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CABINET OFFICE

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From the Secretary of the Cabinet: Sir Robert Armstrong KCB, CVO

Ref: A01458

18th February 1980

An interesting suggestion has been made to Sir Robert Armstrong for relieving the pressure on mortgage rates and he has asked me to pass it on to you for what it is worth.

It is that financial institutions who lend money on mortgage to house purchasers should be allowed to pay the interest on the money which they themselves borrow to finance their lending free of tax to the members. On this basis financial institutions should be able to raise money for mortgage lending at rates well below current market levels and they would be required to pass on the benefit of this to mortgagees.

The source for this suggestion said that concessions of this kind were made to housing loan associations in the United States of America and other countries. He recognised that there would be a significant loss of revenue to the Government, but suggested that in certain circumstances the need to take the pressure of mortgage rates might prevail over the revenue considerations, even if that entailed sharper reductions in public expenditure or increases in taxation to make good the money foregone.

I enclose with this letter a copy of a letter which Sir Robert Armstrong has received following up the suggestion which was originally made to him orally.

I am sending copies of this letter and of the follow-up letter (but not of the document enclosed with the follow-up letter) to Tim Lankester and David Edmonds.

D. J. WRIGHT

(D. J. Wright)

A. J. Wiggins, Esq

My efficient secretary ~~has found what~~ I was looking for in connection with our conversation this afternoon and I enclose it herewith. The point about tax exemption is sidelined in red on Page 40.

As I explained to you, the US Internal Revenue has for many years operated a system of selective exemption from tax for those who lend to institutions regarded as operating in the national interest. This in turn enables such institutions to borrow - and re-lend - at rates at least 30% below the going long-term money rates.

For example, the Parish of Jefferson borrowed 30 year money last year at 7.10% when the going rate was about 10.5%; the same difference will apply at current rates.

The simplest way of starting such a scheme would be to let building societies float interest-free notes in the market and use the proceeds for their current housing loans. This may lead banks and other lenders to cry unfair competition and a system may have to be found of placing the same facility at the disposal of anyone - including private individuals - who makes a housing loan. But such a comprehensive system would be difficult to administer and if the necessary political impact is to be achieved quickly the scheme may have to be initially confined to building societies.