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Volume Author/Editor: Price V. Fishback, Jonathan Rose, and Kenneth Snowden

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Chapter Author(s): Price V. Fishback, Jonathan Rose, Kenneth Snowden

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CHAPTER 9

REPAIRING MORTGAGE AND HOUSING MARKETS

The goals of the HOLC reached beyond the provision of relief to individual lenders and borrowers. HOLC officials were also determined to systematically stabilize mortgage and housing markets by interrupting the vicious cycle of foreclosures and price declines that gripped the country in the early 1930s. By the time the HOLC had begun making loans in late 1933, "foreclosures numbered nearly a thousand a day, the highest in the country's history."[1] Between 1930 and 1934, housing values dropped like a stone. Different regions experienced different price drops, but a survey across forty-eight cities found that the damage was so widespread that the average drop in value was about 32 percent between 1930 and 1934.[2] These price declines propagated additional foreclosures as borrowers lost their jobs and were unable to sell their homes to resolve their debts.

These dynamics were often local. A foreclosure in Michigan was not likely to cause price declines in Massachusetts. Often, business commentators and academics refer to "the" housing market, but we all know that a house in California cannot easily be sold and moved to New York; housing markets necessarily have strong regional attributes. For example, in the early 1930s, homes in Syracuse, Birmingham, San Diego, Lansing, Dallas, and Little Rock had lost an average of more than 40 percent of their resale value. Home owners fared better in Portland (Maine), Providence, Austin, and Topeka, but their houses still lost 20 percent of their value.[3]

Mortgage moratoria were present in some states but not all. They prevented a large number of foreclosures, but were only a stopgap measure to slow the bleeding before something like the HOLC came along. Within this environment the HOLC refinanced loans on one-tenth of the nation's owner-occupied homes and became in three short years its largest residential mortgage lender. Two questions become central to assessing the performance of a program of this size and complexity. First, was the relief provided by the HOLC directed to areas of greatest need? Second, was the relief effective in promoting the program's goals? We examine these two questions in this chapter by broadening our examination of the HOLC's impacts beyond the borrowers and lenders directly affected, to the local housing markets in which they resided and operated.

The Distribution of HOLC Refinancing

By name and public statements of support, the HOLC was a program designed to assist distressed home owners. The program also was designed to meet the expressed needs of badly damaged home mortgage lenders and to rectify general distress in local housing markets. In the actual implementation of a public program of this scale and complexity, other factors could also have affected how HOLC benefits were distributed throughout the nation. HOLC activity could have been used, for example, to provide general relief to local markets that were being ravaged more by unemployment than by housing distress. Alternatively, HOLC refinancing could have been doled out to curry political favor with voters to the benefit of either national or local politicians. It is also possible, moreover, that the HOLC program was simply badly managed, with relief allocated with little regard for need or eligibility. In any of these cases, the HOLC would likely have had a much weaker effect on foreclosures and the housing crises than if the program had pursued its intended goals.

Across the nation's 3,067 counties, an average of about 14 percent of nonfarm home owners applied for HOLC refinancing, and 48 percent of those were ultimately approved for a loan. There was substantial variation, however, in application and participation rates. Both were higher, for example, in Kootenai County, Idaho, where Joshua Clark was among the 21 percent of home owners (484 in all) who applied for HOLC assistance as well as the 72 percent of applicants (or 377) who were accepted into the program. The HOLC program was even more important in other markets, especially the twenty-five counties in which loans refinanced by the HOLC represented more than one-quarter of the number of nonfarm home owners in 1930. These most active HOLC markets included areas as large and dense as Wayne County, Michigan (Detroit), with a population of nearly two million, and as small as Finney, Kansas (1930 population of 11,104), where the number of HOLC loans equaled just less than one-third of the 845 nonfarm home owners who resided there in 1930.

At the other extreme, no home owners applied for HOLC loans in twenty counties, and no HOLC loans were made in sixty-three. Two-thirds of the counties with no HOLC loans were located in Texas, California, Colorado, Kentucky, or Tennessee. There were also 1,264 counties in which HOLC-refinanced loans represented less than 5 percent of the number of nonfarm owner-occupied homes in 1930. Two of these counties, San Francisco and Hamilton, Ohio, claimed more than 500,000 residents in 1930, and another ninety had 1930 populations greater than 50,000. The remainder of markets in which the HOLC had a relatively low profile had smaller populations and were spread throughout all regions of the country.

