.8

Source: F. W. Dodge Corporation

District farmers, completing the harvest of cash and feed crops, entered the winter period with a larger volume of cash crops sold or in storage and larger feed supplies than a year ago. In addition, production in district states of the two major cash crops, cotton and soybeans, is expected to be 8 per cent and 21 per cent above a year ago. As a result, total crop output in the district is expected to rise 15 per cent above last year. District farmers are also running their hog, broiler and cattle feeding enterprises at a higher rate than a year ago.

Prices received by district farmers, however, continued to weaken. For the four-week period ending October 28, prices received by district farmers averaged 2 per cent below the level four weeks earlier, largely because of a 3 per cent drop in livestock and livestock product prices. Recent adjustments have carried prices received to 7 per cent below the year-ago level.

Increased crop and livestock outturn has only partly offset lower prices received. District cash farm receipts for the first eight months of 1955 were 5 per cent below a similar period a year ago. Sharpest declines are being experienced by farmers whose incomes are to a large extent dependent upon the sale of hogs, which are now selling for about one-third below prices of a year ago. A reduction of more than one-fifth in rice and tobacco income, reflecting sharp acreage cutbacks, is expected when the crops are sold this fall. These plus other, less severe, reductions will probably be only partly offset by increased cotton income. Consequently, district cash farm receipts for the year probably will drop slightly more than 5 per cent below the 1954 level. Arkansas may be an exception as a result of stable or higher cash receipts for cotton and broilers, the two most important sales commodities for the state.

Department Store Sales

Sales at district department stores in the first three weeks of October held close to the September level after allowance for seasonal changes and were about 9 per cent larger than a year earlier. For the year to October 22, sales averaged 7 per cent more.

Employment

The labor markets in the district's major metropolitan areas showed about the usual changes in October. Unemployment insurance claims increased slightly in St. Louis in the four weeks ending October 22. In Louisville, Memphis and Evansville, claims for unemployment insurance declined. For all these areas, the number of insured unemployed in October was less than a year earlier but was still greater than two years earlier.

After an approximate allowance for temporary reductions caused by labor disputes, September employment in the district's major labor markets was well ahead of a year ago except in Evansville. The past year's rising activity has brought employment close to September 1953 levels in Louisville, Memphis and Little Rock. In St. Louis and Evansville, however, employment was still somewhat less than two years earlier. The district's five largest labor markets continued to be classified in September as having a slight excess of job seekers over openings.

EMPLOYMENT IN NONAGRICULTURAL ESTABLISHMENTS*
(IN THOUSANDS)

Metropolitan Area	Sept. 1955	Sept. 1954	Sept. 1953
St. Louis	719.3	697.8	747.8
Louisville	246.6	234.9	246.0
Memphis	174.3	166.2	176.8
Evansville	62.9	63.0	75.2
Little Rock	70.2	67.6	70.8

* Includes workers involved in labor disputes.

Source: State Employment Security Divisions.

The improvement in employment was not extensive enough in thirteen smaller labor markets to remove them from the September listing of surplus labor areas. More recent information on one of these areas, Fort Smith, Arkansas, indicated that unemployment had dropped on October 1 to less than 6 per cent of the labor force.

Industrial Production

Industrial production in the district held approximately constant in some lines and crept ahead in others. The steel ingot production rate in the St. Louis area has been steadier at a high level during 1955 than in any other postwar year. In October it held its level of the previous month at 97 per cent of rated capacity. A high rate of auto assembly was reached by the end of October as plants resumed operations after recent model changeovers. Shoe production continued at high levels as plants filled heavy orders placed in anticipation of higher factory prices. Southern pine production rose slightly, in seasonal pattern, and continued above the level of previous years, but Southern hardwood output showed marked improvement, advancing 7 per cent compared with early September to achieve a rate of above 100 per cent of rated capacity for the first time since 1953. Crude oil production, early in October, fell off 4 per cent but was still 15 per cent above a year ago.

