

THE EFFECT OF NEW DEAL REAL ESTATE RESIDENTIAL
FINANCE AND FORECLOSURE POLICIES MADE IN RESPONSE
TO THE REAL ESTATE CONDITIONS OF THE GREAT
DEPRESSION¹

Cotton on the roadside, cotton in the ditch
We all picked the cotton but we never got rich
Daddy was a veteran, a southern Democrat
They oughta get a rich man to vote like that

Sing it . . .

Song, Song of the South
Sweet potato pie and I shut my mouth
Gone, gone with the wind
There ain't nobody looking back again

Well somebody told us Wall Street fell
But we were so poor that we couldn't tell
Cotton was short and the weeds were tall
But Mr. Roosevelt's a gonna save us all

Well momma got sick and daddy got down
The county got the farm and they moved to town
Papa got a job with the TVA
He bought a washing machine and then a Chevrolet . . .

Alabama, *Song of the South*.²

I. INTRODUCTION

While the lyrics of Alabama's "Song of the South" credit jobs with the Tennessee Valley Authority for lifting many poor folks from poverty, it was the Home Owners' Loan Corporation and the Federal Housing Administration, both products of President Franklin Roosevelt's New Deal, which sta-

1. The author would like to Professor Alfred L. Brophy, who suggested a study of mortgage foreclosures in the rural south. This Comment ended up looking rather different, however, from what we both originally envisioned.

2. ALABAMA, *Song of the South*, on SOUTHERN STAR (RCA Records 1989).

bilized and eventually revolutionized how Americans bought homes. Though these important New Deal agencies have received some attention for their role in transforming residential real estate ownership, this Comment provides greater analysis of the legal and economic changes wrought by the Home Owners' Loan Corporation and the Federal Housing Administration on residential mortgage lending and finance. Aside from the intrinsic historical importance of each institution, understanding these changes is important for recognizing the many contemporary residential real estate institutions and policies that can trace their existence to changes in residential real estate finance and foreclosure wrought during the New Deal.

This Comment first provides a brief overview of the system of residential real estate finance and foreclosure prior to the Great Depression and then addresses how the economic conditions of the Great Depression affected real estate finance and foreclosure. The bulk of the Comment discusses the two New Deal institutions which were critical in keeping foreclosures at bay and reviving residential real estate finance: the Home Owners' Loan Corporation and the Federal Housing Administration.

II. THE STATUS OF REAL ESTATE FINANCE BEFORE THE GREAT DEPRESSION

The American system of real estate finance that emerged from the New Deal was remarkably different from the system that existed during the Great Depression. In the period leading up to the Great Depression, many mortgage lenders required high margins on their loans for a number of reasons: to protect against busts from real estate booms; to protect against speculative homeowners who, in hopes of quickly selling the home at a profit, made little or no effort to pay down the principal; and to protect against wildly fluctuating land values due to the incredible growth in America's urban areas in the early Twentieth Century.³

By securing high margins on first mortgages in particular, many lenders paid little attention to such risk factors as the borrower's willingness and ability to pay, the equity the borrower had in the home, the amount of other liens on the property, the location of the property, or the quality of the construction.⁴ The fact that many appraisers determined the value of a home "from the running board of an automobile" only aggravated the existing problems of the real estate finance system.⁵ Such wildly subjective and inadequate appraisals were termed the "'look, spit, and guess' method."⁶ In a time where many mortgages were made with the real estate as the only se-

3. FED. HOME LOAN BANK BD., 1 FEDERAL HOME LOAN BANK REVIEW 3 (1934).

4. *Id.*

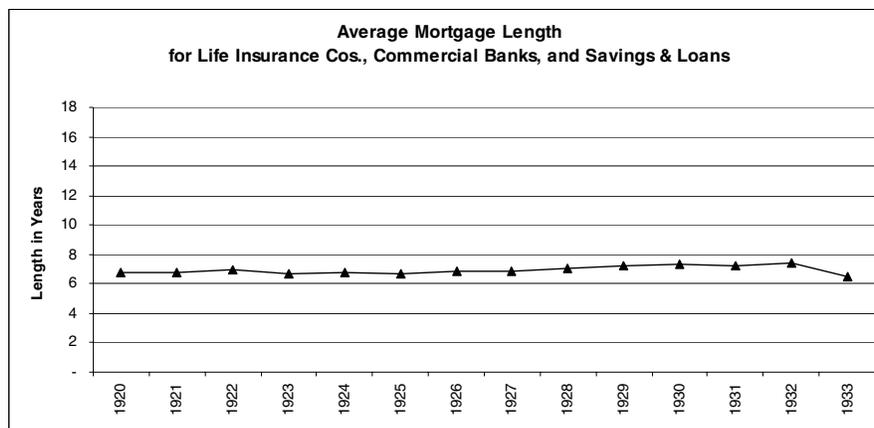
5. *Id.* at 4.

6. FED. HOME LOAN BANK BD., 3 FEDERAL HOME LOAN BANK REVIEW 37 (1936).

curity and little or no down payment,⁷ such appraisals fueled the speculative nature of residential real estate.

In the period before the Great Depression, there were generally two categories of home buyers. The first category usually paid the entire purchase price for their homes in cash or made a substantial cash down payment of at least 30% of the price.⁸ The second category, however, viewed homeownership as a speculative profit-making venture.⁹ Generally, mortgages during this period were often short-term in nature, typically for five-to-ten years.¹⁰ From 1920-1933, for example, urban mortgages were for an average of seven years.¹¹

GRAPH 1¹²



Since mortgages were not commonly amortized, at the end of the term the borrower often had not paid any of the principal of the loan.¹³ The borrower typically had two options at the end of the term: he could either pay

7. STANLEY L. MCMICHAEL & PAUL T. O'KEEFE, *HOW TO FINANCE REAL ESTATE* 4 (2d ed. 1953).

8. DAVID M. KENNEDY, *FREEDOM FROM FEAR: THE AMERICAN PEOPLE IN DEPRESSION AND WAR, 1929-1945*, at 370 (1999).

9. FED. HOME LOAN BANK BD., *supra* note 3.

10. Kenneth T. Jackson, *Race, Ethnicity, and Real Estate Appraisal: The Home Owners Loan Corporation and the Federal Housing Administration*, 6 J. URB. HIST. 419, 422 (1980).

11. See Graph 1, *infra* note 12 for the average mortgage length during the Great Depression and during the years leading up to the formation of the Home Owners' Loan Corporation and the Federal Housing Administration.

12. See J.E. MORTON, NAT'L BUREAU OF ECON. RESEARCH, *URBAN MORTGAGE LENDING: COMPARATIVE MARKETS AND EXPERIENCE* 174 tbl.C-6 (1956) [graph hereinafter Graph 1] (graph represents the average of all loans made by life insurance companies, commercial banks, and savings and loan institutions).

13. *Id.* An amortized mortgage allows a home buyer to make equal payments throughout the life of the mortgage loan, resulting in the full satisfaction of the principal and interest of the mortgage at the end of the term.

the entire amount of the principal in one lump sum balloon payment or refinance the debt.¹⁴

Instead of attempting to pay off the principal of a loan and own the home in fee simple absolute, however, many homeowners sought as small a down payment as possible in the biggest mortgage they could get and would pay only the interest on the loan.¹⁵ They would then carry that mortgage through its short term, hoping that at the end of the mortgage they could sell the home at a profit.¹⁶ Mortgage lenders encouraged this behavior and continued to offer minimal down payments and make second mortgages at exploitative rates.¹⁷ If real estate finance conditions were favorable, but the real estate market conditions were not, it was easy for a speculative borrower to refinance and hope conditions would turn favorable for selling.¹⁸ If real estate financing was tight, however, the borrower might not be able to refinance and would be forced into foreclosure.¹⁹ Since foreclosure was a slow and costly procedure, the widespread practice of real estate speculation, which could lead to foreclosure, increased the risks of lenders and resulted in increased costs to lenders and borrowers.²⁰

In addition to most mortgage lenders only offering short-term, non-amortizing mortgages, some states prohibited mortgage lenders from accepting mortgages that represented more than half of the appraised value of the property.²¹ Between 1920 and 1934 the average loan-to-value ratio of urban mortgages was principally between 50% and 55%.²²

14. MILES L. COLEAN, *THE IMPACT OF GOVERNMENT ON REAL ESTATE FINANCE IN THE UNITED STATES* 44 (1950).

15. *Id.* at 38.

