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A NEW DEAL FOR THE AMERICAN MORTGAGE: THE HOME OWNERS' LOAN CORPORATION, THE NATIONAL HOUSING ACT AND THE BIRTH OF THE NATIONAL MORTGAGE MARKET

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I. INTRODUCTION

The debate between *laissez-faire* economic philosophers and proponents of government regulation has dominated the field of economics. Followers of the latter philosophy frequently identify the miraculous recovery of the American economy fostered by the New Deal in their arguments.¹ Champions of the free market are quick to point out the New Deal would have been a colossal failure without the economic stimulant of the Second World War.² Embedded in that historic era in one field of American

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¹ Works that highlight the successes of the New Deal include RONALD EDSFORTH, *AMERICA'S RESPONSE TO THE GREAT DEPRESSION* (2000); DAVID M. KENNEDY, *FREEDOM FROM FEAR: THE AMERICAN PEOPLE IN DEPRESSION AND WAR 1929-1945* (1999); JAMES S. OLSON, *SAVING CAPITALISM: THE RECONSTRUCTION FINANCE CORPORATION AND THE NEW DEAL, 1933-1940* (1994); JORDAN A. SCHWARZ, *THE NEW DEALERS: POWER POLITICS IN THE AGE OF ROOSEVELT* (1994); JASON SCOTT SMITH, *BUILDING NEW DEAL LIBERALISM: THE POLITICAL ECONOMY OF PUBLIC WORKS* (2006).

² Works that are critical of the New Deal include GARY DEAN BEST, *PRIDE, PREJUDICE AND POLITICS, ROOSEVELT VERSUS RECOVERY, 1933-1938* (1990); JIM POWELL, *FDR'S FOLLY: HOW ROOSEVELT AND HIS NEW DEAL PROLONGED THE GREAT DEPRESSION* (2004); GENE SMILEY,

business is a success story born at the crossroads of the free market and economic regulation. The New Deal's transformation of the American mortgage—that venerable economic instrument foremost in a vast majority of Americans' financial lives—shows the great potential of government regulation by economic philosophers with real-life entrepreneurial experience. The New Deal's business-friendly, unobtrusive regulation of the American housing market fostered a financial triumph. Indeed, the nation of homeowners, unrivaled in the world, and the trillion dollar industry that has grown around the American mortgage, can look to a five-year period in the 1930s when a few bright New Dealers ushered in a revolution in mortgage lending.

Today, the soundness of the institutional changes brought about by the New Deal will be tested like at no time since the Depression. In the twenty-first century, American economists must look not just to the stock market but to the mortgage market to determine the financial health of the economy.³ Currently, the American economy sits in fear of a potential crash of said mortgage market caused by speculative investment in increasingly questionable loans—generalized as the sub-prime market.⁴ As an interesting sign of a possible shift in the winds, the current liquidity crunch⁵ in the American economy is partly the result of the stock market being impacted by events in the mortgage market.⁶ The reverberations of an

RETHINKING THE GREAT DEPRESSION (2002). For collections of essays containing both sides of the arguments, see FIFTY YEARS LATER: THE NEW DEAL EVALUATED, (HARVARD SITKOFF, ED.) (1984); REFLECTIONS ON THE GREAT DEPRESSION, (RANDALL E. PARKER, ED.) (2003); THE NEW DEAL AND THE TRIUMPH OF LIBERALISM, (SIDNEY M. MILKIS AND JEROME M. MILEUR, EDs.) (2002).

³ Justin Fox, *Subprime's Silver Lining*, TIME, Mar. 22, 2007, available at <http://www.time.com/time/magazine/article/0,9171,1601838,00.html>. One explanation of the growth of the mortgage market as a national indicator appeared in *Time* recently:

Declining global interest rates left investors searching for anything that would pay higher yields. Eager to oblige, Wall Street investment bankers devised ever cleverer ways to package ever riskier loans into high-yield securities. And mortgage lenders came up with ever more creative loan terms to attract customers. This lured “unsophisticated borrowers who had difficulty fully understanding how these products would affect them when interest rates rose and housing prices edged off,” says Eugene Ludwig, a former top banking regulator who now runs Promontory Financial Group.

Id.

⁴ Michael Liedtke, *High-Risk Mortgages Become Toxic Mess*, WASH. POST, Aug. 11, 2007, available at <http://www.washingtonpost.com/wp-dyn/content/article/2007/08/10/AR2007081001768.html>.

⁵ Justin Fox, *The End of Easy Money*, TIME, July 30, 2007, available at <http://www.time.com/time/magazine/article/0,9171,1645150,00.html>.

⁶ Tim Paradis, *Stocks Plunge on Rising Credit Anxiety*, ASSOCIATED PRESS, Aug. 9, 2007. For a summary of how the stock market, mortgage market and American economy as a whole are intertwined, see *A Sub-Prime Primer*, TIME, Mar. 15, 2007, available at <http://www.time.com/time/magazine/article/0,9171,1599698,00.html>.

American economic crash are being felt throughout the world—a world where America's strongest export may be its mortgages.⁷

New Deal-era federal enterprises are not considered the direct cause of the sub-prime catastrophe.⁸ However, the Federal National Mortgage Association (Fannie Mae), along with its brother company, the Federal Home Loan Mortgage Corporation (Freddie Mac), deserve their share of the blame. The lending revolution they ushered in allowed other private lenders, and Fannie Mae and Freddie Mac themselves, to take risks and insure mortgages that the federal mortgage market of the 1930s—or of any other decade—would not have tolerated.⁹ Casting blame aside, recent federal action to take over Fannie Mae and Freddie Mac indicates that at least one vestige of that great era of government initiative may become a casualty of its own success and subsequent financial exuberance.¹⁰ This

WHEN HOMEOWNERS CAN'T PAY . . . Borrowers with poor credit and unusual loans have often taken on more debt than they can handle. And if rates rise, they are vulnerable to default and even foreclosure. . . . MORTGAGE LENDERS GET HAMMERED . . . Many lenders resell their high-risk mortgages to investment banks. If defaults rise, the lenders are often forced to buy back the bad loans, which hurts earnings and stock prices. . . . INVESTMENT BANKS LOSE BUSINESS . . . The firms that buy the loans usually repackage them and sell them as securities (for a profit, of course). As securities get riskier, there are fewer buyers. That means lower profits. . . . INSTITUTIONAL INVESTORS ARE EXPOSED . . . Banks, hedge funds, insurers and mutual funds have been buying the risky bonds because they promise high rates of return. As defaults spread, that promise evaporates. . . . AND THEY FLEE THE STOCK MARKET. . . . The mortgage storm plus slowing consumer spending lead investors to look for safer bets than stocks.

Id.

