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CHAPTER 4

PRESSURES FOR GOVERNMENT ACTION

> **The problems confronting the home owner cannot be exaggerated. His condition is most critical. The question as I see it is whether the Congress is going to stand by and see hundreds of thousands of honest citizens and their families turned out into the street, lose their life savings, because they are unable to renew mortgages upon their homes.**
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> **— Charles Cochran, Missouri, before the House of Representatives on April 25, 1933**
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> **I need not tax the patience of Members of the House in discussing the distressed conditions that obtain at this hour. They are recognized by all.**
>
> **— Henry Steagall, Alabama, on introducing the Home Owners' Loan Act to the House of Representatives on April 27, 1933**

Representatives Charles Cochran and Henry Steagall captured the mood of the nation's leaders in the spring of 1933.[1] It was apparent to all that the collapse of the mortgage market was creating a national crisis for borrowers and lenders alike. The establishment of the Federal Home Loan Bank system a year earlier had created hopes that the crisis would be eased, but ultimately the system was not the solution that the market needed. Meanwhile, more than half the states had established foreclosure moratorium laws that made it easier for home owners and farmers to hold on to their properties when they fell behind on making their mortgage payments. These measures were seen as temporary solutions with hopes that the Roosevelt administration and a newly elected Democratic Congress could help resolve the issues for the long run. The solution they came up with was the HOLC.

The HOLC relieved home owners by giving them a mechanism to avoid foreclosure and by adjusting their mortgage payments to the depressed economic circumstances. Roosevelt and his political allies emphasized this relief, and the bill had obvious appeal to voters on these grounds. The HOLC, like most New Deal programs, was designed to gain widespread public and political support while providing specific relief to target audiences. For the home mortgage market, this involved paying attention to the needs and expectations of mortgage lenders, real estate professionals, and home builders as well as to the home owners themselves. As we will see in later chapters, the mortgage lenders received relief from the HOLC because they were able to sell their troubled loans for HOLC bonds valued at or near the amount that was owed to them by the delinquent home owners. The size of the aid given mortgage lenders was not written into the law and came about as the HOLC administered its programs.

State Mortgage Foreclosure Moratoria

Starting in the first months of 1933, twenty-seven states had implemented moratoria that attempted to curtail the downward pressure on home ownership and house prices by simply stopping the wave of foreclosures.[2] Several more states considered such laws. In many of these areas the statutes were passed to address distress among farm borrowers, while in several northeastern states trouble in urban areas played an important role.[3] In either case, nonfarm mortgagors as well as farm borrowers were covered. States used a variety of techniques to delay the ability of lenders to foreclose properties or to lengthen the periods during which borrowers could redeem their properties after foreclosure. Many states also passed legislation to discourage lenders from pursuing foreclosure by limiting access to deficiency judgments. These laws all generally challenged the contract clause of the US Constitution and so had to be rationalized by appealing to the emergency powers of state governments. The assertion of these emergency powers, also used in the context of the banking holidays declared around the same time, reflect the deep distress and dysfunction in credit markets at the time.

As solutions to the mortgage crisis, moratoria had three shortcomings. First, they were temporary measures to buy time and thus not responsive to the underlying decreases in income and house prices that were driving the foreclosure crisis. Second, they were all subject to judicial challenges because they interfered with private contracts. Many were struck down by state courts, and others (including the Minnesota moratorium that was upheld by the Supreme Court in the seminal Blaisdell case) were adjudicated all the way up to the federal level.[4] Third, the temporary assistance that the moratoria provided to borrowers could have led to unintended effects, including additional financial pressure on lenders and their ability to supply mortgage credit.[5]

The HOLC program addressed each of these shortcomings. It created a loan purchase and refinance program that brought mortgage payments in line with the lower levels of borrower income and home prices that had left hundreds of thousands of home owners facing imminent foreclosure in 1933. The sanctity of private contracts was protected because the loan could be modified only after both borrower and lender agreed to participate. Finally, the HOLC's purchase of the loan from the lender replaced the troubled loan with a risk-free HOLC bond that improved the lender's probability of survival.

Federal Intervention before the HOLC

In December 1931 President Hoover responded to the mounting mortgage crisis by convening a national conference on home building and home ownership. Hoover unveiled a proposal at the conference for the creation of a federally sponsored home loan bank system to facilitate the long-run goal of increasing home ownership and to address the immediate emergency in the housing market. Congress created the Federal Home Loan Bank (FHLB) system on July 22, 1932. Mimicking the structures of the Federal Land Bank system (established in 1916) and the Federal Reserve System (established in 1913), the act created a system of twelve regional banks with a supervisory board in Washington, DC, which has survived and evolved to this day. Its beginnings were troubled, though, as it had little success in stemming the foreclosure crisis in the Depression. The FHLB system's failure to stem the housing crisis offers insights into the problems that made collective action by lenders' groups without the HOLC difficult to achieve.