16. See FED. HOME LOAN BANK BD., *supra* note 3. See Graph 2, *infra* note 23 for average home loan-to-value ratios during the Great Depression and during the years leading up to the formation of the Home Owners' Loan Corporation and the Federal Housing Administration.

17. See FED. HOME LOAN BANK BD., *supra* note 3.

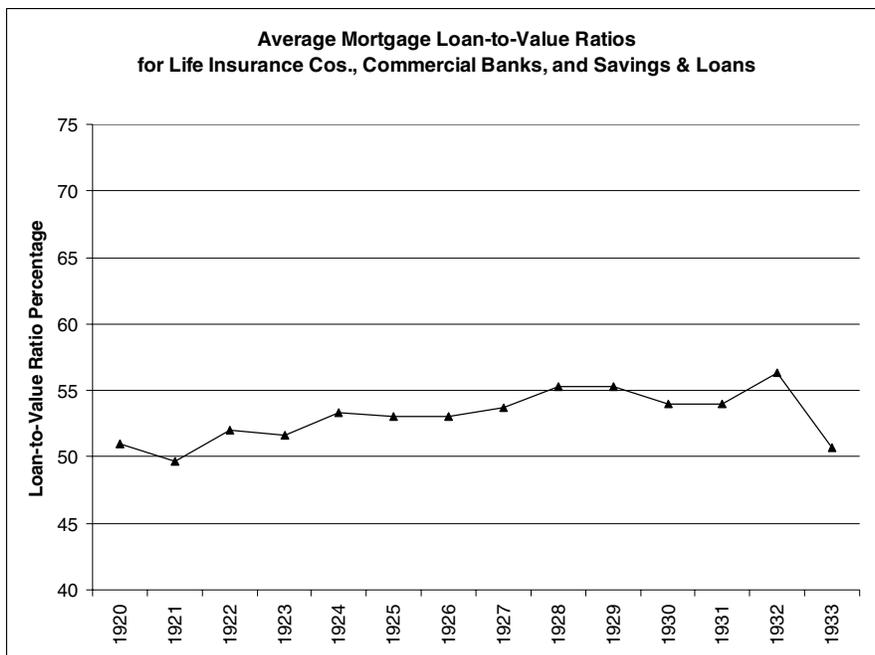
18. See Jackson, *supra* note 10, at 422.

19. *Id.*

20. COLEAN, *supra* note 14, at 46.

21. FED. HOME LOAN BANK BD., *supra* note 3.

22. See Graph 2, *infra* note 23 for the average mortgage loan-to-value ratios for the Great Depression and the years leading up to the formation of the Home Owners' Loan Corporation and the Federal Housing Administration.

GRAPH 2²³

It was thought that by requiring a lower ratio of home value to loan, the mortgage lender would take on less risk.²⁴ This prohibition ostensibly required most homeowners to seek second mortgages to fully finance the home purchase.²⁵ This prohibition also created an environment where, because of such high demand, many second mortgage lenders were able to operate “outside the law,” charging usurious rates to home buyers.²⁶ Among interest, discounts, commissions, and service charges, the true interest rates of second mortgages could be upwards of 30%.²⁷ When interest rates for many first mortgages on urban properties from 1920 to 1933 averaged between 6.0% and 6.5%, it was not difficult to see why second mortgage lenders were looked upon with disdain.²⁸

23. See MORTON, *supra* note 12, at 175 tbl.C-7 [graph hereinafter Graph 2] (graph represents the average of the Mortgage Loan-to-Value ratios for life insurance companies, commercial banks, and savings and loan institutions).

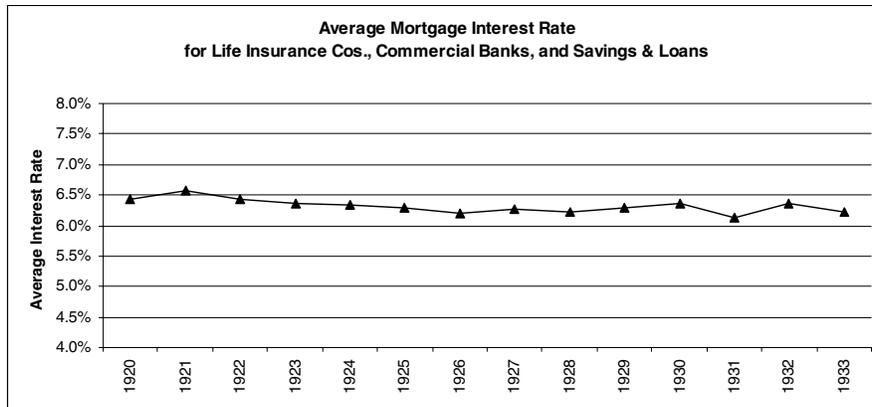
24. *Id.*

25. FED. HOME LOAN BANK BD., *supra* note 3, at 4.

26. *Id.*

27. *Id.*

28. See Graph 3, *infra* note 29 for the average mortgage interest rate for the Great Depression and the years leading up to the formation of the Home Owners' Loan Corporation and the Federal Housing Administration.

GRAPH 3²⁹

The real estate finance system's inaccessibility to those not fortunate enough to have large cash reserves or those unwilling to speculate on real estate values was well known. As President Herbert Hoover noted:

The finance of home building, especially for second mortgages, is the most backward segment of our whole credit system. It is easier to borrow 85% on an automobile and repay it on the installment plan than to buy a home on that basis—and generally the house requires a higher interest rate.³⁰

With devolving economic conditions, many borrowers were unable to keep up with their multiple mortgage payments and were forced into default.³¹ As such, many second mortgage financing institutions, which had only junior interests in the real estate they financed, were wiped out during the Great Depression along with the home buyers they serviced.³²

The lack of mortgage lending standards only further exacerbated the problems of the real estate finance system. While there were a multitude of lenders, they operated without uniformity and without accepted guidelines.³³ As such, these lenders operated with limited oversight and maintained high margins by keeping the costs of real estate financing high.³⁴ Additionally, because of a lack of mortgage lending standards, there were no substantial secondary mortgage markets, and real estate capital could not easily flow

29. See MORTON, *supra* note 12, at 173 tbl.C-5 [graph hereinafter Graph 3] (graph represents the average mortgage interest rates for life insurance companies, commercial banks, and savings and loan institutions).

30. EDITH ELMER WOOD, RECENT TRENDS IN AMERICAN HOUSING 185 (1931).

31. *Id.*

32. FED. HOME LOAN BANK BD., *supra* note 3, at 4.

33. *Id.* at 6.

34. *Id.*

into different areas of the country.³⁵ The absence of standards further led interest rates to vary greatly among regions.³⁶ At one point in 1931, for example, home loan interest rates ranged from 5.9% to 10.0%, depending on the part of the country in which the lender made its loans.³⁷

The system of real estate finance in place before the New Deal required either a large amount of cash or a willingness to speculate on real estate values in order to purchase a home.³⁸ Therefore, it was not surprising that many people chose to rent their residences. From 1890 to 1920, the nation's total annual rate of homeownership, for both rural and farm areas remained below 50%.³⁹

TABLE 1⁴⁰

Percentage of Homes Owned	
Year	Percentage
1890	47.8%
1900	46.1%
1910	45.8%
1920	45.6%

As one would expect, the tendency to rent instead of own was more pronounced in American cities, where approximately only one out of three individuals owned his own home.⁴¹ The thirteen largest cities in the U.S in 1930 had an average homeownership rate of 37%, while the weighted average of homeownership for those cities was only 32%.⁴²

35. *Id.* at 6-7.

