Volume Title: History and Policies of the Home Owners' Loan Corporation

Volume Author/Editor: C. Lowell Harriss

Volume Publisher: NBER

Volume ISBN: 0-870-14142-2

Volume URL: http://www.nber.org/books/harr51-1

Publication Date: 1951

Chapter Title: Financing the Home Owners' Loan Corporation

Chapter Author: C. Lowell Harriss

Chapter URL: http://www.nber.org/chapters/c3215

Chapter pages in book: (p. 152 - 158)

CHAPTER 10

# Financing the Home Owners' Loan Corporation

THE original Home Owners' Loan Act provided for the issue of bonds with an interest rate of not over 4 percent, interest to be guaranteed by the federal Treasury, and a maturity not to exceed eighteen years.[1] A year later, after the guarantee had been extended to principal, the HOLC started what was to be a long process of refunding and refinancing. Falling interest rates made it possible for the United States government to reduce the computed annual interest rate on all its debt from 3.2 percent in 1934 to 1.9 percent a decade later. The HOLC participated in the benefits of this decline.

It benefited also from the fact that throughout its life short-term interest rates were below long-term rates, and it could take advantage of the differential by borrowing "short" and lending "long." Furthermore, the HOLC obtained favorable rates by borrowing in a money market in which the supply of funds was plentiful, and lending in a market in which the supply was short and rates were generally high. The partial tax exemption of interest aided slightly in borrowing in the early years.

## Borrowing Operations

For some years, the HOLC issued its own bonds and sold them directly, though, beginning in 1934, sales were made in cooperation with the Treasury.[2] The influence of the Treasury increased, and eventually the HOLC, as well as all other governmental agencies, obtained their funds from the Treasury rather than directly from the money markets. A few highlights of this shift in policy and of the borrowing of the HOLC may be sketched here.[3]

1 June 13, 1933, c. 64, 48 Stat. 128, Sec. 4 (c).

2 Mr. Fahey was made a member of the Interdepartmental Loan Committee, which helped coordinate the borrowing of all major government agencies.

3 For a more detailed presentation of bond operations, see Appendix Tables B5 and B6.

In agreeing to guarantee the principal of the HOLC bonds, Congress provided that the outstanding 4 percent bonds could be exchanged for new issues. No change was made in the maximum rate of interest chargeable, but the HOLC, acting under the advice of the Secretary of the Treasury, decided to issue 3 percent fully guaranteed bonds callable in ten years. They were issued beginning May 1, 1934, for new funds (refinancing of mortgages) and in exchange for the 4 percent bonds. They commanded slightly higher prices in the market than the 4 percent bonds, but only $307 million were issued in exchange for the $634 million outstanding 4 percent bonds by October 27, 1934, the last day for such exchange without loss of interest.[4] The Treasury agreed not to use the government's authority to call the remaining $327 million of 4 percent bonds immediately.

In the meantime, a series of short-term obligations maturing in one, two, and three years, with rates from 1½ percent to 2 percent, were sold, partly to the public and partly to government trust funds (because the prices bid in the market seemed too low). On August 1, 1934, the HOLC lowered the rate on bonds offered in exchange in the financing of mortgages from 3 percent to 2¾ percent; and of the $2,688 million of bonds issued in exchange for mortgages, roughly 50 percent were these 2¾ percent bonds callable in five years. On July 1, 1935, the remaining $307 million of 4 percent bonds were called and exchanged or refunded for 1½ percent bonds maturing in four years. The HOLC continued to refund bonds at lower interest rates. During the fiscal years 1935 and 1936, it retired through market operations $736 million of 3 percent and 2¾ percent bonds in exchange for 2¼ percent bonds callable in seven years.