⁷ Adam Smith, *How a U.S. Credit Crunch Went Global*, TIME, Aug. 10, 2007, available at <http://www.time.com/time/business/article/0,8599,1651865,00.html>; Julia Werdigier, *Europeans are Wondering About Subprime Exposure*, N.Y. TIMES, Aug. 11, 2007, available at <http://www.nytimes.com/2007/08/11/business/worldbusiness/11regulate.html>.

⁸ Fox, *supra* note 3 (arguing in support of FHA and Fannie Mae).

⁹ Fannie Mae, along with Freddie Mac, which was created in the 1970s as an offshoot of the work of Fannie Mae, have not been without criticism:

It was during the long housing boom that the seeds of destruction were sowed for Fannie and Freddie. They appeared to be very profitable, so pressures mounted for them to find ways to finance housing for poorer Americans, often living in areas where banks had historically been hesitant to lend. . . . At the same time, the private mortgage industry was becoming more and more reckless in its own lending. . . . As those standards deteriorated, there was pressure on Fannie and Freddie to relax their own standards, both to remain competitive and to meet the Congressional goals. In some cases, the goals were met by buying subprime mortgage securities sold by private lenders.

Floyd Norris, *The Dilemma of Fannie and Freddie*, N.Y. Times, Sept. 8, 2008, available at <http://www.nytimes.com/2008/09/08/business/08norris.html?pagewanted=print>.

¹⁰ Stephen Labaton & Edmund L. Andrews, *In Rescue to Stabilize Lending, U.S. Takes Over Mortgage Finance Titans*, N.Y. TIMES, Sept. 8, 2008, at A1. As a result of the sweeping federal action, Fannie Mae and Freddie Mac will be placed in "a government conservatorship, much like a bankruptcy

article will discuss the early beginnings of the American mortgage market. Beyond mere nostalgia, a revisit to the birth of the national mortgage market will show the spirit and philosophy behind the Depression-era mortgage industry. This look back in time will expose the degree to which the mortgage market has deviated from the original intentions. Perhaps through an examination and reminder of where the mortgage market revolution began, we can see in the past the potential in the market for future recovery.

Between 1933 and 1938, the pieces were put in place to transform the concept of mortgage lending in the United States. This article will review the crisis in the American mortgage market at the outset of the Depression and focus on the system-wide changes that occurred in the mortgage industry through New Deal legislation. It will begin with a history and discussion of the Home Owners' Loan Corporation (HOLC), a small, unheralded New Deal relief agency created to assist defaulting borrowers and failing banks. The article will examine how the success of this agency led a few economic experts to create the Federal Housing Administration (FHA). This agency brought permanent institutional changes in the form of an improved, standardized mortgage document, more uniform and cohesive mortgage practices and introduced mortgage insurance. This article will discuss the FHA's innovations, which were built on the experiences of the HOLC, and then show how, as security in the American economy increased through these changes and lenders felt more confident in borrowers' ability to pay back their loans, economists attempted to enhance liquidity through the creation of a market for these (now) safe investments in the form of the Federal National Mortgage Association (Fannie Mae). After 1938 and over the course of the next seventy years these economic innovations—this New Deal for the American mortgage—democratized home ownership and, at times, propelled the entire American economy. Whether anticipated or not, an investment revolution was born.

II. THE CRISIS IN AMERICAN MORTGAGE LENDING

On April 13, 1933, President Franklin D. Roosevelt submitted a bill to Congress "to provide emergency relief with respect to home mortgage indebtedness."¹¹ Forty days prior, the President proclaimed fear as America's greatest enemy and commenced a revolutionary period of social transformation through extraordinary legislation known as the "Hundred

reorganization." *Id.* The entities will lose much of what made them private companies and possibly usher in a Treasury takeover. *Id.*

¹¹ *Roosevelt's Bill Proposing Refinancing of Mortgages for Home Owners*, N.Y. TIMES, Apr. 14, 1933, at 2 [hereinafter *Roosevelt's Bill*].

Days.”¹² The New Deal was still in its infancy. A mere one month prior to the President’s proposal to assist homeowners, FDR announced the “bank holiday” and closed American banks.¹³ Under the bi-partisan Emergency Banking Act, America’s banks were now re-opened under government supervision.¹⁴ Although a catastrophe in capitalism was averted, mere government reactions to the emergency would not suffice. A structural overhaul of the American economy was needed. By this time, legislation unparalleled in its social magnitude had passed or been proposed creating agencies to rescue agriculture (the Agricultural Adjustment Agency), to employ and assist the unemployed (the Civilian Conservation Corps and the Federal Emergency Relief Administration, respectively), to support American industry (the National Recovery Administration), to insure bank deposits (the Federal Deposit Insurance Corporation), and to harness the potential of hydroelectric power (the Tennessee Valley Authority).¹⁵

The crisis in mortgage delinquencies and foreclosures equaled the greatest of the Great Depression’s dilemmas. Hence, the President proposed the mortgage relief bill after only forty days in the White House. Why was rescuing the foundering mortgage industry so vital a part of the entire New Deal recovery program to warrant inclusion among the other great acts of the pivotal Hundred Days?

When President Roosevelt delivered his first Inaugural Address, mortgages on residential homes in the United States were being foreclosed at a rate of one thousand per day.¹⁶ Banks, suffering from the scores of foreclosures, were closing their doors unlike at any other time in history.¹⁷ Massive unemployment combined with a precipitous drop in property values brought about these unprecedented results.¹⁸ However, these obvious causes told an incomplete story. The magnitude of failed mortgages and failing banks was a symptom of inherent defects in the very foundation of American mortgage lending—defects that made the collapse inevitable.

The pre-New Deal American mortgage was made by a homebuyer with a large down payment—in excess of 30 percent of the value of the

¹² KENNEDY, *supra* note 1, at 134–53. The author gives a comprehensive account of the Hundred Days, which he describes as “a masterpiece of presidential leadership unexampled then and unmatched since.” *Id.* at 140.

¹³ *Id.* at 135–37.

¹⁴ *Id.*

¹⁵ *Id.* at 153, 144, 151 and 148–49.

¹⁶ KENNETH T. JACKSON, *CRABGRASS FRONTIER: THE SUBURBANIZATION OF THE UNITED STATES* 193 (1985).

¹⁷ OLSON, *supra* note 1, at 8–9 (stating “[w]hen the financial dust cleared for 1930, more than 1,350 commercial banks had closed. It was the worst year in United States financial history”).

