Learning from the Last Great Mortgage Mess

Price Fishback, Board Member, National New Deal Preservation Association, and
Ken Snowden

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For the past four years the U.S. has faced a housing crisis that shows no signs of ending. The situation was similar in June 1933 when the Home Owners' Loan Corporation was created to address the nation's last severe mortgage crisis. Some have suggested that a new HOLC could help resolve the current crisis, but their characterizations of the HOLC have been incomplete. Our goal here is to summarize recent research that provides a fuller picture of the HOLC and its impact on housing markets in the 1930s.

Between 1933 and 1936 the HOLC bought and then refinanced one million severely delinquent mortgages, representing roughly one-tenth of the nation's nonfarm owner-occupied homes. The total amount refinanced was $3 billion or about 20 percent of the outstanding mortgage debt on 1-4 family homes in 1933. A program of similar proportions in 2011 would refinance 7.6 million loans worth $2 trillion.

The typical HOLC borrower was more than two years behind on the original mortgage and property taxes and could find no private lender to refinance the outstanding mortgage. Despite these problems, nearly all HOLC borrowers had been considered good credit risks just a few years earlier when they contributed down payments of 33 to 50 percent of the property's value. These borrowers ran into difficulties between 1929 and 1933 when the unemployment rate spiked above 20 percent and real GDP fell 30 percent.

The HOLC was promoted primarily as a means of aiding these home owners. Yet the corporation provided as much or more relief to mortgage lenders. It served as a "bad bank" by purchasing the worst 20 percent of loans held by private lenders in 1933 at nearly the full value of the debt owed them. Recent research has shown that in nearly half of the HOLC loan purchases, the price paid covered the principal on the original loan plus all of the interest payments and real estate taxes missed by the borrower. In the rest of the cases the price covered all but some of the missed interest payments, but the HOLC tried to limit the amount of haircuts in order to encourage lender participation.

Although HOLC refinancing did not appreciably decrease homeowners' debts, they benefitted greatly from its generous loan terms. The HOLC charged 5 percent interest rates on 15-year amortized loans written for up to 80 percent of the property's value. Borrowers could also opt for a 3-year moratorium on monthly principal payments. In all of these dimensions HOLC loans dominated the terms on loans that were available in the private market given the strict underwriting standards of the time. The HOLC could assist borrowers while bailing out for lenders, therefore, because it offered much lower rates, much longer terms and much higher loan to value ratios than had been originally written into the existing delinquent loans.

When servicing the loans it refinanced the HOLC was slow to foreclose and cautious not to depress local home prices when it disposed of foreclosed properties. The HOLC, nonetheless, ended up having to foreclose on 20 percent of its mortgage portfolio. Despite the high number of foreclosures, the HOLC showed a small surplus of total income over expenses in government accounts when it liquidated in 1951. The U.S. Comptroller General concluded that the program actually earned modest losses of roughly 2 percent on its $3 billion loan portfolio, however, after all costs of capital were considered in the government accounting process. The size of the government subsidy to housing markets was actually much larger, because the interest expense to the HOLC would have been much higher had the interest and principal on its bonds not been fully guaranteed by the Federal Government. Had the interest rate on HOLC bonds been one percent higher, the total subsidy would have been about 12 percent of the value of the $3 billion loan portfolio.

We have each independently worked with co-authors to estimate the impact of HOLC lending activity on local housing markets between 1935 and 1940. Both studies found that the typical amounts loaned by the HOLC in roughly 2500 small counties led to sizeable benefits by preventing a 3 percent drop in the home ownership rate and a 20 percent drop in housing prices within that county. HOLC lending, on the other hand, had no significant impact on the recovery in homebuilding. We emphasize that these impacts were estimated for counties outside the nation's largest cities because data limitations in these dense urban markets precluded estimation of HOLC impacts.

Finally, the beneficial impacts that we have estimated for the HOLC at best only limited the damage during the last great housing crisis. Between 1930 and 1940 housing prices still fell by an average of 45 percent and nonfarm homeownership decreased by nearly 5 percent. The HOLC, therefore, ameliorated but did not fully resolve the mortgage crisis of the 1930s. The historical record suggests that proposals for a modern HOLC should take into account both the success and limitations of the original program.

Price Fishback at the University of Arizona and Ken Snowden from the University of North Carolina, Greensboro are currently working with Jonathan Rose on a book summarizing their research on the HOLC.