From 1936 to 1940, it borrowed a total of $375 million from the United States Treasury at ¼ percent interest, repayable at any time. In May 1939, it borrowed $320 million from the Treasury at ⅜ percent and ⅝ percent interest, repayable in one and two years, to retire the maturing 1½ percent bonds issued in 1935. On June 1, 1939, it issued $763 million of 1½ percent bonds callable in six years for exchange and refunding of the outstanding 2¾ percent bonds callable on August 1. This issue at 1½ percent interest was necessitated by the fact that the $320 million borrowed from the Treasury at the same

[4] *Second Annual Report,* Federal Home Loan Bank Board (December 31, 1934) pp. 81 and 87. At least one investment banking firm recommended against exchange because of the interest differential. *New York Times,* April 1, 1934, Sec. 2, 11:1.

time represented approximately all the principal receipts contemplated during the next two years; hence, any further borrowing on a short-term basis was impractical. Furthermore, in view of the financial recession then, it was not considered desirable to offer the whole $763 million issue for sale on the open market. Instead, the HOLC offered to exchange these 1½ percent bonds bearing interest from May 1 for the 2¾ percent bonds with interest accrued to August 1. This resulted in $687 million of the bonds being exchanged, leaving only $76 million to be sold in order to retire all of the outstanding 2¾ percent bonds. Since 1940, all HOLC borrowings have been from the Treasury, repayable at any time, at 1 percent through 1947 and at 1¼ percent in 1948 and 1949.

The HOLC was required by statute to use all principal repayments received from loans to retire its own debt. It was authorized to purchase its own obligations in the open market at par or below. Except for the earliest period, however, its issues sold at a premium (with a few exceptions during 1935, 1936, and 1937).[5] It was required, therefore, to rely upon maturities or callable issues, and the receipt of funds and such maturing or calling of issues were not always ideally matched. During the period immediately preceding May 1, 1944, the earliest callable date of its 3 percent bonds, the HOLC accumulated a considerable amount of cash, which it was required to deposit with the United States Treasury and on which it received no interest. If it had received from the Treasury the same rate it paid the Treasury, the HOLC's total income would have been several million dollars higher.

The various operations involved in HOLC financing may be summarized as follows:

> The $2,688 million of bonds issued in exchange for mortgages during 1933 to 1935 had to be acceptable to the former mortgagees both as to interest rate and maturity or callable date. The average interest rate on these bonds was 3.095 percent.
>
> The $701 million of bonds sold to provide capital and cash had an average interest rate of 1.136 percent, including the $87 million

[5] Consequently, it had very limited scope for refunding the high-rate bonds issued in the early years. For example, on June 30, 1941, when it was able to borrow on short term for one-half of 1 percent or less, it had outstanding $779 million 3 percent bonds and $875 million 2¼ percent bonds which were selling above par and were not callable until 1944 and 1942, respectively. *Ninth Annual Report,* Federal Home Loan Bank Board (June 30, 1941) p. 264.

of 4 percent and 3 percent bonds sold in 1933 and 1934. These latter bonds had an average interest rate of 3.039 percent, and the subsequent $614 million bonds sold to provide capital had an average interest rate of 0.654 percent.

The various refunding operations involved the issue of $5,014 million of bonds, and these had an average interest rate of 1.387 percent.

When the Treasury undertook responsibility in 1941 for all borrowing, a question arose as to the terms on which funds would be available to different agencies. The Treasury rates differed, depending upon the length of the maturity, eligibility of the security for bank holding, and other features, such as redeemability. Furthermore, the market was by no means completely free, with limits placed upon the amount of certain of the higher-yield issues that could be purchased by single investors. The principal problem which this complex of factors presented was how much the HOLC should pay for the funds it acquired from the Treasury. The HOLC, of course, needed some short-term funds because it would normally expect to retire some of its debt as it collected borrowers' amortization payments; however, from the evidence available then it seemed clear that the Corporation would not retire all its debt within a few years, or even by 1951. The certainty, however, that some of its debt would persist for at least a decade did not require the HOLC to borrow on a ten-year basis; it might follow the general Treasury practice of borrowing funds for short periods and repaying out of new borrowings. As long as short-term rates remained significantly lower than long-term rates, there were naturally strong inducements to borrow for short rather than for long periods, and there was no clear reason why the HOLC could not have done so had it been borrowing directly from the market. In this case it might have obtained about the minimum rate—one-half of 1 percent or, at times, less—on all new borrowings (refundings).

No clear analysis of principle seems to have been developed in settling the terms on which the agencies would reimburse the Treasury. Arguments could be advanced for and against several rates—for instance, the highest paid by the Treasury in market borrowings, the lowest, the average, or the average for some average pattern of maturities. In any case, there was no obvious reason why all agencies should pay the same rate; yet there was no clearly defined basis for differentiation. So far as the government as a whole was concerned, the matter was one of internal accounting, but for the agencies concerned it affected financial results, and thus their record, prestige, and perhaps their continuance.