¹⁸ JACKSON, *supra* note 16, at 193.

home—with a local institution.¹⁹ The savings deposits of people in the community supplied the money lent by these institutions; mortgage money was at the mercy of local thrift.²⁰ Decisions disbursing these limited funds among various potential borrowers underscored the insularity of the mortgage system as it stood at the outset of the Depression. Common sense judgments based on a person's reputation and standing in the community determined obtaining a mortgage in this day before Social Security numbers, national credit agencies and computerized records.²¹ Additionally, appraisal of land, a vitally important business decision in identifying safe collateral investments, required an intimate knowledge of peculiar land values in thousands of diverse American cities and towns. National appraisal standards were as yet unknown.

The mortgage as it existed in the 1930s was anywhere from five to ten years in length.²² Payments were made of interest only, at a rate of usually no less than 8 percent.²³ Upon maturity a balloon payment of the entire unreduced principal was due.²⁴ Most homeowners lacked sufficient funds to pay off the entire mortgage at maturity; thus borrowers would be compelled to refinance and begin the process anew, with another five to ten year mortgage.²⁵ Self-amortizing mortgages, where equal monthly payments gradually reduce and eventually pay off the entire principal, were rare.²⁶

¹⁹ KENNEDY, *supra* note 1, at 370.

²⁰ See Michael H. Schill, *The Impact of the Capital Markets on Real Estate Law and Practice*, 32 J. MARSHALL L. REV. 269, 270 (1999); Michael H. Schill, *Uniformity or Diversity: Residential Real Estate Finance Law in the 1990s and the Implications of Changing Financial Markets*, 64 S. CAL. L. REV. 1261, 1263–64 (1991).

²¹ Kenneth G. Gunter, *Computerized Credit Scoring's Effect on the Lending Industry*, 4 North Carolina Banking Institute 443, 444–45 (2000). Although the concept of credit reporting has existed in America since the nineteenth century, credit reports were not readily available to local banks before the computer age. Often, the expense of credit reports was the greatest hurdle. “[T]he lenders who, due to costs, chose not to use these types of systems were forced to rely primarily upon the business judgment of their lending officers to approve loan applicants.” *Id.*

²² JACKSON, *supra* note 16, at 196. KENNEDY, *supra* note 1, at 370.

²³ KENNEDY, *supra* note 1, at 370.

²⁴ JACKSON, *supra* note 16, at 196. KENNEDY, *supra* note 1, at 370.

²⁵ KENNEDY, *supra* note 1, at 370.

²⁶ Amortization was popular among building and loan and savings and loan organizations. However, these institutions were limited geographically to whom they could lend—usually only within one hundred miles from their locations. Buildings and loans only gave mortgages to members who deposited in their institutions. These limited deposits from the community created the mortgage money lent. For an overview of the Building and Loan Industry, see DAVID L. MASON, *FROM BUILDING AND LOANS TO BAIL-OUTS: A HISTORY OF THE AMERICAN SAVINGS AND LOAN INDUSTRY, 1831-1995* (2001). Or, think of the scene in “It’s a Wonderful Life” where this guy named Tom has “\$242 here [the Bailey Bros. Building and Loan]” and he wants to withdraw all of his money because “\$242 is not going to break anybody,” but George tells him, “You’re thinking of this place all wrong. As if I had the money

Beyond the expense of a new mortgage every five years, the need for frequent refinancing was a particular problem in times of tight money when the supply of funds was limited. The cost of mortgage money increased as a result.²⁷ At the outset of the Great Depression, the need for mortgage money created by this inefficient system went from problematic to catastrophic.

According to Winfield W. Riefler, an economic advisor to the President's Executive Council, and a draftsman of the National Housing Act, the boom in home construction in the 1920s increased the amount of debt held in short-term mortgages and created "the sort of financing which is bound to develop into a very serious crisis."²⁸ The Depression led to a precipitous drop in property values and panic among lenders. "[L]enders became excited about the value of their security and asked for heavy curtailments [in creating new mortgages]."²⁹ These "heavy curtailments" combined with a "serious liquidity problem" caused by the removal of savings by depositors reeling from the early effects of the Depression and in desperate need of cash, created a scarcity in mortgage money.³⁰ "[Thus] the mortgage market froze at the very time when people were least able to curtail [borrowing]."³¹ In this way, the lack of mortgage money for people in desperate need to refinance mirrored the cash-flow problem caused by the margin purchasing of stock—a fad of the 1920s—and the collapse caused by the call to meet the margin (pay back borrowed money used to purchase stock devalued by the crash), when people were least able to afford it.³² With thousands of unemployed homeowners facing foreclosure, hundreds of banks failing and a scarcity of available mortgage money, the structurally unsound

back in a safe. The money's not here. Your money's in Joe's house right next to yours. And in the Kennedy house, and Mrs. Macklin's house, and a hundred others. Why, you're lending them the money to build, and then, they're going to pay it back to you as best they can." *IT'S A WONDERFUL LIFE* (Liberty Pictures 1947).

²⁷ JACKSON, *supra* note 16, at 196 (indicating the homeowner was periodically at the mercy of arbitrary and unpredictable forces in the money market).

²⁸ *National Housing Act: Hearing on S. 3603 Before the S. Comm. on Banking and Currency*, 73d Cong. 2, 50 (1934) [hereinafter *National Housing Act Hearings of 1934*]. Mr. Riefler explained: "We went through a building boom from 1922 to 1929, in which we added enormously to our mortgage debt. That building boom was not financed in a sound way. In general the mortgages were not amortized. People expected not to pay them off but to renew them by refunding in the market." *Id.*

²⁹ *Id.*

³⁰ C. LOWELL HARRISS, *HISTORY AND POLICIES OF THE HOME OWNERS' LOAN CORPORATION* 8 (1951).

³¹ *National Housing Act Hearings of 1934*, *supra* note 28, at 50.

³² ROBERT S. McELVAINE, *THE GREAT DEPRESSION: AMERICA, 1929-1941* 47 (1993).

Depression-era mortgage market was crumbling. “[T]he home-financing system was drifting toward complete collapse.”³³

III. THE HOME OWNERS’ LOAN ACT OF 1933

The bill that President Roosevelt proposed on April 13, 1933, was reprinted on the second page of *The New York Times* the following day.³⁴ It was modestly described as a proposal “to set up machinery for refinancing home mortgages.”³⁵ The goals of the bill were summarized in the heading of the proposed legislation: “to refinance home mortgages [and] to extend relief to the owners of homes who occupy them who are unable to amortize their debt elsewhere.”³⁶ The Home Owners’ Loan Corporation (HOLC) would be created by the Federal Home Loan Bank Board to achieve these goals. The new Corporation would be capitalized up to a maximum of \$200 million, funded by the Reconstruction Finance Corporation.³⁷ The HOLC would issue its own bonds to local lenders in exchange for delinquent mortgages in their portfolios. These bonds were tax exempt (no federal, state or local tax), paid a maximum interest rate of 4 percent (guaranteed by the federal government), and held a maximum eighteen-year maturity.³⁸ Loans could be made on one to four family dwellings for 80 percent of the appraised value of the property or less.³⁹

Displaying the immediacy of the Hundred Days and the urgency of the mortgage crisis, a mere one week after FDR’s proposal, the Home Mortgage Subcommittee of the United States Senate Committee on Banking and Currency would hold hearings on the bill titled “The Home Owners’ Loan Act of 1933.”⁴⁰ Senator Robert J. Bulkley of Kentucky, as chairman of the

³³ JACKSON, *supra* note 16, at 193. Mr. Riefler, in his testimony before the Senate Banking and Currency committee, used the term “collapse” as well to describe the state of the mortgage market at the outset of the Depression. *National Housing Act Hearings of 1934*, *supra* note 28, at 50.