36. *Id.*

37. *Id.* at 18. See Graph 3, *supra* note 29 for the average mortgage interest rate for the Great Depression and years leading up to the formation of the Home Owners' Loan Corporation and the Federal Housing Administration.

38. *Id.*

39. WOOD, *supra* note 30, at 37. See Table 1, *infra* note 40 for homeownership percentages for the years leading up to the Great Depression and the formation of the Home Owners' Loan Corporation and the Federal Housing Administration.

40. WOOD, *supra* note 30, at 37 [table hereinafter Table 1].

41. GAIL RADFORD, MODERN HOUSING FOR AMERICA: POLICY STRUGGLES IN THE NEW DEAL ERA 119, 239 n.24 (1996). See Table 1, *supra* note 40 for historical home ownership rates from 1890 to 1930.

42. See Table 2, *infra* note 43 for comparative home ownership rates for the thirteen largest cities in the United States in 1930.

TABLE 2⁴³

Homeownership Rates for 13 Largest Cities in 1930		
City	Population	Home Ownership Rate
New York	6,930,446	20%
Chicago	3,376,438	31%
Philadelphia	1,950,961	51%
Detroit	1,568,662	41%
Los Angeles	1,238,048	37%
Cleveland	900,429	37%
St. Louis	821,960	31%
Baltimore	804,874	50%
Boston	781,188	26%
Pittsburgh	669,817	40%
San Francisco	634,394	32%
Milwaukee	578,249	42%
Buffalo	573,076	43%
Average		37.0%
Weighted Average		32.1%

Things would change, however. Where once only one in three owned his own home, four decades after the New Deal and its initiatives to stave off foreclosure, increase housing construction, and reinvent the existing system of real estate finance, American homeownership increased 100%.⁴⁴

III. THE GREAT DEPRESSION'S EFFECT ON RESIDENTIAL REAL ESTATE FINANCE: ECONOMIC REALITIES AND LEGAL ENVIRONMENT OF FINANCE

A. *Economic Realities: Residential Foreclosure*

During the Great Depression, the existing system of financing residential real estate was thrown into a vicious downward spiral and, as a result, so was the system of foreclosure. Here is an idea of the potential impact of a

43. See RADFORD, *supra* note 41, at 239 n.24 [table hereinafter Table 2].

44. See Steven A. Ramirez, *The Law and Macroeconomics of the New Deal at 70*, 62 MD. L. REV. 515, 560-61 (2003).

total collapse of the real estate market: the real estate mortgage debt in 1932 of \$43 billion was three times that of total railroad debt; four times that of industrial long-term debt; and nearly the same size as that of the combined federal, state, county, and municipal debt.⁴⁵

Widespread unemployment also reduced the ability of individuals to meet their mortgage obligations and resulted in an increased number of foreclosures.⁴⁶ The escalating number of defaulting loans shrank the deposits of lenders and only worsened with the devolving economic conditions.⁴⁷ As a result, lenders were often compelled to foreclose or dispose of their real estate holdings in order to meet their obligations.⁴⁸ In turn, mass sales of real estate for insufficient payment of taxes accompanied by the increasing numbers of foreclosures further depressed real estate prices, increasing the risks and inevitably the costs of mortgage lending.⁴⁹ Many mortgage lenders were then all but forced to retain their foreclosed assets instead of attempting to sell them at a below market price among the glut of other foreclosed residences.⁵⁰ As such, real estate lenders became increasingly reluctant to use what little cash they had to finance real estate, fearing deflating real estate values and the risks of holding defaulted and foreclosed mortgages, neither of which offered liquidity.⁵¹

Millions of homeowners faced not only losing their homes by foreclosure but also faced losing whatever equity they had in those homes as a result of depressed prices at foreclosure sales. Lenders were headed toward insolvency or heavy losses that threatened their existence, state and local governments were under-funded by their inability to fully collect property taxes, and new housing construction was dead in the water.⁵²

The net effect of the Great Depression and the aggravating conditions of the existing system of real estate finance came to a head in 1933. Nearly a quarter of a million homes had been foreclosed the prior year,⁵³ and the rate of foreclosure continued to increase to over one-thousand foreclosures per day.⁵⁴

45. FED. HOME LOAN BANK BD., *supra* note 3, at 3.

46. C. LOWELL HARRISS, *HISTORY AND POLICIES OF THE HOME OWNERS' LOAN CORPORATION* 8 (1951).

47. *Id.*

48. *Id.*

49. *Id.*

50. Robert H. Skilton, *Developments in Mortgage Law and Practice*, 17 *TEMP. U. L.Q.* 315, 378-79 (1943).

51. See Lawrence N. Bloomberg, *The Role of the Federal Government in Urban Housing*, 41 *AM. ECON. REV.* 586, 590 (1951).

52. HARRISS, *supra* note 46, at 9.

53. RADFORD, *supra* note 41, at 76.

54. *Id.* See Table 3, *infra* note 55 for the number of non-farm foreclosures for the years leading up to the Great Depression and the formation of the Home Owners' Loan Corporation and the Federal Housing Administration.

TABLE 3⁵⁵

U.S. Non-Farm Foreclosures	
Year	Number
1930	150,100
1931	193,800
1932	248,700
1933	252,400

Frustrated, some citizens even formed lynching parties for sheriffs attempting to conduct foreclosure sales.⁵⁶ By the spring of 1933, foreclosure threatened to further cripple the nation's already depressed economy as over half of the nation's mortgage debt was in default.⁵⁷

B. State Initiatives to Protect Defaulting Home Owners

State institutions attempted to address the ever-growing number of foreclosures and the effect they had on the grim residential real estate situation. Many state legislatures enacted mortgage moratorium legislation in the early 1930s, granting homeowner-debtors some sort of relief from their mortgage obligations.⁵⁸ Mortgage moratorium legislation generally fell into one of three categories. One form saw the legislature giving courts the authority to delay foreclosure proceedings for a specified amount of time.⁵⁹ A second form of mortgage moratorium legislation simply allowed for the extension of existing redemption periods.⁶⁰ A third form sought to prevent inflated deficiency judgment values by either setting a price under which the foreclosed property could not be sold, or requiring the court to set a fair market value for the property to be used in determining the amount of the deficiency judgment instead of the actual sale price.⁶¹ Though debtor relief legislation, such as mortgage moratorium legislation, was ruled unconstitutional by many courts in the nineteenth century, the Supreme Court of the United States joined the many government institutions and began to permit such measures.⁶²

55. FED. HOME LOAN BANK BD., 7 FED. HOME LOAN BANK REVIEW supp., tbl. 14, at 19 (1941). [table hereinafter Table 3].

56. Bloomberg, *supra* note 51, at 589.

57. RADFORD, *supra* note 41, at 178.

58. Clifford C. Hynning, *Constitutionality of Moratory Legislation*, 12 CHI.-KENT L. REV. 182, 183-84 (1934). One count has at least twenty-eight states passing some form of mortgage moratorium. J. Douglass Poteat, *State Legislative Relief for the Mortgage Debtor During the Depression*, 5 LAW & CONTEMP. PROBS. 517, 520 (1938).

59. Poteat, *supra* note 58.

60. *Id.*

61. *Id.*

62. See Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398 (1934); see also Lee J. Alston, *Farm Foreclosure Moratorium Legislation: A Lesson from the Past*, 74 AM. ECON. REV. 445 (1984).