In September the use of industrial electric power by selected firms in the Eighth District rose 7 per cent from August and held to a level of 12 per cent over the like month a year ago. Among the 14 industry groups reporting, nonelectrical machinery manufacture, with production interrupted by a work stoppage, was the only one showing weakness.

Bank Loans and Interest Rates

During the four weeks ended October 19, total loans at weekly reporting banks in the district, excluding those to other banks, rose at a slower rate than in recent months. In fact, the increase was less than normal for this season of the year. The moderation in the growth of loan portfolios reportedly resulted from a number of influences. For one thing, district banks were generally short of reserve funds and as a result were under pressure to preserve or build up their cash positions. To ease the pressure, a few banks sold some paper, both real estate and business loans, to other institutions. In addition, customers in many cases were asked if they could postpone or scale down their needs for credit at this time. Moreover, district banks received sizable net repayments from sales finance companies, which apparently were tapping nonbanking sources for short-term funds to an increasing extent. At the same time it was reported that the demand for new loans continued in nearly as vigorous a fashion as in recent months.

Interest rates on business loans were marked up another one-quarter of one per cent during October and now generally stand one-half of one per cent higher than in early August. In some instances, the increase in rates may have affected the demand for bank credit. Also, the desire for bank loans may have been temporarily influenced by a decline in automobile sales as manufacturers shifted to 1956 models.

The District Record

Industry

VARIOUS INDICATORS OF INDUSTRIAL ACTIVITY

	Sept. 1955	Sept. 1955* compared with Aug. 1955	Sept. 1955* compared with Sept. 1954
Industrial Use of Electric Power (thousands of KWH per working day, selected industrial firms in 6 district cities)	14,114	+ 7%	+12%
Steel Ingot Rate, St. Louis area (operating rate, per cent of capacity)	97	— 3	+54
Coal Production Index—8th Dist. (Seasonally adjusted, 1947-49=100)	81 p	— 6	+11
Crude Oil Production—8th Dist. (Daily average in thousands of bbls.)	387.8	+ 1	+20
Freight Interchanges at RRs—St. Louis. (Thousands of cars—25 railroads—Terminal R. R. Assn.)	106.6	— 1	+19
Livestock Slaughter—St. Louis area. (Thousands of head—weekly average)	104.8	+24	— 8
Lumber Production—S. Pine (Average weekly production—thousands of bd. ft.)	200.2	— 3	+10
Lumber Production—S. Hardwoods. (Operating rate, per cent of capacity)	98	+ 9	+ 7

* Percentage change figures for the steel ingot rate, Southern hardwood rate, and the coal production index, show the relative per cent change in production, not the drop in index points or in percents of capacity.

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Banking

BANK DEBITS[1]

	Sept. 1955 (In millions)	Sept. 1955 compared with Aug. 1955	Sept. 1955 compared with Sept. 1954
Six Largest Centers:			
East St. Louis—National Stock Yards, Ill.	$ 138.0	+ 6%	+ 6%
Evansville, Ind.	161.6	— 8	+19
Little Rock, Ark.	185.7	+ 5	+14
Louisville, Ky.	815.7	— 6	+15
Memphis, Tenn.	748.3	+12	— 1
St. Louis, Mo.	2,238.6	+ 2	+15
Total—Six Largest Centers	$4,287.9	+ 1%	+12%
Other Reporting Centers:			
Alton, Ill.	$ 40.6	+ 6%	+21%
Cape Girardeau, Mo.	15.5	+ 2	+10
El Dorado, Ark.	30.8	+13	+11
Fort Smith, Ark.	53.9	+ 1	+10
Greenville, Miss.	32.8	+27	+13
Hannibal, Mo.	10.4	-0-	+18
Helena, Ark.	11.9	+67	— 7
Jackson, Tenn.	26.1	+ 9	-0-
Jefferson City, Mo.	76.4	+10	+ 9
Owensboro, Ky.	46.5	+ 4	+21
Paducah, Ky.	26.1	— 3	—16
Pine Bluff, Ark.	46.5	+53	+19
Quincy, Ill.	37.7	— 4	+ 6
Sedalia, Mo.	15.8	— 2	+24
Springfield, Mo.	86.4	+ 2	+20
Texarkana, Ark.	20.8	+ 2	+19
Total—Other Centers	$ 578.2	+ 8%	+12%
Total—22 Centers	$4,866.1	+ 2%	+12%