³⁴ *Roosevelt’s Bill*, *supra* note 11.

³⁵ *Id.*

³⁶ *Id.*

³⁷ HARRISS, *supra* note 30, at 11. The Reconstruction Finance Corporation was created in January 1932, by President Hoover. *Id.* Its purpose was to make low interest loans to banks and businesses. *Id.* Historian James S. Olson described its goal as follows: “to rejuvenate private money markets with injections of government money . . . [to] stimulate business production and employment.” OLSON, *supra* note 1, at 14–15.

³⁸ HARRISS, *supra* note 30, at 11.

³⁹ The HOLC would exchange bonds for mortgages for three years. OLSON, *supra* note 1, at 12. HOLC mortgages were to be in first position on the property and cash loans could be made to assist in payment of real estate taxes. *Id.*

⁴⁰ *Home Owners’ Loan Act: Hearing on S. 1317 Before the S. Subcomm. on Banking and Currency*, 73d Cong. 1 (1933) [hereinafter *Home Owners’ Loan Act Hearings*].

Subcommittee on Home Mortgages, presided over the two-day hearings on the Home Owners' Loan Act.⁴¹ Horace Russell, General Counsel for the Federal Home Loan Bank Board in Atlanta and a draftsman of the bill, was the first witness.⁴² Mr. Russell explained at the outset that the HOLC would take over the mortgage origination power of the Federal Home Loan Banks that "ha[d] proved to be utterly unworkable."⁴³ The Federal Home Loan Bank Act of 1932 gave these federal institutions direct lending power to originate loans.⁴⁴ Mr. Russell explained why this power, placed in the act at the last minute, proved to be a complete failure: "such direct lending and a conservative reserve system are inconsistent."⁴⁵ The lending practices proved to be too cautious; loans were made "only where the risk was slight" and as a result "[e]xactly *three* were approved."⁴⁶ Some sort of intermediary organization without the conservative tendencies of a federal reserve had to do the job.

Mr. Russell explained that the HOLC would issue bonds and place mortgages on homes worth a maximum of \$10,000, thus spreading the Corporation's limited \$200 million original capitalization among the greatest number of houses.⁴⁷ However, he admitted that no standard had yet been established for appraisals to determine what constituted a \$10,000 house.⁴⁸ Although the HOLC would contribute toward creating "an organized system of home financing" it could not become that system.⁴⁹ "[T]he Government will not propose to go behind all of the home mortgages . . . in the country."⁵⁰

As the witness proposed alternative opportunities to encourage investor involvement in the HOLC bonds,⁵¹ Senator James Couzens of Michigan quickly interjected: "As I understand, the whole purpose of this bill is to protect the home owner and not the investor."⁵² Mr. Russell did not directly

⁴¹ *Id.* at 5

⁴² *Id.*

⁴³ *Id.* at 5–6.

⁴⁴ JACKSON, *supra* note 16, at 196.

⁴⁵ *Home Owners' Loan Act Hearings, supra* note 40, at 6.

⁴⁶ JACKSON, *supra* note 16, at 194 (emphasis added). Obviously, those three refinances did not "reverse the downhill slide of housing conditions." *Id.* However, Mr. Jackson warns the reader "we should not minimize the satisfaction that those three families received from this evidence of federal compassion." *Id.*

⁴⁷ *Home Owners' Loan Act Hearings, supra* note 40, at 6.

⁴⁸ *Id.* at 12.

⁴⁹ *Id.* at 11.

⁵⁰ *Id.*

⁵¹ *Id.* (discussing ideas including mixing apartment or hotel mortgages with home mortgages to increase returns).

⁵² *Id.*

support nor disagree with the senator's perspective.⁵³ This understanding of the purpose of the proposed legislation shows a complete misunderstanding of mortgage lending. This aversion for federal assistance to entrepreneurs fails to acknowledge the symbiotic relationship between lenders and borrowers. Mass foreclosures of entire lender portfolios would evict hundreds of thousands from their homes and bankrupt banks by the thousands. Financing for future mortgages would nearly vanish with huge numbers of banks out of business. Owning one's own home would become an impossible dream. Revitalization of the mortgage industry required assistance to both borrowers and lenders. Therefore, to support legislation that gave assistance to homeowners exclusive of lenders was a doomed strategy.

Mr. Russell understood the need to assist both borrowers and lenders in his support for enhancing the marketability of the bonds issued by the HOLC in exchange for failing mortgages. "[T]here are other institutions that would take these bonds if they had a market for them and [convert] them into cash."⁵⁴ Increasing liquidity for local lenders would allow the origination of more loans and ease the tight money crisis. The HOLC would initiate a chain reaction by issuing marketable bonds that could be traded to increase the supply of money for future mortgage lending—a remedy diminishing the need for federal involvement. "Therefore, if [the bonds] could be made more marketable the act would operate very much more effectively."⁵⁵ Remarkably, Mr. Russell predicted the future of mortgage lending enhanced by the secondary market for mortgages.

Although ideas were discussed showing a glimpse of the near future of mortgage lending, much was needed in 1933 to bring these ideas to fruition. Walter S. Schmidt, representing the National Association of Real Estate Boards, testified on the importance of and the need for amortization. Although he found the Home Owners' Loan Act insufficient to "meet[] the exigencies of the situation"⁵⁶ he supported its amortization principles. Mortgages paid off over fifteen years would give people the opportunity to gradually own their homes. The constant refinancing caused by the short-term mortgage system "for what should be a long-term investment [was] . . .

⁵³ See *id.*

⁵⁴ *Id.* at 17.