Relief for defaulting homeowners also came from state courts. Some state courts, such as those in New York and Illinois, sought to provide relief to defaulting debtors and refused to allow deficiency judgments.⁶³ These state law initiatives, however, proved ineffective in providing sufficient relief and recovery at a rate acceptable to the Hoover Administration.⁶⁴ In response to the ineffectiveness of state law initiatives, President Herbert Hoover signed the Home Loan Bank Act into law in July of 1932.⁶⁵

C. *An Initial Federal Attempt at Real Estate Finance Reform*

Through the Federal Home Loan Bank Act of 1932,⁶⁶ President Hoover's administration attempted to address the devolving conditions in the nation's system of real estate finance through the nation's first permanent piece of federal housing legislation.⁶⁷ The act created the Federal Home Loan Bank Board (FHLBB), which in turn created twelve regional federal home loan banks.⁶⁸ These regional federal home loan banks were charged with overseeing and making credit advances to savings and loan institutions, which would use their first mortgages as security for the credit advances from the regional federal home loan banks.⁶⁹ As savings and loan institutions possessed one-third of the nation's mortgage holdings, the FHLBB was attempting to infuse the most active real estate lenders with the necessary credit to keep the real estate market afloat.⁷⁰ In theory this would allow lenders, who were cash-starved by increasing numbers of defaults and foreclosures, to continue to lend by redistributing capital from areas of lower demand to areas of higher demand.⁷¹

While the FHLBB would, in later years, become an integral factor in residential real estate financing, this first step by the federal government to stem the tide of residential foreclosures was toothless to say the least.⁷² Within two years after its enactment, 41,000 homeowners applied for loans that fell under the act—just three were approved.⁷³ While the FHLBB attempted to stimulate the real estate market by subjecting savings and loan institutions to direct federal control through its reserve credit system, the Federal Housing Administration would eventually prove more successful by stimulating the real estate market through a different method.⁷⁴

63. MORTON KELLER, *REGULATING A NEW ECONOMY* 180 (1990).

64. See GUY S. CLAIRE, *ADMINISTRACY: THE RECOVERY LAWS AND THEIR ENFORCEMENT* 34 (1934).

65. Ramirez, *supra* note 44, at 560.

66. Pub. L. No. 72-522, 47 Stat. 725 (1932).

67. RADFORD, *supra* note 41, at 53.

68. NATHANIEL S. KEITH, *POLITICS AND THE HOUSING CRISIS SINCE 1930*, at 21 (1973).

69. *Id.*

70. David M. French, *The Contest for a National System of Home-Mortgage Finance*, 35 AM. POL. SCI. REV. 53, 56 (1941).

71. MCMICHAEL & O'KEEFE, *supra* note 7, at 46-47.

72. KEITH, *supra* note 68; see also RADFORD, *supra* note 41, at 178.

73. Ramirez, *supra* note 44, at 560.

74. French, *supra* note 70, at 62.

IV. NEW DEAL ATTEMPTS TO REFORM RESIDENTIAL REAL ESTATE FINANCE AND FORECLOSURE: HOME OWNERS' LOAN CORPORATION

A. Formation of the Home Owners' Loan Corporation

Upon taking office as President in 1933, Franklin D. Roosevelt sought relief for the many distressed homeowners who had fallen, or were in danger of falling, victim to the ruinous economic conditions of the Great Depression and losing their homes to foreclosure.⁷⁵ Such relief was of critical importance to Roosevelt as he considered mortgages on single family homes as the "backbone of the American financial system."⁷⁶ The President's principal aims in establishing a program to provide such relief were to "(1) protect small homeowners from foreclosure, (2) relieve them of part of the burden of excessive interest and principal payments incurred during a period of higher values and higher earning power, and (3) declare that it was national policy to protect home ownership."⁷⁷ Just as important as his principal aims, and the key to receiving bipartisan support for his program, was the mandate that the program put a minimal burden on the federal treasury and "avoid injustice to the investor."⁷⁸ Two months later the Home Owners' Loan Corporation (HOLC) was signed into law on June 13, 1933 under the Home Owners' Loan Act.⁷⁹

B. Operation of the HOLC

The HOLC program primarily provided relief to homeowners and security to lenders by exchanging with mortgage lenders federally guaranteed HOLC bonds for home mortgages in default.⁸⁰ The lender would accept HOLC bonds bearing a lower rate of interest than the rate of the mortgages they held because the federal government, through the HOLC, guaranteed payments of both principal and interest.⁸¹ This then allowed HOLC to refinance the homeowners' mortgage debt at a more modest interest rate to further assist homeowners in meeting their loan obligations.⁸² In refinancing the homeowners' debt, the HOLC rolled the homeowner's other real estate related debts into the refinanced mortgage, such as delinquent property taxes that threatened to result in foreclosure.⁸³ Straight cash loans were also

75. Jackson, *supra* note 10, at 421. See Table 3, *supra* note 55 for the potential effect of the Home Owners' Loan Corporation on non-farm foreclosures.

76. See Ronald Tobey et al., *Moving Out and Settling In: Residential Mobility, Home Owning, and the Public Enframing of Citizenship, 1921-1950*, 95 AM. HIST. REV. 1395, 1417 (1990) (quoting Franklin D. Roosevelt, Campaign Address on the Eight Great Credit Groups of the Nation (Oct. 21, 1932), in 1 THE PUBLIC PAPERS AND ADDRESSES OF FRANKLIN D. ROOSEVELT 829 (1938)).

77. Jackson, *supra* note 10, at 421.

78. HARRISS, *supra* note 46, at 9.

79. Jackson, *supra* note 10, at 421.

80. HARRISS, *supra* note 46, at 1.

81. CLAIRE, *supra* note 64, at 35.

82. KEITH, *supra* note 68, at 24.

83. *Id.*

made available to redeem homes already lost by foreclosure or voluntary surrender and to pay the necessary taxes to prevent foreclosure.⁸⁴ Moreover, on a recently refinanced loan, the HOLC could agree to postpone the homeowner's interest payments for up to three years to provide further relief until the economy recovered, thereby preventing the recently refinanced homeowner from again defaulting on the loan.⁸⁵

C. Qualifying for HOLC Homeowner Assistance

The HOLC's charter did not allow it to make unlimited loans.⁸⁶ The Home Owners' Loan Act of 1933 provided several mandates for HOLC-provided assistance.⁸⁷ The HOLC was initially limited to authorizing up to \$4.75 billion of its own bonds during a three-year period that bore a maximum of 4% interest and matured in less than eighteen years.⁸⁸ Further, the HOLC was not authorized to make a loan to any homeowner with a mortgage in default.⁸⁹ The HOLC was limited to making loans for residential property that had a value greater than \$20,000 or for residential property that housed more than four families.⁹⁰ Furthermore, the HOLC could not make loans for an amount greater than 80% of the HOLC appraisal value of the property or for more than \$14,000.⁹¹

The HOLC played a significant role in changing the way real estate was appraised by implementing a uniform system of real estate appraisal. Until that time, there were no widely accepted standards.⁹² Since appraisal of property was a critical step to determine what relief could be granted, the HOLC created a system of appraisal that could be uniformly implemented across the country.⁹³ This appraisal system was complete with standardized written procedures and a training program for appraisers to ensure uniformity in appraisal methodologies.⁹⁴

Though the introduction of a uniform system of real estate appraisal was obviously beneficial to those receiving loan assistance from the HOLC, the HOLC's appraisal system was also the first instance of "redlining."⁹⁵ Community groups in Chicago coined the phrase to refer to the red lines that lenders and insurers admitted to drawing on maps around neighborhoods they would not serve because of the perceived risk.⁹⁶

84. HARRISS, *supra* note 46, at 1.

85. CLAIRE, *supra* note 64, at 35.

86. HARRIS, *supra* note 46, at 11.

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.* at 12.

91. *Id.*

92. Jackson, *supra* note 10, at 422.

93. *Id.*

94. *See id.*

95. *See id.* at 423.