Each of the twelve FHLBs was empowered to make loans, called advances, to member financial institutions. The collateral on these advances, assets pledged to one of the FHLBs, were the mortgage loans held by the financial institutions. These advances were designed to provide mortgage lenders with more funds that would allow them to make additional mortgage loans. The advances also could help lenders get cash quickly when they faced short-run financial strains. By providing cash in emergencies, the regional FHLBs were serving the same purpose for mortgage lenders that the regional Federal Reserve Banks served for commercial banks. A program that provides loans of this type is typically described as a "discount facility." Through such a facility, the FHLB potentially had the laudable effect of stabilizing mortgage lending, which, in turn, could help stabilize home prices and increase production and employment in the home-building industry.

The FHLB discount facility, however, did not have much to offer to lenders already burdened by bad loans or lenders who were facing long-run financial strain. Only loans in good standing could be used as collateral for loans from the system. This made it difficult for the lenders in the most trouble to qualify as FHLB members, and without membership they had no access to the discount facility. Even members of the FHLB system had to be careful in making new loans because the FHLB would not lend to them if they accumulated too large a share of problem loans and put their long-term viability at risk. Altogether, the FHLBs were designed to provide cash to those short of liquidity, but the system did not deal with troubled loans or provide capital to lenders on troubled loans.[6]

In addition, the FHLB's impact was limited because it generally worked with only one of the most important lender groups. Although Hoover had envisioned an FHLB system that served all institutional residential mortgage lenders, leaders of the B&L movement—who had lobbied for a system like the FHLB system for more than decade—succeeded in limiting the FHLB system to just B&Ls. Life insurance companies, mutual savings banks, commercial banks, and other lenders combined accounted for about the same amount of lending on residential mortgages as B&Ls, and were largely left out of the FHLB system. As a result, an effective solution involving all residential home lenders had not been tried by 1933.

The FHLB system possessed one final tool to address the mortgage market's problems. The FHLB Act gave the FHLB system the ability to make direct loans to the hundreds of thousands of home owners who had fallen behind on their mortgage payments in the early 1930s. In a remarkable bout of inaction, the FHLBs never made a single loan under this authority. FHLB officials blamed their inactivity on the infeasibility of such a program, such as the administrative difficulties of creating a new lending program. There was also much confusion about whether loans could be made only in areas that were not already served by existing FHLB members. These protestations have some merit, yet it seems clear that FHLB officials had little interest in making direct loans to residential mortgage borrowers, and they were quite relieved when that power was transferred to the HOLC after less than a year. As a result, during the debate over the Home Owners' Loan Bill in the spring of 1933, many congressmen expressed frustration and outrage that the FHLB had done so little and sought assurance that the HOLC would not have a similar record. These sentiments are exemplified in a speech by Representative John Cochran of Missouri:

> We passed a bill in the last session which we were told was for the relief of the home owners. We created a home-loan bank, and what was it? It was nothing but a political fraud, and up to this hour not one single individual in this country has been able to get 5 cents from that home-loan bank to retire a mortgage. It was a bill for the relief of building-and-loan associations. The bill which is to be considered now should be a real relief bill for home owners in the large cities. We have given everything to the farmers, we have given everything to the corporations, but what have we done for the man who owns a little home in the city, representing his life savings?[7]

The FHLB was the last major piece of legislation during the Hoover administration. The HOLC bill was passed during the first hundred days of the Roosevelt administration as part of its effort to deal with a wide range of problems created by the Great Depression.

The Passage of the HOLC

The HOLC was one of many programs that Franklin Roosevelt and a newly Democratic Congress enacted to address the crumbling economy in their first hundred days in office. The Federal Emergency Relief Administration, Civilian Conservation Corps, and Public Works Administration provided direct relief payments and jobs for millions of unemployed. The Agricultural Adjustment Act and farm credit legislation provided aid to farmers facing declining incomes and farm foreclosures. The Reconstruction Finance Corporation made loans and took ownership stakes in hundreds of banks under the Hoover administration, and then provided extensive aid to hundreds of industrial firms and dozens of railroads under Roosevelt. National bank holidays, the move off the gold standard, new banking regulations, the Federal Deposit Insurance Corporation, and new Federal Reserve policies helped save commercial banks and restructure the system. The National Recovery Administration was meant to help industry and workers by raising wages and prices.