⁵⁵ *Id.*

⁵⁶ *Id.* at 44. The witness favored grander legislation. *Id.* Mr. Schmidt, who predicted "anarchy" unless actions were taken to fix the mortgage system, proposed expanding the Federal Home Loan Bank and renaming it the "Federal mortgage bank." *Id.* This newly christened institution would act as "a permanent discount system for long-term financing." *Id.* at 43–45. Likewise, economist Henry Woodhouse of New York City felt the bill, although "a noble one" was insufficient to meet the crisis. *Id.* at 76.

one of the greatest injustices that is done to the homeowner.”⁵⁷ Not all the senators were convinced of the need for amortization. Senator Couzens opined, “[T]here is no reason why a man should not pay for his house in less than 30 years, or 20 years, if he exercises thrift.”⁵⁸ In the senator’s mind, amortization was simply a form of reckless installment buying seen with appliances and other luxuries.

Charles O’Connor Hennessy, President of the Savings and Loan Bank of the State of New York, was openly against the Home Owners’ Loan Act. He saw an intrinsic flaw in the diversity of state mortgage laws. “You cannot successfully build a Federal mortgage system upon mortgages assembled under 48 different State systems.”⁵⁹ Although Senator Alben Barkley suggested that a national law on the subject of mortgages might resolve this issue—a prediction of sorts to the mortgage standardization that would take place in the 1970s—Mr. Hennessy was entirely against any federal involvement.⁶⁰ Perhaps he viewed such involvement, even improvements, as a threat to the diminished profits of the Depression.

Mr. Hennessy felt the proposed HOLC would provide no relief and involve the federal government in “dubious liabilities.”⁶¹ He expressed “the gravest doubt that those bonds [issued by the HOLC in exchange for mortgages] will have any substantial market at all.”⁶² With concern over the bonds’ “marketability” and their corresponding liquidity, most lenders would simply “unload[] upon this [Corporation], and indirectly upon the Government of the United States, the ‘cats and dogs’ of the mortgage business in this country.”⁶³ Thus, in Mr. Hennessy’s opinion, the HOLC would become a warehouse of unwanted, unworkable mortgages, for which lenders would receive illiquid bonds creating no new mortgage money.

Not all of the opinions on the proposed Home Owners’ Loan Act were as negative. The April 16, 1933, issue of *The New York Times* featured an article by Joseph P. Day dissecting the current problems with the mortgage market and supporting the proposed legislation as a step toward a potential solution.⁶⁴ The author agreed that mortgages needed to become long-term

⁵⁷ *Id.* at 63.

⁵⁸ *Id.*

⁵⁹ *Id.* at 66.

⁶⁰ As the witness consistently disagreed any time any senator mentioned some of the benefits of the legislation, Senator Barkley suggested, “You are just opposed to this whole scheme?” *Id.* at 70. The witness agreed, adding he had been “consistently opposed to it.” *Id.*

⁶¹ *Id.* at 70, 72.

⁶² *Id.* at 71.

⁶³ *Id.* at 70.

⁶⁴ Joseph P. Day, *Mortgage Relief for Home Owners; Possibilities of Federal Legislation Are Discussed*, N.Y. TIMES, Apr. 16, 1933, at RE1.

investments to remove the “uncertainty” and “overhead” of constant refinancing.⁶⁵ Mr. Day predicted “the real estate mortgages of the future” would be paid off over extended periods of time, “for twenty-five years or longer.”⁶⁶ This improvement would create “more desirable, more marketable” mortgages since “steady amortization” meant the gradual payment in full of the mortgage itself and unencumbered home ownership.⁶⁷ This “stability” in mortgage lending would make mortgages more attractive investments that “would command a higher price” in the market.⁶⁸ In the optimistic opinion of Mr. Day, a greater supply of mortgage money available meant future mortgages would “command a lower rate of interest.”⁶⁹ Obviously, numerous political, economic, and emotional factors dictate interest rates. However, what is certain is that if investors felt more secure in purchasing mortgages, additional funds would be infused into local banks, and additional mortgage money would be available to more people. Mortgage lending in the twentieth century was shaped by this idea of enhancing the marketability of mortgages through improvements to the mortgage itself and the potential of mortgages as commodities.

On June 13, 1933, exactly two months to the day the bill was proposed, President Roosevelt signed the Home Owners’ Loan Act in front of the members of the Federal Home Loan Bank Board and Senator Joseph Taylor Robinson of Arkansas, the bill’s sponsor.⁷⁰ The Senate Hearings of the preceding April lasted only two days, in order to “speed action.”⁷¹ The bill passed the House by a vote of 383 to 4⁷² and the Senate without a recorded vote.⁷³ Upon signing, President Roosevelt declared the law was “another important step toward the ending of deflation.”⁷⁴ Recognizing the need for

⁶⁵ *Id.* (recalling a conversation twenty years earlier with railroad magnate August Belmont: “If I had to finance railroads every three to five years the way you have to real estate, the railroads could not stand the overhead”).

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ *Id.* Mr. Day explained this in terms of supply and demand: “In the long run, of course, the interest rate on any security is determined by the law of supply and demand. Mortgage money seeks a certain interest level...Make the mortgage [a] more attractive security by freeing it from uncertainty, provide for amortization...and it will at once become more desirable, more marketable and...command a lower rate of interest.” *Id.*

⁷⁰ *Roosevelt Signs Home Loan Bill: Asks Foreclosure Moratorium Until Machinery Is Set Up to Aid Owners*, N.Y. TIMES, June 14, 1933, at 8 [hereinafter *Moratorium*].

⁷¹ HARRISS, *supra* note 30, at 9.

⁷² *Id.* at 11. See also H.R. 77 CONG. REC., pt. 3, 73d Cong. 2474-2507, 2567-88 (1933).

⁷³ H.R. 77 CONG. REC., pt. 3, 73d Cong. 2474-2507, 2567-88 (1933); H.R. 77 CONG. REC., pt. 5, 73d Cong. 4974-75 (1933).

⁷⁴ *Moratorium*, *supra* note 70.

wholesale assistance to lenders and borrowers, the President acknowledged “the act extends relief not only to people who have borrowed money on their homes but also to their mortgage creditors.”⁷⁵ Contrary to historical stereotypes, the liberal President Roosevelt appreciated the need to assist big business to accelerate recovery and foster prosperity. Further, the President asked for cooperation from lenders in the spirit of united action to tackle the emergency: “I appeal to mortgage creditors . . . until full opportunity has been given to make effective the refinancing provisions of the home mortgage act that they abstain from bringing foreclosure proceedings.”⁷⁶ As *The New York Times* correctly reported, this was nothing short of a presidential plea for a foreclosure moratorium until the HOLC was up and running.⁷⁷

IV. THE HOME OWNERS’ LOAN CORPORATION

Although the task before the Home Owners’ Loan Corporation—“to set up machinery for refinancing home mortgages,”⁷⁸—seemed simple and straightforward, the revolutionary new Corporation given the task of introducing novel answers to old questions such as financing homes faced a massive undertaking. The HOLC’s challenge to create and introduce economic innovation was similar in concept to those of its dozens of alphabetically-nicknamed sister New Deal organizations.