INDEX OF BANK DEBITS—22 Centers
Seasonally Adjusted (1947-1949=100)

1955 Sept.	1955 Aug.	1954 Sept.
156.2	159.0	139.4

[1] Debits to demand deposit accounts of individuals, partnerships and corporations and states and political subdivisions.

CASH FARM INCOME

(In thousands of dollars)	Aug. 1955	Percentage Change: Aug. '55 from Aug. '54	Percentage Change: Jan. thru Aug. 1955 compared with 1954	Percentage Change: Jan. thru Aug. 1955 compared with 1953
Arkansas	$ 23,073	+14%	+ 5%	+ 2%
Illinois	131,324	+ 4	—10	—11
Indiana	87,200	— 6	— 9	—10
Kentucky	25,815	—14	— 8	—14
Mississippi	23,697	+ 8	— 3	—24
Missouri	71,645	— 9	— 6	— 8
Tennessee	24,059	— 8	— 5	—12
7 States	$386,813	— 3	— 7	—11
8th District	$159,039	— 3	— 5	—11

Source: State data from USDA preliminary estimates unless otherwise indicated.

Construction

INDEX OF CONSTRUCTION CONTRACTS AWARDED EIGHTH FEDERAL RESERVE DISTRICT*

(1947-1949=100)

	Aug. 1955	July 1955	Aug. 1954
Unadjusted			
Total	235.3 p	208.6	206.2
Residential	250.8 p	293.8	281.3
All Other	228.0 p	169.0	171.3
Seasonally adjusted			
Total	192.9 p	165.1	169.5
Residential	209.0 p	251.1	234.4
All Other	185.4 p	125.2	139.3

* Based on three-month moving average (centered on mid-month) of value of awards, as reported by F. W. Dodge Corporation.

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ASSETS AND LIABILITIES EIGHTH DISTRICT MEMBER BANKS

(In Millions of Dollars) Assets	Weekly Reporting Banks: Oct. 19, 1955	Weekly Reporting Banks: Change from Sept. 21 1955	All Member Banks: Sept. 28 1955	All Member Banks: Change from Aug. 31 1955
Loans[1]	$1,533	$+ 32	$2,420	$+45
Business and Agricultural	782	+ 34*		
Security	52	+ 5		
Real Estate	276	— 2*		
Other (largely consumer)	443	— 6*		
U. S. Government Securities	986	+ 3	1,940	— 7
Other Securities	245	+ 2	493	-0-
Loans to Banks	20	— 3		
Cash Assets	912	+ 30	1,407	+58
Other Assets	44	+ 1	65	— 2
Total Assets	$3,740	$+ 65	$6,325	$+94
Liabilities and Capital				
Demand Deposits of Banks	$ 685	$+ 3	$ 705	$+50
Other Demand Deposits	2,156	+ 66	3,861	+72
Time Deposits	562	-0-	1,211	— 6
Borrowings and Other Liabilities	72	— 5	88	—24
Total Capital Accounts	265	+ 1	460	+ 2
Total Liabilities and Capital	$3,740	$+ 65	$6,325	$+94

[1] For weekly reporting banks, loans are adjusted to exclude loans to banks; the total is reported net; breakdowns are reported gross. For all member banks loans are reported net and include loans to banks; breakdown of these loans is not available.

