

6. YIELDS RESULTING FROM FEDERAL GUARANTEE IN LIEU OF TAX
EXEMPTION

Most companies concluded that a Federal guarantee in exchange for tax exemption would not make municipal securities more attractive to them. Beyond this, taxable, guaranteed securities might also be less well received by other investors, unless interest rates were substantially above AAA corporates. The companies' expectations varied somewhat concerning the interest rate levels that would probably accompany such guaranteed securities. As one company noted, these levels might vary, dependent on whether the Federal guarantee was direct, as described below. A number of companies thought that interest rate levels would approximate those of other Federal Government guaranteed issues or Federal agency obligations. If yield levels approximated those of Federal agency securities, these might then not sell so well, one company added. In any event, life insurance companies are not usually investors in low yielding, no risk investments. For taxable guaranteed municipal securities to be attractive to most companies, yields would have to be considerably above expected levels in order to be competitive with yields on corporate bonds and mortgage loans. The following quotations are illustrative of replies to this question:

This avenue of approach, an exchange of yields of order of Federal agency obligations for elimination of tax exemption would be less fruitful than the retention of exemption. The volume of investment funds potentially tapped by a quasi-agency obligation might well be smaller than the volume currently receptive to tax-exempt issues, except at interest rates substantially exceeding those available at the quality of AAA corporate obligations.

* * * a Federal Government guarantee would likely reduce the offered yield of municipal securities, making them less attractive investment opportunities to us. If the Federal Government were to guarantee directly municipal securities, I would expect that these securities would bear rates of interest somewhat higher than U.S. Treasury securities and somewhat lower rates of interest than either Federal agency obligations or corporate bonds. However, should Congress create a new instrumentality of the Federal Government, and municipal securities were to be guaranteed by this agency, with original capital only supplied by the U.S. Treasury, I would expect that these securities would earn a higher rate of return than U.S. Treasury securities and Federal agency obligations and a lower rate of return than corporate bonds. Under these circumstances municipal securities would be increasingly attractive compared to Federal agency obligations as the yield differential between Federal agencies and municipals widened. However, any form of Federal Government guarantee would remove municipal securities as an alternative investment consideration to mortgage loans.

A Federal Government guarantee of municipal securities in exchange for making the interest income taxable would probably make such securities the equivalent of other high-grade taxable Government-guaranteed issues such as the ship mortgage loans guaranteed under title XI of the Merchant Marine Act and certain Federal agency loans, both of which obtain yields equivalent to AAA-rated corporate bonds, but somewhat higher than the yields on direct U.S. Government obligations of comparable maturities. Such yields would not be attractive to [this company] in view of our practice of emphasizing higher yielding investments in satisfactory conventional residential, commercial, and farm mortgages and direct, nonrated, corporate obligations.