96. Amy E. Hillier, *Redlining and the Home Owners' Loan Corporation*, 29 J. URB. HIST. 394, 395 (2003).

The HOLC used three equally weighted factors to arrive at an appraisal value: (1) an estimation of what the property could bring on the current market, “(2) the cost of a similar lot at the time of the appraisal plus the cost of reproducing the building, less depreciation, and (3) the capitalization of the monthly reasonable rental value of the property for the last 10 years.”⁹⁷ To reach the appraisal value by these factors, HOLC appraisers were trained to divide cities into discrete neighborhoods by occupation, income, and the race of the inhabitants along with the “age, type of construction, price range, sales demand, and general state of repair of the housing stock.”⁹⁸

As the appraisal value of the property was critical to determine if the HOLC could make a loan to a homeowner in default, a low appraisal would prove fatal to a homeowner seeking relief.⁹⁹ Factoring the race of the inhabitants of a home and of a neighborhood into appraisal values, the HOLC allowed its perceptions of racial worth to affect who would receive relief from a mortgage in default.¹⁰⁰

In keeping with its systemization of its appraisal processes, the HOLC used a ranked list of ethnic groups that standardized the HOLC’s perceived effect of a particular ethnic presence on property values.¹⁰¹ This list ranked English, Germans, Scottish, Irish, and Scandinavians as all having the least adverse effect on property values, and ranked “Negroes” and “Mexicans” as having the most adverse effect on property values.¹⁰² Though this process would be decried today as a blatant example of racism, the use of race and ethnicity was justified as a reasonable proxy for family income.¹⁰³ The HOLC appraisal process also assumed that the socioeconomic characteristics of the inhabitants of a home and the surrounding neighborhood were more relevant to appraising the true value of a home than its structural characteristics.¹⁰⁴ Homogeneity of the higher value racial groups within a particular neighborhood also created higher appraisal values: “Social differences so great as to create a gap between the members of a community are undesirable, as a wholesome community spirit cannot flourish in such an atmosphere.”¹⁰⁵

As a result, neighborhoods with blacks were consistently rated as the most hazardous areas in which to make loans, and those neighborhoods were outlined in red on HOLC maps to denote the economic risk of refinancing mortgages in default in those neighborhoods.¹⁰⁶ Though the HOLC deemed those neighborhoods risky, one commentator has noted that

97. GERTRUDE SIPPERLY FISH, *THE STORY OF HOUSING* 190 (1979).

98. Jackson, *supra* note 10, at 422.

99. See HARRISS, *supra* note 46, at 25.

100. Charles L. Nier, III, *Perpetuation of Segregation: Toward a New Historical and Legal Interpretation of Redlining Under the Fair Housing Act*, 32 J. MARSHALL L. REV. 617, 622 (1999).

101. *Id.* at 622 n.35.

102. *Id.*

103. *Id.* at 623.

104. *Id.*

105. FED. HOME LOAN BANK BD., *supra* note 6, at 112.

106. Hillier, *supra* note 96.

“[s]trong evidence exists to indicate that the HOLC impartially issued mortgage assistance and made the majority of its obligations in yellow and red neighborhoods.”¹⁰⁷

In the end, there were two contrasting views on the impact of the HOLC’s policy of racial redlining. One view was that the true impact of the policy occurred not during the HOLC’s implementation, but when the HOLC’s system was adopted or used as a model by other credit institutions in deciding whether to lend and on what terms.¹⁰⁸ This view held that while the HOLC may have curbed the number of immediate foreclosures for some, it closed many avenues of credit for future home buyers since private lending institutions adopted the HOLC’s discriminatory policies, and the HOLC policies also significantly influenced how the Fair Housing Administration and the Veterans Administration decided to underwrite loans.¹⁰⁹

The HOLC’s appraisal methods may have spread into private real estate appraisal through various methods such as the availability of the HOLC’s documentation to private industry, HOLC appraisers leaving HOLC to work in private industry, or the dissemination of HOLC appraisal practices through such organizations as The Society of Residential Appraisers or the American Institute of Real Estate Appraisers.¹¹⁰

The HOLC’s appraisal methods also likely spread through appraisal conferences held by the HOLC for members of the private real estate industry. In January 1940, it was reported that as a result of the expertise gained in training over three million appraisals, the HOLC would hold conferences to share its advances in real estate appraisal techniques.¹¹¹ At that time, the HOLC already held real estate appraisal conferences in sixteen cities, with audiences ranging from twenty-five to one-hundred and fifty members.¹¹² The reception received from the HOLC’s appraisal conferences was so favorable that the HOLC “planned to hold at least one 3-day meeting in every State where sufficient interest [was] shown.”¹¹³ The great attraction to these meetings was not merely to learn abstract principles of appraisal, but also to understand community dynamics. The Federal Home Loan Bank Board noted:

Of major importance to the success of the conferences held thus far has been the emphasis placed on neighborhood standards and their influence upon appraisals. Discussion of such factors as size of family, income levels, community growth, type of construction, racial groups, . . . has led to a better understanding of those influences

107. Nier, *supra* note 100, at 623. Yellow neighborhoods were considered less risky than red neighborhoods but more risky than green or blue neighborhoods. *Id.*

108. *Id.* at 623-24.

109. *Id.*

110. FED. HOME LOAN BANK BD., *supra* note 6, at 37-38.

111. FED. HOME LOAN BANK BD., 6 FEDERAL HOME LOAN BANK REVIEW 106 (1940).

112. *Id.*

113. *Id.*

constantly at work in any community which affect the stability of property values.¹¹⁴

Proponents of the alternative view of the impact of the HOLC argued that the HOLC neither initiated nor institutionalized the practice of redlining.¹¹⁵ This view was supported by the fact that the existence of HOLC redlined maps was not widely known, the maps were not available to the public, and other factors, such as the existence of real estate texts calling for a consideration of racial composition *prior* to the creation of HOLC.¹¹⁶ While the impact of the HOLC in creating or perpetuating a system of redlining may be debated, it is undeniable that the HOLC positively affected both the economic conditions of defaulting homeowners as a whole and the system by which real estate would come to be financed.

D. Effect of the HOLC on Real Estate Finance

The HOLC, along with the Federal Housing Administration, had an enormous impact in changing how housing was financed and how real estate was appraised.¹¹⁷ The HOLC played a significant role in protecting homeowners by not only introducing new forms of lending in the mortgage market, but also by proving the viability of these new forms.¹¹⁸ Before the New Deal legislation most mortgages were short-term (from three to five years) and not amortized—the principal of the loan was not fully paid off at the final settlement of the loan.¹¹⁹ Since the loan obligation was not satisfied at the end of the mortgage, and homeowners were often unable to make a balloon payment to satisfy the principal of the loan, homeowners would be forced to seek a renewal of the mortgage from the lender.¹²⁰ As conditions worsened, however, the lender required funds to meet its own obligations and would readily foreclose on those short-term mortgages in default.¹²¹ The initial loans of the HOLC, on the other hand, were significantly longer (fifteen years) and were self-amortizing.¹²² These long-term, self-amortizing loans were desirable as the popular belief was that as the homeowner's equity grew, the chances of his default decreased.¹²³

Prior to the New Deal most borrowers required second mortgages on their homes because many state laws prohibited mortgage lenders from accepting mortgages that represented more than half of the appraised value of

114. *Id.* at 106-07.

115. Hillier, *supra* note 96, at 396, 412.

116. *Id.* at 412.

117. Jackson, *supra* note 10, at 422-23.

118. *See id.* at 422.