The HOLC administrators approached the challenges before them with four central concepts gleaned from the hearings: (1) Bolster lenders by freeing them from the failing mortgages in their portfolios; (2) assist borrowers by refinancing and substituting short-term interest-only mortgages with long-term amortized mortgages; (3) create certainty in investments through standardized appraisal methods; and (4) enhance liquidity for lenders by converting mortgages from stagnant liens into marketable commodities. This multi-faceted approach of four interdependent ideas was pro-business and pro-consumer; one can imagine the draftsmen worried and hoped it would work as well in practice as it worked in theory.

After the rapid creation of a wide infrastructure, the Home Owners’ Loan Corporation was open for business. A decentralized system of local offices, totaling 458 locations at its operating peak staffed by as many as 20,000 employees disbursed throughout the United States, received applications starting in June 1933.⁷⁹ The new Corporation was easily

⁷⁵ *Id.*

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *Roosevelt’s Bill, supra* note 11.

⁷⁹ HARRISS, *supra* note 30, at 140.

accessible, reaching "a great majority of its borrowers by local telephone, local transit, or a short automobile drive."⁸⁰ The HOLC was widely publicized upon its introduction. The public was familiar with the lending practices of the new Corporation through various radio addresses and press statements.⁸¹ A June 18, 1933, article in the Real Estate section of The New York Times drafted by the Brooklyn Real Estate Board answered frequently asked questions about applying for loans and the corporate makeup.⁸² The HOLC helped its own publicity with the issuance of a pamphlet describing its functions and practices in August 1933.⁸³

The progress of the Chicago location of the Home Owners' Loan Corporation was followed closely by the Chicago Daily Tribune and serves as an informal example of the early days of the HOLC. William G. Donne, the Illinois manager of the HOLC, took his oath of office in Washington the week of July 12, 1933.⁸⁴ Mr. Donne provided "large stacks of application blanks at the Chicago City State Bank and Trust" so that on opening day completed applications could be processed.⁸⁵ However, these applications would not be handled in order of submission: "The man who needs federal aid the most is going to get the quickest relief."⁸⁶ In fact, during the first thirty days of operation, the branch would only entertain "acute distress cases" for relief.⁸⁷ Mr. Donne hoped this policy would prevent "the riotous scene" on the opening day of the Detroit office, where applicants began lining up at 4 a.m. and quickly turned into a "mob scene."⁸⁸ In Chicago, public interest was tremendous, with applicants requesting 200 applications a day.⁸⁹

The HOLC opened its Chicago office at 134 North La Salle Street on August 1, 1933.⁹⁰ The response was overwhelming, with 15,000 home owners waiting in line to receive applications on the first day.⁹¹ A picture of

⁸⁰ *Id.*

⁸¹ *Id.* at 15 (explaining that efforts were made to acquaint the public with the new agency through radio addresses by Senator James F. Byrnes and Louis McHenry Howe). In the tri-state New York, New Jersey, Connecticut area, Congressman Fred A. Hartley of New Jersey explained the new law on Station WOR on June 17, 1933. *House Group Seeks Aid on Mortgages*, N.Y. TIMES, July 18, 1933, at 12. It is likely that similar radio addresses occurred throughout the United States.

⁸² *Essential Factors in Home Loan Bill*, N.Y. TIMES, June 18, 1933, at RE1.

⁸³ HARRISS, *supra* note 30, at 15.

⁸⁴ *Home Owners Loan Office to Function Soon*, CHI. TRIB., July 16, 1933, at A7.

⁸⁵ Al Chase, *Home Owners In Distress Get First U.S. Loans*, CHI. TRIB., July 20, 1933, at 23.

⁸⁶ *Id.*

⁸⁷ Al Chase, *Home Loan Will Take Only Past Due Cases First*, CHI. TRIB., July 27, 1933, at 22.

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ Al Chase, *Thousands Ask U.S. Home Loans on First Day*, CHI. TRIB., Aug. 2, 1933, at 9.

⁹¹ *Id.* (revealing that 2,000 persons came to the office that day with questions, 5,000 letters were received requesting applications, and 3,000 persons went to two satellite locations).

scores of those in line under the caption, "Asking Aid of Uncle Sam," appeared in the paper a few days later, next to a photograph of William G. Donne, Senator William H. Dieterich and a seemingly overwhelmed office worker opening one of the mountains of letters on her desk.⁹² Mr. Donne, in a radio address that week, described two types of loans, one which would receive HOLC assistance, and one which would be rejected.⁹³ The primary requirement was "distress." If foreclosure was imminent, action would be quick: "A loan probably will be made within the next two weeks."⁹⁴ By the fourth day of business, the HOLC treasurer was suffering from "writer's cramp," necessitating the appointment of an assistant treasurer to help sign the "eighteen thousand interim certificates for loans."⁹⁵

The first mortgage negotiated by the Chicago office of the HOLC was on the home of "Mr. and Mrs. Theodore Burgwald, at 10628 Avenue F, South Chicago."⁹⁶ In fact, the Chicago Daily Tribune, under a picture of the "six room brick bungalow," claimed this was the first mortgage issued by the HOLC in the entire United States.⁹⁷ Whether this is true or not is unknown, particularly since the date of the mortgage closing is missing from the article; it is likely that articles similar to this one appeared in scores of America's newspapers as publicity, giving hope to readers accustomed to seeing only bad economic developments for several years. What is certain is that in exchange for a \$4,000 mortgage on premises at 10628 Avenue F, the South Chicago Savings bank accepted HOLC bonds with a 4 percent return and the Burgwalds did not lose their home, which they had owned since 1919.⁹⁸ These fortunate homeowners refinanced their distressed mortgage with the United States of America as the new lender, through the Home Owners' Loan Corporation.⁹⁹ This new \$5,000 mortgage (covering the original principal, accrued interest, and taxes) was to be paid in \$40 monthly installments amortized over the next fifteen years—all for only \$35 in closing costs.¹⁰⁰ Other success stories appeared in the Chicago Daily Tribune throughout the ensuing months.¹⁰¹ One can imagine local papers

⁹² Al Chase, *Home Owners Told What U.S. Considers Distress Mortgage Cases*, CHI. TRIB., Aug. 6, 1933, at 22.

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *Home Saved by Uncle Sam*, CHI. TRIB., Aug. 20, 1933, at A12.

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ For just a sampling of similar "success story" articles in the *Chicago Daily Tribune*, see Al Chase, *Donne Fights to Save Family From Eviction*, CHI. TRIB., Sept. 19, 1933, at 28; Al Chase, *H.O.L.C. Rescues Miller Family from Eviction*, CHI. TRIB., Sept. 20, 1933, at 23; *3 Flat, Cottage Owners Given Home*

throughout the United States saw similar stories of the Home Owners' Loan Corporation saving the nation's homeowners.