The New Dealers sought to provide aid to nearly all parts of society. Therefore, it would have been unusual if they had ignored the residential mortgage crisis. In the HOLC's case, a number of different constituencies combined to support the legislation. Home owners were the constituents most likely to vote in elections, and lenders and urban real estate professionals had active lobbies that pressed for continued aid. Their lobbying efforts gained strength from the early passage of the farm credit legislation that reorganized the aid provided to farm mortgages. President Roosevelt and numerous legislators had every reason to champion a program to aid distressed home owners and lenders.

EMPATHY FOR HOME OWNERS AND THEIR STRENGTH AT THE BALLOT BOX

Distressed home owners and their neighbors had clout in elections because they were the ones turning out to vote and making small contributions to political campaigns. Politicians ignored that clout at their peril.

Public speeches advocating for the HOLC focused primarily on the importance of protecting home owners from the widespread and acute foreclosure crisis described in chapter 3. This was similar to the justifications used by the Roosevelt administration and Congress to promote a constellation of other New Deal relief programs. When the president submitted the draft HOLC legislation to Congress, in the accompanying message he emphasized how the legislation would provide home owners with relief: "As a further and urgently necessary step in the program to promote economic recovery, I ask the Congress for legislation to protect small home owners from foreclosure and to relieve them of a portion of the burden of excessive interest and principal payments incurred during the period of higher values and higher earning power."[8]

President Roosevelt's message to Congress additionally emphasized that the HOLC was specifically intended "to protect the small home owner." The proposed bill restricted the program to homes that were valued at no more than $10,000, but the limit excluded only about 15 percent of nonfarm home owners in the 1930 census. In the final version of the bill, the maximum limit was raised to $20,000 at the behest of the greater New York City congressional delegation, who pointed out that between one-third and one-half of their constituents who owned homes were excluded by the original $10,000 limit. Under the final $20,000 limit, only 3.4 percent of the nation's home owners were excluded from the program. Altogether, the HOLC was accessible to all but the most affluent home owners in the country.[9]

To preempt complaints that the HOLC was helping affluent Americans, President Roosevelt noted the unfairness imposed on debtors in a time of deflation and poor economic prospects. He asserted it was inherently "inequitable" for home owners to be allowed to suffer "enforced liquidation, in a time of general distress." He went even further by outlining a moral framework to underpin the need for federal intervention: "Implicit in the legislation which I am suggesting to you, is a declaration of national policy. This policy is that the broad interests of the nation require that special safeguards should be thrown around home ownership as a guaranty of social and economic stability, and that to protect home owners from inequitable enforced liquidation, in a time of general distress, is a proper concern of the Government."

Roosevelt's moral framework therefore created a momentous and far-reaching argument for the HOLC. It argued that not only *could* the federal government give relief to home mortgage borrowers, but that it *should* do so, given the circumstances prevailing in the Depression.

The HOLC continued to emphasize these ideas after it had been established. HOLC annual reports perennially noted that its mission was "to aid a class of home owners in hard straits largely through no fault of their own."[10] Such characterizations were unlikely to be disputed by anybody who had tried to get a home loan. To get a loan in the 1920s required a hefty down payment of 40 or 50 percent of the value of the house, and a second mortgage could be obtained only by paying an interest rate of 11 or 12 percent. These were conservative loans that were dependable in normal times. Many of the problems developed only after people lost jobs or could not obtain new loans because the lenders were struggling as well. Many borrowers were pushed into default when they tried to follow the standard procedure of renewing the loan when the principal came due, and discovered the lender did not have the funds to renew.

In the environment of the 1930s, empathy for families in danger of losing their homes in foreclosure was not hard to come by. By 1933, incomes had fallen sharply in households in all parts of the income distribution.[11] Many home owners saw their neighbors facing possible loss of their home and thought that they might well face the same situation soon. They expressed these fears in a variety of ways. Each Monday night in the spring of 1933, one thousand people met in a New York church to pray for home owners who were threatened by foreclosure. These developments created a powerful political coalition among voters for the passage of the HOLC.[12]

ROOSEVELT COULD NOT HELP FARMERS WITHOUT SIMILAR AID TO HOME OWNERS

The case for aid to home owners was bolstered by the passage of legislation in mid-May, about two months after Roosevelt took office, to address problems with farm mortgages. J. Marvin Jones, a Texas Democrat who headed the House Agriculture Committee, introduced a bill for federal refinancing of farm mortgages on February 18, 1933, two weeks before Roosevelt was inaugurated.[13] Roosevelt began to address the issue soon after taking office. When he submitted the Emergency Farm Mortgage Act to Congress on April 3, his message emphasized that the bill was designed to provide farmers with reasonable loan terms to "lighten their harassing burdens and give them a fair opportunity to return to sound conditions." This reasoning anticipates much of the framework Roosevelt used later that spring to urge passage of the HOLC.