119. *Id.*

120. HARRISS, *supra* note 46, at 7.

121. FISH, *supra* note 97, at 189.

122. *Id.*

123. FED. HOME LOAN BANK BD., *supra* note 3, at 7.

the property.¹²⁴ The HOLC, however, was authorized to make loans for up to 80% of the HOLC appraisal value of the home—a substantially greater value-to-loan ratio.¹²⁵ While HOLC loans were only available for mortgages in default, the successful implementation of these high-ratio loans proved their effectiveness to the federal government and private lenders in helping to avoid foreclosures and, with the further assistance of the Federal Housing Administration, sought to minimize the impact of the many usurious second mortgage lenders.¹²⁶

The existing system of real estate finance, however, could not withstand the economic pressures of the Great Depression. When, at the end of the original loan, economic conditions had deteriorated from those at the time the homeowner originated the initial loan, it was difficult for a homeowner to renew the loan because of his worsened economic position, likely forcing him into foreclosure.¹²⁷ As a result of the high number of foreclosures, lenders amassed quantities of properties in a market for which there were few buyers.¹²⁸ By ensuring the refinanced loans it issued were fully amortized and extended for longer terms such as twenty years, the HOLC not only helped slow the number of foreclosures, but it also influenced how private mortgage lenders would eventually make their loans.¹²⁹

E. Economic Effect of the HOLC

The HOLC received over 1.8 million applications for HOLC home mortgage financing.¹³⁰ Nearly half of the applications, however, were either rejected by the HOLC for properties failing to meet its mandated guidelines or were withdrawn before final consideration.¹³¹ One HOLC study found that nearly 18% of the applications it rejected were for inadequate security.¹³² Since loans could be made for up to 80% of the HOLC appraisal value of the property, the HOLC appraisal became a critical factor in determining whether the home was sufficiently valuable and possessed adequate security for HOLC assistance.¹³³ Still, because of discriminatory practices in the HOLC appraisal process, many families did not receive the HOLC assistance for which they were otherwise qualified.¹³⁴

Overall, however, the HOLC's economic effect was significantly positive: it prevented a number of foreclosures by providing relief for one out of every ten owner-occupied, non-farm homes in the United States, using over

124. *Id.* at 3.

125. FISH, *supra* note 97, at 189.

126. RADFORD, *supra* note 41, at 179.

127. Jackson, *supra* note 10, at 422.

128. RADFORD, *supra* note 41, at 86.

129. Jackson, *supra* note 10, at 422.

130. HARRISS, *supra* note 46, at 16.

131. *Id.* at 23.

132. *Id.* at 24.

133. *Id.* at 25.

134. Jackson, *supra* note 10, at 423.

\$3 billion in funds applied to over a million mortgages from July 1933 to June 1935.¹³⁵

TABLE 4¹³⁶

Loans Closed by the HOLC		
Year	Number	Amount (000s)
1933	50,772	\$ 141,000
1934	739,308	\$ 2,241,000
1935	192,291	\$ 595,000
1936	35,450	\$ 116,000
Total	1,017,821	\$ 3,093,000

135. Jackson, *supra* note 10, at 421. See Table 4, *infra* note 136 for a summary of the annual activity of the HOLC in loans closed and amount loaned. See Table 5, *infra* note 137 for the number of non-farm foreclosures for the period before and after the Great Depression and the formation of the Home Owners' Loan Corporation and the Federal Housing Administration.

136. See HARRISS, *supra* note 46, at 30 tbl.4 [table hereinafter Table 4].

TABLE 5¹³⁷

U.S. Non-Farm Foreclosures	
Year	Number
1930	150,100
1931	193,800
1932	248,700
1933	252,400
1934	230,350
1935	228,713
1936	185,439
1937	151,366
1938	118,505
1939	100,961
1940	75,310

The relief was much needed. The average homeowner for whom the HOLC refinanced a loan was two years delinquent on the original mortgage and behind almost three years on property taxes.¹³⁸ One view on the economic effect of the HOLC was that it not only prevented a total collapse in residential real estate financing through its efforts, but it also stimulated recovery by freeing funds which lingered in defaulted mortgages, allowing lenders to resume making new mortgages.¹³⁹

F. Foreclosure under the HOLC

As effective as it was, the HOLC was no panacea for preventing foreclosures. The HOLC itself foreclosed or received title by voluntary transfer on approximately 20% of its refinanced loans.¹⁴⁰ According to HOLC records, however, only 18% of the loans on which it foreclosed (2.5% of the HOLC's total loans) were due to a total inability to pay.¹⁴¹ Two-thirds of the foreclosures were due to a borrower's failure to cooperate with the HOLC or an obstinate refusal to pay when the homeowner had, in the HOLC's estimation, an ability to pay.¹⁴²

137. FED. HOME LOAN BANK BD., 7 FED. HOME LOAN BANK REVIEW supp., tbl. 14, at 19 (1941) [table hereinafter Table 5].

138. KEITH, *supra* note 68, at 24.

139. *Id.*; see Table 6, *infra* note 143 for the number of mortgages foreclosed by the HOLC from 1936 to 1942.

140. HARRISS, *supra* note 46, at 71. See Table 6, *infra* note 143 for HOLC foreclosures.

141. *Id.* at 79.

142. *Id.* at 76-79.

TABLE 6¹⁴³

HOLC Foreclosures (estimated) by Year	
Year	Estimated Foreclosures
1936	20,626
1937	50,323
1938	51,197
1939	34,400
1940	19,260
1941	11,540
1942	5,570
Total	192,925

Even if a homeowner defaulted, the HOLC rarely sought deficiency judgments against borrowers, even when it could.¹⁴⁴ There were two exceptions, however, to the HOLC's leniency in this area. First, the HOLC sought a deficiency judgment when the HOLC was certain that the borrower could actually meet his or her loan obligation.¹⁴⁵ Second, the HOLC sought a deficiency judgment when it was necessary under state law to protect its property interest.¹⁴⁶

V. THE FEDERAL HOUSING ADMINISTRATION AND A NEW SYSTEM OF REAL ESTATE FINANCE

While the HOLC may have stemmed the rushing tide of foreclosures as Roosevelt had hoped, it did not immediately spark the real estate market back to health, much less jumpstart the national economy.¹⁴⁷ Further, although external economic conditions were recovering, without fundamental change in the system of real estate finance, economic conditions could once again lead to large numbers of foreclosures, inadequate real estate finance, and all of the accompanying problems.¹⁴⁸

A. Formation of FHA

Roosevelt believed residential construction was "the wheel within the wheel to move the whole economic engine."¹⁴⁹ In an attempt to get this

143. See HARRISS, *supra* note 46, at 73 [table hereinafter Table 6].

144. *Id.* at 86.

145. *Id.*

146. *Id.* If the HOLC was required under state law to seek a deficiency judgment in order to protect its interests in the property, it did not press these deficiency claims and actually try to collect.

147. RADFORD, *supra* note 41, at 179.

148. *Id.*

149. *Id.*

“wheel within the wheel” rolling, Roosevelt was advised that a “large-scale, publicly financed construction program” was needed.¹⁵⁰ He was uneasy, however, about growing budget deficits. Instead he successfully pushed a program which required only minimal direct federal spending.¹⁵¹ The result was the National Housing Act of 1934 that created the Federal Housing Administration (FHA).¹⁵² In contrast to the HOLC, essentially a \$3 billion direct relief measure,¹⁵³ the FHA sought to stimulate the recovery through indirect measures.