By August 14, 1933, two months after creation of the Home Owners' Loan Corporation, a survey in Washington, D. C., reported that nationwide, the Corporation already saved 3,000 homes from foreclosure, with 13,300 applications being processed.¹⁰² The survey also reported nationally, "courts are showing a willingness to hold up foreclosures and evictions pending action by the [Corporation]."¹⁰³ Almost overnight, the HOLC was being utilized to the advantage of distressed homeowners—and unscrupulous opportunists. Twenty-five firms in Chicago and five firms in New York had been indicted for charging bogus fees to assist in filling out and processing HOLC applications.¹⁰⁴

Many important issues confronted Mr. Donne, along with most other local and state HOLC chairmen, such as enhancing the marketability of the Corporation's bonds¹⁰⁵ and convincing local courts to slow the process of foreclosure and eviction to allow the HOLC to work.¹⁰⁶ Although various branches met with different degrees of success, the story did not end happily for Mr. Donne, who resigned from his position on December 18, 1933, in response to "charges of irregularity" against his administration of the HOLC, including patronage and imposing excessive appraisal fees.¹⁰⁷

Loan Aid, CHI. TRIB., Aug. 31, 1933, at 24; 7 *State Offices Ready to Lend On Homes Today*, CHI. TRIB., Aug. 29, 1933, at 22. The New York Times was also not above this enthusiastic championing of New Deal victories. See 318 *Foreclosures in Homes Averted; Activities in New York State are Detailed by the Home Owners' Loan Corporation*, N.Y. TIMES, Oct. 17, 1933, at 39.

¹⁰² U.S. Loans Save Foreclosure on Homes of 3,000, CHI. DAILY TRIB., Aug. 15, 1933, at 7.

¹⁰³ *Id.*

¹⁰⁴ Al Chase, *Threatens Suit Against 25 For Home Loan Fees*, CHI. DAILY TRIB., Aug. 15, 1933, at 22.

¹⁰⁵ See Philip Hampson, *Home Loan Bond Market Arouses Banks' Interest*, CHI. DAILY TRIB., Aug. 20, 1933, at A8; *Making Market for Home Bonds Proves Hard Job*, CHI. DAILY TRIB., Aug. 23, 1933, at 24; *U.S. Will Create Market for New Home Loan Bonds*, CHI. DAILY TRIB., Sept. 5, 1933, at 24. Additionally, bond companies, such as Chas. E. Quincy and Co., advertised offerings of HOLC eighteen-year, 4 percent bonds which would materialize in 1951. *Display Ad 24*, CHI. DAILY TRIB., Sept. 11, 1933, at 24. Even a woman's apparel store, the Boston Store, advertised to bondholders of the HOLC that said bonds would be accepted at par value with the purchase of merchandise. *Display Ad 69*, CHI. DAILY TRIB., Jan. 27, 1935, at D11.

¹⁰⁶ See Al Chase, *Building-Loan Delay is Urged on Foreclosure*, CHI. DAILY TRIB., Oct. 3, 1933, at 26; Al Chase, *Chancellors and H.O.L.C. Head To Discuss Foreclosure Situation*, CHI. DAILY TRIB., Aug. 20, 1933, at A12; Al Chase, *Municipal Court Head Promises Home Owner Aid*, CHI. DAILY TRIB., Aug. 22, 1933, at 22; *Home Loan Head Asks Halt in Foreclosures if U.S. Aid is Sought*, CHI. DAILY TRIB., Oct. 21, 1933, at 26.

¹⁰⁷ *Donne Removed as Manager of Home Loan Here*, CHI. DAILY TRIB., Dec. 19, 1933, at 1.

Officials from Washington and the new director of the local HOLC restructured the Chicago branch; no criminal charges were brought.¹⁰⁸

While the local branches fought the daily battle of saving the American people from foreclosure one house at a time, a larger project was being carried on at the national level. One section of the Home Owners' Loan Act, added by the Senate Committee on Banking and Currency, required the formation of uniform rules for appraisal throughout the United States.¹⁰⁹ As C. Lowell Harriss, an historian of the Home Owners' Loan Corporation writing in the 1950s, identified, "the success of the HOLC . . . hinged on its appraisal policies."¹¹⁰ Appraising properties above their real value would expose the Corporation to great risk in the event of foreclosure of an undervalued property. Below market valuation of a property would cause unfair denials of applications otherwise entitled to assistance.

The appraisers' greatest hurdle was to decipher the nuances of local land values. This challenge led the HOLC to hire appraisers from the localities. "Centralization with full-time appraisers was undesirable, since familiarity with local conditions was essential."¹¹¹ So, "part-time fee appraisers" chosen by state managers in the many local HOLC offices were hired; they received a payment of \$5 per home regardless of a property's appraised value, to discourage inaccurate valuations for the purpose of payment.¹¹² Full-time appraisers were retained in large cities and to oversee the work of part-timers.¹¹³

To supervise a diverse system of appraisals spanning the nation, "uniform procedures and standards had to be established and enforced."¹¹⁴ By January 1934, appraisal standards were in place; a form was created with ninety-eight questions.¹¹⁵ It contained "a warning against willful overvaluation" and

¹⁰⁸ Al Chase, *Zander Named HOLC Manager To Clean House*, CHI. DAILY TRIB., Dec. 20, 1933, at 7. Following an investigation, Mr. Donne was able to avoid criminal charges. *Ousts 8 Donne HOLC Men, More Heads May Fall*, CHIC. DAILY TRIB., January 4, 1934, at 6.

¹⁰⁹ HARRISS, *supra* note 30, at 11. In the same New York Times article reporting passage of the Home Owners' Loan Act, a review of the new law by the Federal Home Loan Bank Board Chairman William F. Stevenson acknowledged: "In view of present unsettled conditions as to real estate values, the appraisal problem is a difficult one for the corporation." *Moratorium*, *supra* note 70, at 8.

¹¹⁰ HARRISS, *supra* note 30, at 41.

¹¹¹ *Id.*, at 42.

¹¹² *Id.* at 43 & n.4.

¹¹³ *Id.* at 43-44. "By June 1935, over 6,000 applications for appraisal positions had been examined and rated, about 1,300 qualifying for salaried, and 2,700 for fee, positions." *Id.* at 44.

¹¹⁴ *Id.* at 43 (noting that regulations were prepared on hiring procedures, through consultation with the American Institute of Real Estate Appraisers).