A team of scholars used regression analysis to assess the influences that accounted for this marked variation in HOLC application and acceptance rates.[4] Their approach was to determine how differences in measures of general economic distress, housing market conditions, and political influence were related to differences in the intensity of HOLC activity. To isolate the impact of these most important factors, the model also controlled for other characteristics of local markets including the age, race, and marital status of the population; the importance of manufacturing and agriculture to the local economy; and the average level of household income.

In interpreting the results of the analysis, the researchers noted that three parties were involved in each HOLC transaction—the borrower who applied for HOLC refinancing, the original lender who had to agree to sell the loan, and the HOLC staff who determined the eligibility of the borrower and negotiated the purchase price of the original loan. Because these interactions were complex, it is not possible to connect the behavior of any one group to the spatial pattern of HOLC application or acceptance rates. Instead, the regression analysis was designed to uncover how the market conditions in each county affected the interactions among borrowers, lenders, and HOLC staff that determined the rate of HOLC application activity and acceptances.

A central issue in all discussions of New Deal fund distribution has been whether variations in HOLC activity across markets reflected the program's eligibility requirements and responded to the housing distress that it was designed to relieve. The evidence indicates that HOLC performed as intended in both dimensions. Both application and acceptance rates were higher in markets with higher median 1930 home values, a characteristic that should have been associated with both a greater reliance on mortgage financing and stronger post-crisis housing collateral. A strong positive effect of rapid post-1925 building activity also indicated that HOLC applications were higher in markets in which a greater share of homes were under mortgage and remained good prospects for refinancing. Finally, a large positive impact of the 1930 home-ownership rate on the HOLC acceptance rates indicates that HOLC lending was concentrated in more settled, established residential areas where the prospects for successful loan modifications were better than in mixed, transitional neighborhoods.

The analysis also indicates that the relief of housing-specific distress was an important factor in HOLC application and acceptance rates. Areas with more housing distress during the Depression tended to receive more funds, as did areas with more unemployment. Counties with younger populations and higher rates of marriage were also more likely to apply for HOLC refinancing and more likely to obtain it. But most important were measures of housing market distress and housing market characteristics. HOLC funding was positively associated with both higher home prices and higher rates of home ownership. Many studies of total New Deal spending and spending on relief, public works, and farm activity found strong political motivations in the distribution of funds. More was spent in areas where a larger share of the population voted, and where there was more swing voting and more long-run support for Democratic presidential candidates. The HOLC was an unusual program in that many of the patterns of presidential politicking seen in the distribution of funds from other programs did not show up in the study of the allocation of HOLC funds.

A final influence on rates of HOLC activity was the distance between each county and the nearest HOLC office in which the home owner had to apply. Each loan purchase and refinance required multiple meetings with the lender and the borrower, appraisals, visits to the home, and meetings between appraisers and HOLC officials. All of these activities were less costly if the home was in the same community as the HOLC office. They became increasingly costly as people had to travel longer distances. As a result, the regression analysis showed that borrowers were more likely to apply for funds and were more likely to receive funds if they were in or close to counties with HOLC offices. The influence of distance between borrowers and HOLC offices proves to be of great importance in assessing the overall effectiveness of HOLC refinancing.

The Impact of the HOLC on Local Markets

The HOLC meant to stabilize housing markets by purchasing loans on the verge of foreclosure from lenders and refinancing the loans for the home owners. The goal was to prevent a drop in the demand for owned homes and prevent a fall in the supply of owned homes and a sudden rise in the number of rental properties. Achieving this goal would have led to a positive relationship between the HOLC loans and the number of home owners and the value of homes. This was a heroic undertaking, and so the major question remains and must be asked: Did it work?