B. Operation of the FHA

The plan of the proposed organization to put the “wheel in motion” was “to create conditions in which the building industry can go ahead and provide higher standards of residential facilities on a sound basis to people who can afford it, and at costs and prices which they can afford to pay.”¹⁵⁴ It was also believed that such an organization would have a substantial effect on lowering unemployment.¹⁵⁵ One federal official estimated that more than one-third of all the unemployed persons in the spring of 1934 were directly or indirectly involved with the construction industry.¹⁵⁶

The FHA attempted to stimulate reform in private mortgage lending by inducing private mortgage lenders to engage in a new method of mortgage lending.¹⁵⁷ The FHA would insure up to 20% of new mortgages by private lenders if the private lenders based their loans on federally-defined criteria.¹⁵⁸ The result was that a private mortgage lender would be protected by the FHA against loss from defaulting homeowners.¹⁵⁹ In return, the mortgage lender was required to make long-term, fully-amortizing loans to homeowners at a high percentage (initially 80%) of the cost of the home.¹⁶⁰ With Roosevelt’s concerns about growing budget deficits, the system was not primarily funded by the federal government, but rather, it was funded by each home buyer in the form of a small mortgage insurance premium rolled into the monthly mortgage payment.¹⁶¹

150. *Id.*

151. *Id.*

152. MCMICHAEL & O’KEEFE, *supra* note 7, at 89.

153. FISH, *supra* note 97, at 192.

154. Bloomberg, *supra* note 51, at 591.

155. Jackson, *supra* note 10, at 431.

156. *Id.*

157. RADFORD, *supra* note 33, at 179.

158. *Id.*

159. KEITH, *supra* note 62, at 25.

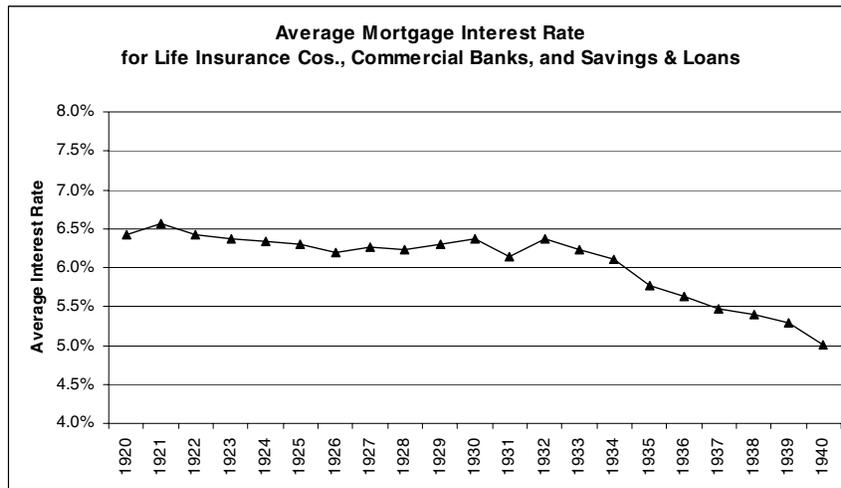
160. *Id.* at 25-26; RADFORD, *supra* note 41, at 179. See Graph 6, *infra* note 172 for the average mortgage length during the years leading up to and following the formation of the Federal Housing Administration in 1934.

161. KEITH, *supra* note 68, at 25; RADFORD, *supra* note 41, at 179.

C. *Effect on Real Estate Finance*

The FHA system had several effects on the existing system of real estate finance. Chief among them was that private mortgage lenders became willing to accept a lower interest rate on FHA insured mortgages, lowering costs to borrowers.¹⁶² Mortgage interest rates continued to fall as the FHA became a well-established institution.¹⁶³

GRAPH 4¹⁶⁴



Further, across the nation, interest rates became uniform as a result of the FHA's measures.¹⁶⁵ The high interest rate second mortgages that had once been so prevalent declined because the FHA would finance such a high percentage of the value of the property.¹⁶⁶ As more private mortgage lenders began to see the benefits of taking FHA insured mortgages, the overall ratio of the mortgage loan-to-value began to rise.¹⁶⁷

162. MCMICHAEL & O'KEEFE, *supra* note 7, at 100. See Graph 4, *infra* note 164 for the average mortgage interest rates for the years before and after the introduction of the Federal Housing Administration in 1934.

163. See Graph 4, *infra* note 164.

164. See MORTON, *supra* note 12, at 173 tbl.C-5 [graph hereinafter Graph 4] (graph represents the average mortgage interest rates for life insurance companies, commercial banks, and savings and loan institutions).

165. Bloomberg, *supra* note 51, at 592.

166. *Id.* The initial FHA-insured mortgages were offered at 80% of the value of the property. MCMICHAEL & O'KEEFE, *supra* note 7, at 100.

167. See Graph 5, *infra* note 168.

GRAPH 5¹⁶⁸

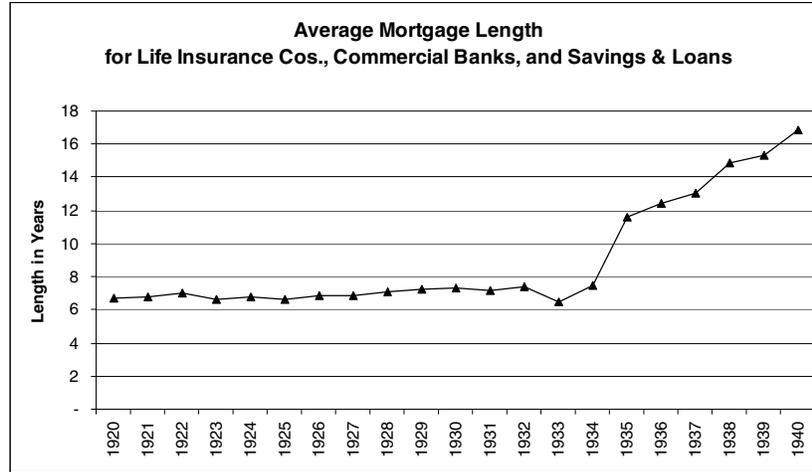
The self-amortizing mortgage also became commonplace, further reducing the need for high interest rate second mortgages.¹⁶⁹ Mortgage payments began to include money for taxes and insurance, helping to reduce the risks of default to lenders and buyers.¹⁷⁰ Government backing permitted lenders to make long-term loans with high loan-to-value ratios, allowing borrowers to make lower monthly payments and eliminating the need for costly second and third mortgages.¹⁷¹

168. See MORTON, *supra* note 12, at 175 tbl.C-7 [graph hereinafter Graph 5] (graph represents the average Mortgage Loan-to-Value ratios for life insurance companies, commercial banks, and savings and loan institutions).

169. Bloomberg, *supra* note 51, at 592.

170. *Id.*

171. RADFORD, *supra* note 41, at 179. See Graph 6, *infra* note 172 for the average mortgage length during the years leading up to and following the formation of the Federal Housing Administration in 1934.

GRAPH 6¹⁷²

As a result of the FHA's requirements and the resulting changes in lending by private lenders, barriers to homeownership were significantly lowered. The FHA also had a substantial influence on the evolution of real estate development. Because the FHA had a powerful weapon in its authority to insure mortgages, it was able to influence real estate developers on the kinds of property that should be developed.¹⁷³ The FHA's power grew as it increasingly insured new residential construction.¹⁷⁴

172. See MORTON, *supra* note 12, at 174 tbl.C-6 [graph hereinafter Graph 6] (graph represents the average mortgage length for life insurance companies, commercial banks, and savings and loan institutions).

173. RADFORD, *supra* note 41, at 193.

174. See Tables 6, *supra* note 143; Table 7, *infra* note 175.

TABLE 7¹⁷⁵

New Non-Farm Dwellings Financed by FHA-Insured Loans as a Percentage of All Privately Financed New Non-Farm Dwellings	
Year	Percentage
1935	7%
1936	19%
1937	20%
1938	32%
1939	37%
1940	37%
1941	39%
1942	59%
1943	82%
1944	67%

175. LEO GREBLER ET AL., CAPITAL FORMATION IN RESIDENTIAL REAL ESTATE 146 tbl.37 (1956) [table hereinafter Table 7].

TABLE 8¹⁷⁶

Amount of Government-Insured Home Mortgage Debt	
Year	FHA & VA Home Mortgage Debt (in millions)
1935	\$ 12
1936	\$ 203
1937	\$ 594
1938	\$ 967
1939	\$ 1,755
1940	\$ 2,349
1941	\$ 3,030
1942	\$ 3,742
1943	\$ 4,060
1944	\$ 4,190
1945	\$ 4,578
1946	\$ 6,292
1947	\$ 9,581
1948	\$ 12,469
1949	\$ 15,006
1950	\$ 18,863
1951	\$ 22,877
1952	\$ 25,370
1953	\$ 28,090

The FHA established minimum standards for home construction that eventually became nearly universal and raised the quality of new home construction.¹⁷⁷ The FHA was able to set standards, which, if followed by developers, would result in the FHA insuring the mortgages for all of the homes that the developers built.¹⁷⁸ These assurances made it easier and cheaper for developers to secure financing because it assured the developer's potential lenders that the sales in the development would be profit-

176. MORTON, *supra* note 12, at 25 tbl.6 [table hereinafter Table 8].

177. Jackson, *supra* note 10, at 431.

178. RADFORD, *supra* note 41, at 193.

able.¹⁷⁹ Because FHA officials believed certain uses of land were likely to preserve the value of the land, such as setbacks, neighborhoods with cul-de-sacs, and residential property separated from commercial areas, the FHA was able to encourage developers to pursue developing these properties.¹⁸⁰ By taking advantage of its power to insure mortgages, the FHA was able to impose its beliefs in land planning on private developers.