The arrangement that developed left the decision largely to the relative bargaining strength and inclination of the Treasury on the one hand and to the HOLC and other agencies on the other, with Treasury influence, in fact, dominant. The average interest rates paid by the HOLC from 1934 to 1949 are shown in Table 41. The weighted average in the fiscal years 1933 through 1949 was 2.243 percent.

TABLE 41 — AVERAGE INTEREST RATES PAID BY THE HOLC, 1934-49 [a]

| *Fiscal Year* | *Interest Rate* | *Fiscal Year* | *Interest Rate* |
|---|---|---|---|
| 1934 | 3.625% | 1940 | 2.138% |
| 1935 | 2.645 | 1941 | 2.257 |
| 1936 | 2.658 | 1942 | 1.928 |
| 1937 | 2.585 | 1943 | 2.118 |
| 1938 | 2.527 | 1944 | 1.283 |
| 1939 | 2.098 | 1945–49 | 1.076 |

[a] Data made available by the HOLC.

## BUDGETARY LIMITATIONS

The HOLC financed all of its operations through its earnings or from the proceeds of its borrowings. At no time did Congress appropriate any Treasury funds for the use of HOLC. The HOLC Act, originally and as amended, provided that "The Corporation shall be entitled to the free use of the United States mails for its official business in the same manner as the executive departments of the Government, and shall determine its necessary expenditures under this Act and the manner in which they shall be incurred, allowed, and paid, without regard to the provisions of any other law governing the expenditure of public funds." [6] Beginning with the fiscal year 1938, Congress specified the amount of HOLC funds which the Corporation might make available and expend for its administrative expenses. No such limitation was placed upon availability of HOLC funds for nonadministrative expense. The usual budgetary processes

[6] June 13, 1933, c. 64, 48 Stat. 128, Sec. 4 (j).

were followed, that is, appearance and justification of its estimate of administrative expenses by HOLC representatives before the Bureau of the Budget and before the Subcommittee of the House Committee on Appropriations.

"Administrative" expenses embraced personnel costs, rent, public utilities, printing, office supplies, travel and transportation, furniture, telephone and telegraph, services of the Federal Home Loan Bank Board, Department of the Interior, Treasury Department, and other such expenses normally incident to the administration of any agency. "Nonadministrative" expenses were defined in the appropriation acts as ". . . all necessary expenses (including services performed on a force account, contract or fee basis, but not including other personal services) in connection with the acquisition, protection, operation, maintenance, improvement, or disposition of real or personal property belonging to the Home Owners' Loan Corporation or in which it has an interest. . . ." [7] The appropriation acts also provided, respecting both "administrative" and "nonadministrative" expenses, "That except as herein otherwise provided, the administrative expenses and other obligations . . . shall be incurred, allowed, and paid in accordance with the provisions of . . . the Home Owners' Loan Act of 1933, as amended." [8]

Except for the distinction between "nonadministrative" and "administrative" expense, the position of the HOLC was significantly different from, and its field of action freer than, that of the established department. Interest on its debt was not considered as falling within the limits of administrative expenses. As noted in the last chapter, some functions were performed by salaried personnel or by personnel on a contract or fee basis. By such varied use of personnel the HOLC could, to some extent, make up a shortage of funds for payment of necessary salaried personnel, but indulgence in that practice for other than promotion of efficiency of operation is not apparent.

In most years, the Bureau of the Budget seems to have cut somewhat the amount requested by the HOLC for administrative expenses. Congress often made additional cuts, and the HOLC always spent less than was authorized. This record—a source of some pride to

[7] U. S. Congress, House, Hearings before the Subcommittee of the Committee on Appropriations on the *Independent Offices Appropriation Bill for 1944*, 78th Congress, 1st Session (1943) pp. 988-89.

[8] *Ibid.*, p. 989.

HOLC officials—meant that in general the HOLC had as much money for operations as it wished; nonadministrative expenses were controlled by its own judgment, while funds available for administrative expenses were somewhat greater than the amounts spent.