Although the HOLC was focused on home ownership and home prices, its activities could have affected other housing market outcomes. Local housing markets, for example, were closely connected to local rental markets, and problems in one could spill into the other. Foreclosed families had to move somewhere, after all, and would have raised the demand for rental housing. The supply of rental housing, on the other hand, could have been augmented if lenders had difficulty selling foreclosed properties and decided instead to rent them out. As the HOLC bought loans from lenders, in addition, it could have effectively increased the supply of new mortgage funds, lowered its cost, and stimulated new construction. In assessing the impacts of the HOLC, therefore, it is important to focus not only on its stated goals of home ownership and housing prices, but also on changes within local rental markets and new residential construction.[5]

In the past few years, two research teams independently examined these issues by compiling and analyzing data on HOLC loan activity, housing markets, and a variety of socioeconomic factors for all of the counties in the United States.[6] The goal in each analysis was to isolate to what extent the introduction of HOLC loans in each county raised housing values and home ownership. To do so each team had to overcome an important obstacle to estimating the true impact of the HOLC impact. We have shown above that HOLC lending was greater in counties that experienced severe housing distress; as a result, we know that HOLC lending volume was positively associated with poorer housing market outcomes. This leads to a problem that arises quite often in program evaluations: it can be difficult to detect a positive impact of greater HOLC activity, given that these funds were disproportionately allocated to local housing markets that were already hardest hit by the crisis. To guard against this possibility, it is necessary to estimate the impact on home ownership and housing prices of variations in HOLC lending volume that were not related to program need. A complete explanation of this problem and its solution is provided in the appendix. The bottom line, however, is that the negative effect of distance between borrowers and HOLC offices provides just the right kind of variation to overcome the problem, because a borrower who lived farther from an office would have been less likely to apply to the HOLC, or to be accepted, for any given level of distress.

Both research teams used the "distance from office" effect to estimate the true impact of the program on home ownership and housing prices and concluded that the HOLC was successful at maintaining the number of home owners and housing values at levels well above where they likely would have ended up without the program.[7] The estimates suggest that a $1 increase in HOLC loans per capita in counties with less than fifty thousand people would have raised housing values by $115.70 in 1940. That same dollar, moreover, would have raised the number of nonfarm home owners by 81.5 people.[8]

The information in table 9.1 shows that, had the HOLC program not existed, the median house value likely would have fallen by $1,078 from $2,278 in 1930 to $1,200 in 1940. Average HOLC lending in the small counties came to about $1.90 per capita. That additional $1.90 would have raised the typical 1940 home value by $231, from $1,200 to $1,431. Therefore, the HOLC helped reduce a potential decline in housing values of 47 percent from $2,278 to $1,200 over the decade of the 1930s to a decline of only 37.2 percent from $2,278 to $1,431. Essentially, it helped eliminate 21.4 percent of the potential decline.

Comparing 1930 to 1940 may actually understate the effectiveness of the HOLC at staving off the decline in housing values. Much of the decline in housing values occurred between 1930 and January 1934, which was about the time the HOLC had begun making loans. The Civil Works Administration survey implied an average drop of about 32 percent in home values during

Table 9.1. Evaluating the impact of HOLC spending per capita on nonfarm home values and the number of home owners in counties with fewer than fifty thousand people

Estimated impact of the HOLC on house prices in a typical county, 1930–1940		
A	Median house value in 1930	$2,278
B	Estimated median value in 1940 without the HOLC	$1,200
C	Estimated median house value in 1940 with the HOLC	$1,431
D	Change between 1930 and 1940 without the HOLC (line A – line B)	–$1,078
E	Difference in 1940 value associated with the HOLC (line C – line B)	$231
F	Percentage of potential 1930–1940 decline prevented by the HOLC (line E ÷ line D)	21%
Estimated impact of the HOLC on house prices in a typical county, 1934–1940		
G	Median house value in 1934	$1,549
H	Estimated median value without the HOLC in 1940	$1,200
I	Estimated median value with the HOLC in 1940	$1,431
J	Change between 1934 and 1940 without the HOLC (line H – line G)	–$349
K	Difference in 1940 value associated with the HOLC (line I – line H)	$231
L	Percentage of potential 1934–1940 decline prevented by the HOLC (line K ÷ line J)	66%
Estimated impact of the HOLC on home ownership in a typical county, 1930–1940		
M	Number of home owners in 1930	1,200
N	Estimated number of home owners in 1940 without the HOLC	1,223
O	Estimated additional home owners in 1940 due to average HOLC loans per capita	155
P	Number of home owners in 1940 with the HOLC (line N + line O)	1,378
Q	Change in number of home owners from 1930 to 1940 with the HOLC (line P – line M)	178
R	Percentage of 1930–1940 increase in home owners due to the HOLC (line O ÷ line Q)	87%
Estimated impact of the HOLC on home ownership in a typical county, 1934–1940		
S	Estimated number of home owners in 1934	1,164
T	Estimated number of home owners in 1940 without the HOLC	1,223
U	Estimated additional home owners in 1940 due to average HOLC loans per capita	155
V	Number of home owners in 1940 with the HOLC (line T + line U)	1,378
W	Change in number of home owners from 1934 to 1940 with the HOLC (line V – line S)	214
X	Percentage of 1934–1940 increase in home owners due to the HOLC (line U ÷ line W)	72%