The FHA was also able to leverage its unique position to limit the fees charged by lenders and builders to FHA borrowers.¹⁸¹ The FHA protected home buyers from such practices as the charging of usurious interest rates by second mortgage lenders, a commonplace practice prior to the passing of New Deal housing legislation.¹⁸²

To help further the growth of the residential real estate market, the FHA also provided builders with services such as research; design standards; projected demand analyses; and planning studies that investigated whether a proposed development was properly coordinated with other local infrastructure such as utilities, transportation, and schools.¹⁸³ These types of services were rare in the residential real estate market at the time and further fueled the growth of residential real estate.¹⁸⁴ The aggregate effect of these FHA services was that construction costs fell,¹⁸⁵ and they provided further impetus to the revival of residential real estate construction and the economy as a whole. Construction, as a result, boomed in comparison to the doldrums in residential construction seen at the height of the Great Depression.¹⁸⁶

179. *Id.*

180. *Id.*

181. See SAUL B. KLAMAN, *THE POSTWAR RESIDENTIAL MORTGAGE MARKET* 85 (1961).

182. RADFORD, *supra* note 41, at 179.

183. *Id.*

184. *Id.*

185. *Id.*

186. See Table 9, *infra* note 187, and Table 10, *infra* note 188 for residential construction numbers for the years leading up to and after the formation of the FHA in 1934.

TABLE 9¹⁸⁷

New Private Residential Construction in All Urban Areas	
Year	Number
1930	249,000
1931	184,000
1932	62,000
1933	45,000
1934	46,000
1935	118,000
1936	198,973
1937	205,467
1938	245,753
1939	342,106
1940	386,958

TABLE 10¹⁸⁸

Estimates of Non-Farm Residential Construction (in 000's)			
Year	Total	Urban	Rural Non-Farm
1930	330	236	94
1931	254	174	80
1932	134	64	70
1933	93	45	48
1934	126	49	77
1935	221	117	104
1936	319	211	108
1937	336	218	118
1938	406	262	144
1939	515	359	156
1940	603	397	206
1941	715	440	275

187. FED. HOME LOAN BANK BD., 7 FEDERAL HOME LOAN BANK REVIEW supp., tbl.7, at 10 (1941) [table hereinafter Table 9].

188. FED. HOME LOAN BANK BD., 8 FEDERAL HOME LOAN BANK REVIEW 400 (1942) [table hereinafter Table 10].

Moreover, the standardization of mortgage terms and security, brought about by the FHA, allowed a sustainable secondary mortgage market to exist.¹⁸⁹ A secondary mortgage market would help to ensure that real estate capital was readily available so that mortgage lenders could remain relatively liquid and continuously make new mortgages.¹⁹⁰ Private investors, however, were still nervous about economic conditions and shied away from forming a secondary mortgage association that would purchase mortgages from primary mortgage lenders.¹⁹¹ Since private investors would not form a secondary mortgage market to ensure real estate capital liquidity, the federal government in 1938 formed the Federal National Mortgage Association (FNMA), popularly known as Fannie Mae.¹⁹² The purpose of the FNMA was to provide a secondary marketplace not just for any mortgage, but specifically for FHA insured mortgages.¹⁹³ This served as further incentive for mortgage lenders to comply with FHA guidelines to ensure that there was a ready buyer for its mortgages.¹⁹⁴ It was not until after the Second World War, however, when the FNMA was authorized to purchase Veterans Administration guaranteed mortgages, that the FNMA would purchase sufficient quantities of mortgages to become a major factor in the secondary mortgage market.¹⁹⁵

D. *The Federal Housing Administration and Redlining*

Though the HOLC was often associated with racial redlining, the FHA also played a role in extending the system of redlining to private lending. The FHA maintained its own system of redlined maps that differentiated “areas with concentrations of an ‘undesirable element’ such as distinct racial, national, or income groups.”¹⁹⁶ In addition to creating its own redlined maps accessible to the public, the FHA also created its *Underwriting Manual* to provide details on how to appraise neighborhood risk.¹⁹⁷ The *Underwriting Manual*, which was widely known and distributed, included a risk-rating system that considered a neighborhood’s stability, its “‘protection from adverse influences,’ and ‘infiltration of inharmonious racial or nationality groups’” as the primary considerations in rating a neighborhood.¹⁹⁸ While not solely responsible for the practice of private redlining, the FHA, through its widely publicized and available neighborhood ranking criteria,

189. French, *supra* note 70, at 63.

190. MCMICHAEL & O’KEEFE, *supra* note 7, at 148.

191. FISH, *supra* note 97, at 207.

192. *Id.*

193. MCMICHAEL & O’KEEFE, *supra* note 7, at 148.

194. Hillier, *supra* note 96, at 403.

195. FISH, *supra* note 97, at 208-09.

196. Hillier, *supra* note 96, at 402.

197. *Id.* at 403.

198. *Id.*

did have a strong influence in advancing the so-called importance of the effect of neighborhood composition and condition on lender risk.¹⁹⁹

Though the standardization of the appraisal process by the HOLC and FHA may have contributed to redlining by the private sector, it also had a beneficial effect on real estate finance. While appraisers previously employed the “look, spit, and guess’ method” for appraising,²⁰⁰ mortgage lenders were often unsure to the extent they could trust the appraised value of a home in making their lending decision.²⁰¹ The new disciplined approach to appraising made popular by the HOLC and FHA helped bring greater confidence to lenders in the true value of the mortgaged properties.²⁰² Such confidence, in combination with the confidence inspired by the FHA insured mortgages, allowed lenders to offer both lower rates and more mortgages to more potential borrowers.

E. Economic Effect of the FHA

The FHA requirement that private mortgage loans be fully-amortized in order for the mortgage lender to be insured by the federal government was a powerful incentive to private mortgage lenders.²⁰³ The long-term mortgages systemized by the FHA created lower monthly payments for home buyers, and since lenders were insured, private investment began to re-enter residential building at such a rate that an increase in housing starts was seen in 1934 for the first time since 1926.²⁰⁴ Further, as the FHA requirements made borrowing for residential real estate less expensive and less risky to consumers, the demand for residential real estate capital grew.²⁰⁵

VI. CONCLUSION

The effect of New Deal organizations such as the HOLC and FHA went beyond stemming the tide of foreclosures during the Great Depression and contributing to economic recovery. Notoriously, they likely contributed in some way to the practice of redlining. More importantly, however, with the introduction of new methods of real estate finance, and concurrent changes in foreclosure policies, these organizations were a fundamental stepping-stone to the existing system of real estate finance and foreclosure laws of today.

Fred Wright

199. *Id.* at 405.

200. FED. HOME LOAN BANK BD., *supra* note 6, at 37.

201. *See* KENNEDY, *supra* note 8, at 370.

202. *Id.* at 369.

203. RADFORD, *supra* note 41, at 179-80.

204. *Id.* at 180, 193.

205. *Id.* at 179.