The farm foreclosure crisis had started much earlier than its residential counterpart, with a genesis in the rapid expansion in mortgage debt during the World War I–era US agricultural boom. In 1920, as the demand for US farm products fell back to normal levels, a surge of farm foreclosures began. Foreclosures remained elevated even in the second half of the 1920s.[14] The federal government was heavily invested in the farm mortgage problems because it supported a network of cooperative lending agencies, the Federal Land Banks, and supervised a system of privately owned farm mortgage joint-stock banks, all set up by Congress in 1916. By 1930 these two sets of lenders held about one-fifth of the nation's farm mortgage debt.[15] In 1932, 4.2 percent of farm mortgages ended in either foreclosure or forced sale due to tax debt, up from 2.0 to 2.5 percent in each year since 1926. Altogether, from

1926 to 1942, 17.5 percent of farm mortgages were transferred by foreclosure or forced sale. The Federal Land Banks were bailed out by cash infusions from Congress in February 1932, and the joint-stock banking system faced imminent collapse by 1933.[16]

In a sign of the times, life insurance companies—the largest private farm mortgage lenders—had voluntarily suspended foreclosures so that they could avoid seizing and managing even more farmland than they already had.[17] The situation was analogous to that in the home mortgage sector, with lending activity at a standstill and lenders looking to the federal government for a solution.[18]

When proposing the farm mortgage relief bill, Roosevelt noted that he would "presently ask for additional legislation . . . extending this wholesome principle to the small home owners of the nation." Later that spring, when Roosevelt sent to Congress the HOLC bill, he again noted that "the legislation I propose follows the general lines of the farm mortgage refinancing bill." Fundamentally, the genesis, design, and political success of the HOLC were joined at the hip to the federal government's response to the parallel farm mortgage crisis.[19]

LOBBYING BY LENDERS AND REAL ESTATE PROFESSIONALS

The federal government's action to establish the HOLC followed months of lobbying by urban mortgage lenders and real estate professionals throughout the country.[20] Lenders had become disenchanted with the FHLB system. They considered it inadequate to the task of dealing with the crisis, particularly because it ignored so many of the troubled lenders other than B&Ls. Even though many lenders had supported state-level measures, such as mortgage moratoria, to deal with the mortgage crisis, each measure was often seen as "a temporary measure . . . until some national legislation is formulated, either by liberalizing the Home Loan Bank System or establishing a Mortgage Bank of Discount."[21] Compared to the general public, lenders and real estate professionals had the advantage of being able to organize as a special interest in lobbying government. They were easier to organize because they had more focused interests and each had more at stake from the passage of a specific law. They represented an important voice, therefore, in policy formulation.

The nonfarm real estate industry proposals generally focused on three major principles in developing the solution to the foreclosure crisis. First, many emphasized the importance of reducing foreclosures through voluntary, cooperative action between borrower and lender rather than legislative mandates. Second, to facilitate these voluntary resolutions, there was widespread support for lower interest rates and liberal extensions for principal repayments as resolution mechanisms. The idea of reducing the principal on loans, however, was virtually never mentioned. One commentator who at least broached the subject listed principal reduction as a last and a "drastic" solution to foreclosure resolution of defaults on property taxes.[22]

Third, the professional real estate community provided active support for resolution of the wave of property tax delinquencies that accompanied mortgage defaults. Lenders, even with first mortgage liens, had junior claims to local tax authorities in the event of foreclosure and could not effect loan modifications with their borrowers without addressing a tax delinquency.[23] In his study of the property tax revolt of the early 1930s, David Beito characterizes the National Association of Real Estate Boards (NAREB) as the "closest facsimile" to a national organization in the movement.[24] The broad coalition supporting the HOLC therefore also likely included local governments.

The design and implementation of the HOLC followed all three of these principles. We will discuss the HOLC's refinancing terms in detail in chapters 5 and 6, but note some key features here in the context of what lenders and real estate professionals had proposed. First, in line with the call for voluntary action, the HOLC had no power to compel lenders to cooperate. The HOLC had to purchase each loan from the lender that owned it before it could offer refinancing. The HOLC paid values in bonds that typically covered the lion's share of the full amount owed to the lender. Second, HOLC interest rates were lower than prevailing rates on private loans, durations were longer, and the HOLC also offered an optional three-year period during which only interest payments were required. Finally, the HOLC worked diligently with lenders and borrowers to cover tax payments and avoid loss of the property to local governments.

In the end, the HOLC was supported by nonfarm home owners, who had power at the ballot box, along with lenders and urban real estate interests, who were a powerful lobby. This combination, along with the argument that home owners in trouble should be aided if the government was helping everybody else, clearly bore fruit. The HOLC Act passed the House of Representatives 383–4 and on a voice vote in the Senate on June 13, 1933.[25]