that time. If this was the average drop for all counties below fifty thousand people, the typical median value of housing would have fallen from $2,278 in 1930 to $1,549 by the beginning of 1934. Without the HOLC, the typical median house value would have fallen from $1,549 in 1934 to $1,200 in 1940, roughly a loss of $349 in value. An injection of the $1.90 average HOLC spending loans per capita would have raised the 1940 price by $231.40 from $1,200 to $1,431. Thus, the HOLC loans per capita were able to stave off $231 or 69 percent of a potential decline of $349 in housing values between 1934 and 1940.

HOLC activity also helped account for nearly all of the increase in the number of nonfarm home owners in a typical small county over the course of a decade. Without the HOLC average spending of $1.90 per capita, the typical small county would likely have seen a rise in the number of home owners from 1,200 in 1930 to only 1,223 in 1940, an increase of only 23 home owners over the course of the decade. Given that the HOLC had been put in place, the actual rise in the number of home owners was 178, from 1,200 in 1930 to 1,378 in 1940. Table 9.1 shows that the HOLC added an additional 155 home owners in the typical small county and accounted for as much as 87 percent of the rise in the number of home owners between 1930 and 1934.

We do not have comprehensive figures on the number of home owners in US counties during the mid-1930s. Comparisons of 1930 census home-ownership rates to home-ownership rates in a 1934 survey of sixty-one cities by the Civil Works Administration, however, suggest an average drop in the home-ownership rate of about 3 percent. This seems roughly consistent with the rise in foreclosure rates to around 1 percent each year in the early 1930s. Thus, the number of home owners probably fell by about 3 percent between 1930 and the beginning of 1934. If the number of home owners fell 3 percent from the 1930 census average of 1,200, the typical number of home owners would have fallen from 1,200 to 1,164 by 1934. Thus, the typical number of home owners would have risen by 214, from 1,164 in 1934 to 1,378 in 1940. With $1.90 in HOLC spending per capita, the HOLC would have raised the number of home owners by 155, which is about 72 percent of the rise of 214 between 1934 and 1940 in a typical small county.

As successful as the HOLC was in smaller counties, neither research team could find a strong positive effect of the HOLC in counties with more than fifty thousand people in which most HOLC offices were located. There are two potential reasons for this. One possibility is that the "distance from office" strategy, described above and explained more completely in the appendix, was much less effective in larger cities than in smaller cities. We are still working on this issue but have made little headway on it.

The second possibility is that the HOLC might have had little impact in larger cities because there tended to be a stronger network of institutions in the cities that were more effective at backstopping troubled lenders. Thus, the HOLC was needed less in the larger cities than in smaller towns. This situation is similar to what occurred with commercial banks in the 1920s and early 1930s, even though they were not heavily involved in residential mortgage lending. The lion's share of the failures in commercial banks in the 1920s and early 1930s occurred in smaller towns and cities, where there were often only a handful of banks, who all experienced sharp drops simultaneously when the local economy was falling apart.

The statistical analysis of the experience with the HOLC in small counties suggests that the HOLC was a powerful force in staving off declines in home values and home ownership. However, the evidence currently suggests that HOLC activity did not increase building activity. Courtemanche and Snowden examined the issue using information on the year built for every structure reported in the census of 1940. They could find no relationship between the number of homes built after 1934 and HOLC loans per capita. In unpublished work, moreover, neither team could find a positive effect of HOLC lending on the number of building permits before and after the HOLC program in the largest 270 cities in the country.

More work needs to be done in this area, but it does not appear that the replacement of toxic assets on the lenders' books did much to stimulate building construction. One reason may have been that the lenders were still holding a large inventory of foreclosed housing from the early 1930s. This problem was made worse when the HOLC ended up foreclosing on 20 percent of its loans. Thus, builders and lenders may not have seen much opportunity for fruitful investment in home construction during the late 1930s.[9]