* Figures for September 21 revised to reflect some reclassifications

Trade

DEPARTMENT STORES

	Net Sales: Sept., 1955 compared with Aug., '55	Net Sales: Sept., 1955 compared with Sept., '54	Net Sales: 9 Mos. '55 to same period '54	Stocks on Hand: Sept. 30, '55 comp. with Sept. 30, '54	Stocks-Sales Ratio: Jan. 1 to Sept. 1955	Stocks-Sales Ratio: Jan. 1 to Sept. 1954	Percentage of Accounts and Notes Receivable Outstanding Sept. 1, '55, collected during Sept.: Instal. Accounts	Percentage of Accounts and Notes Receivable Outstanding Sept. 1, '55, collected during Sept.: Excl. Installment Accounts
8th F.R. District Total	+ 4%	+ 9%	+ 7%	+ 8%	2.92	2.95	16	49
Fort Smith Area, Ark.[1]	— 3	+10	+12	+ 6	3.08	3.20	....	40
Little Rock Area, Ark.	+ 1	-0-	-0-	— 3	3.00	3.07	11	41
Quincy, Ill.	+ 5	+ 5	+ 2	+10	3.55	3.57	———	———
Evansville Area, Ind.	+ 8	+11	+ 5	-0-	2.44	2.72	———	———
Louisville Area, Ky., Ind.	— 1	+ 5	+ 6	+ 1	2.60	2.70	20	51
Paducah, Ky.	-0-	— 4	— 7	— 4	3.02	3.00	———	....
St. Louis Area, Mo., Ill.	+ 8	+13	+ 8	+14	2.92	2.89	18	55
Springfield Area, Mo.	— 3	+36	+39	+15	2.98	3.52	....	....
Memphis Area, Tenn.	— 5	+ 3	+ 4	+ 5	3.10	3.02	14	39
All Other Cities[2]	+ 5	+13	+ 8	+ 2	3.46	3.84	....	———

[1] In order to permit publication of figures for this city (or area), a special sample has been constructed which is not confined exclusively to department stores. Figures for any such nondepartment stores, however, are not used in computing the district percentage changes or in computing department store indexes.

[2] Fayetteville, Pine Bluff, Arkansas; Harrisburg, Mt. Vernon, Illinois; Vincennes, Indiana; Danville, Hopkinsville, Mayfield, Owensboro, Kentucky; Chillicothe, Missouri; Greenville, Mississippi; and Jackson, Tennessee.

RETAIL FURNITURE STORES

	Net Sales: Sept., 1955 compared with Aug., '55	Net Sales: Sept., 1955 compared with Sept., '54	Inventories: Sept., 1955 compared with Aug., '55	Inventories: Sept., 1955 compared with Sept., '54
8th Dist. Total[1]	— 8%	+ 5%	+ 8%	+10%
St. Louis Area	— 3	+ 5	+ 9	+11
Louisville Area	—18	+ 9	+ 6	+11
Memphis Area	—27	+19	*	*
Little Rock Area	— 3	+31	*	*
Springfield Area	—21	— 8	+11	+ 5

* Not shown separately due to insufficient coverage, but included in Eighth District totals.

[1] In addition to following cities, includes stores in Blytheville, Fort Smith, Pine Bluff, Arkansas; Owensboro, Kentucky; Greenwood, Mississippi; Evansville, Indiana; and Cape Girardeau, Missouri.

NOTE:—Figures shown are preliminary and subject to revision.

INDEXES OF SALES AND STOCKS—8TH DISTRICT

	Sept. 1955	Aug. 1955	July 1955	Sept. 1954
Sales (daily average), unadjusted[3]	122	109	102	111
Sales (daily average), seasonally adjusted[3]	119	120	132	109
Stocks, unadjusted[4]	133	126	116	123
Stocks, seasonally adjusted[4]	123	126	126	114

[3] Daily average 1947-49=100

[4] End of Month average 1947-49=100

Trading days: Sept., 1955—25; Aug., 1955—27; Sept., 1954—25.

OUTSTANDING ORDERS of reporting stores at the end of Sept., 1955 were 38 per cent larger than on the corresponding date a year ago.

PERCENTAGE DISTRIBUTION OF FURNITURE SALES

	Sept., '55	Aug., '55	Sept., '54
Cash Sales	14%	14%	15%
Credit Sales	86	86	85
Total Sales	100%	100%	100%