¹¹⁵ *Id.* at 45. Examples of questions included: "give the building code classifications, if any, the material used (brick, frame, stucco, and the like), the quality of the structure (cheap, fair, good or expensive), the number and kinds of rooms, repairs necessary to protect the structure." *Id.* at 46.

required the appraisers to provide photographs of the property, a location map, dimensions of the lot and additional information so supervisors could “visualize the territory surrounding the subject property.”¹¹⁶

The HOLC appraisers established a rating system of four color-coded categories from the most desirable neighborhoods, color-coded green, to the least desirable neighborhoods, color-coded red.¹¹⁷ The significance of a property receiving any one of the four ratings was understood uniformly throughout the country. This standardized system allowed informed business decisions as to the worthiness of investments anywhere in the nation, regardless of familiarity with the nuances of local property values. As Kenneth T. Jackson has identified: “The ultimate aim was that one appraiser’s judgment of value would have meaning to an investor located somewhere else.”¹¹⁸ Local appraisers implemented the system throughout the nation, first dividing cities and then giving each section the requisite color-coding.¹¹⁹

A terrible corollary to the benefits of uniformity was the institutionalization and perfection afforded to the invidious process of “redlining”—the very term a product of the HOLC color-code red for least desirable properties.¹²⁰ Never before could mortgage investors determine the racial or ethnic makeup of a given neighborhood with such certainty. Discrimination in mortgage-lending decisions became a tragic science under the uniform appraisal practices of the HOLC.¹²¹

One significant difference between the Home Owners’ Loan Corporation and other New Deal agencies was in the former’s ability to avoid constitutional controversy. While agencies such as the National Recovery Administration and the Agricultural Adjustment Administration were embroiled in the titanic constitutional struggle between President Roosevelt and a conservative Supreme Court bloc, immortalized in history

¹¹⁶ *Id.* at 45.

¹¹⁷ JACKSON, *supra* note 16, at 197–98. The four categories from best (“A”) to worst (“D”) were as follows: The first grade (A) color-coded green properties were “new, homogenous and ‘in demand as residential locations in good times and bad’”; the second grade (B) color-coded blue properties were “‘still desirable’ areas that had ‘reached their peak,’ but were expected to remain stable for many years”; the third grade (C) color-coded yellow properties were “definitely declining”; and the fourth grade (D) color-coded red properties were “areas ‘in which the things taking place in [category] C areas have already happened.’” *Id.*

¹¹⁸ *Id.* at 197.

¹¹⁹ *See id.*

¹²⁰ *Id.*

¹²¹ *See id.* at 197–203 (describing how redlining practices were perfected through the information provided by the HOLC). *But see* Amy E. Hillier, *Redlining and the Home Owners’ Loan Corporation*, 29 J. URB. HIST. 4, 394–420 (2003) (arguing that discriminatory lending occurred in what were later identified as red-color coded neighborhoods well before the HOLC).

as the four horsemen of the apocalypse, the HOLC went about unscathed—but not unnoticed. The constitutionality of the HOLC was challenged in several cases brought to the Supreme Court.

Kay v. United States was the first challenge to the constitutionality of the Home Owners' Loan Act.¹²² Gertrude Kay was the holder of a second mortgage against a New York home whose owner applied for and received HOLC assistance.¹²³ Ms. Kay agreed to accept the bonds of the HOLC in exchange for repayment of the mortgage.¹²⁴ While “executing the consent to accept bonds” to satisfy the outstanding principal, the defendant falsely inflated the amounts outstanding, claiming the total sum of \$1240 was owed, when the actual total amount due was \$435.¹²⁵ In challenging her conviction for “knowingly making false statements with intent to mislead”¹²⁶ Ms. Kay argued that Congress lacked the authority to create the HOLC.¹²⁷ In a unanimous decision¹²⁸ upholding the conviction, written by Chief Justice Charles Evans Hughes, the court avoided the issue of the HOLC's constitutionality.¹²⁹ The Chief Justice held that the petitioner lacked standing: “When one undertakes to cheat the Government . . . by false statements, he has no standing to assert that the operations of the Government in which the effort to cheat or mislead is made are without constitutional sanction.”¹³⁰

The next opportunity the Supreme Court had to review the constitutionality of the HOLC, *Graves v. New York ex rel. O'Keefe*, involved the question of whether a state tax on an employee of the HOLC represented “an unconstitutional burden upon the federal government.”¹³¹ The majority opinion found the state tax on the income of the federal

¹²² 303 U.S. 1 (1938).

¹²³ *Id.* at 5.

¹²⁴ *Id.*

¹²⁵ *Id.*

¹²⁶ *Id.* at 5–6.

¹²⁷ *Id.* at 6.

¹²⁸ Justice Cardozo took no part in the consideration and decision. *Id.* at 10.

¹²⁹ *Id.* at 6.

¹³⁰ *Id.* In the decision below, the Second Circuit Court of Appeals held that the creation of the HOLC was within the constitutional power of Congress: “The power ‘to lay and collect Taxes * * * and provide for the * * * general welfare of the United States * * * is explicitly conferred and necessarily contains the implied power of appropriation.’ *United States v. Kay*, 89 F.2d 19, 21 (1937). Additionally, “[t]he power ‘to borrow money on the credit of the United States’ is granted without express limitation.” *Id.* at 21. The Second Circuit Court of Appeals then looked to a pattern of cases holding constitutional “the expenditure of public funds for a public purpose” and, after briefly noting the \$21 billion in outstanding mortgage debt in 1933, concluded the HOLC was created for a “national public purpose . . . to relieve the distress of foreclosure.” *Id.* at 22.

¹³¹ 306 U.S. 466 (1939).

employees constitutional.¹³² The decision, drafted by Justice Harlan Stone, asserted the constitutionality of the HOLC.¹³³ With no argument, the Court cited its decision in *Kay v. United States*, where the court avoided the issue entirely, to “assume that the creation of the Home Owners’ Loan Corporation was a constitutional exercise of the powers of the federal government.”¹³⁴ Perhaps this decision, coming after Justice Owen Roberts’s famous “switch in time” in *West Coast Hotel v. Parish* was just another example of the new Supreme Court approach, deferential to economic regulation.¹³⁵

However, in dissent, Justice James Clark McReynolds and Justice Pierce Butler, staunch conservatives and intransigent enemies of the New Deal, implicitly supported the constitutionality of the HOLC.¹³⁶ They took issue with the majority opinion’s conclusion that a state tax on employees of a federal agency was not an “unconstitutional burden” on the federal agency itself but merely “a non-discriminatory tax on income applied to salaries [of a HOLC employee] at a specified rate.”¹³⁷ This view, according to the dissenters, overruled several precedents immunizing federal employees from state taxation.¹³⁸ In their disagreement with this approach, these conservative anti-New Deal justices accepted—in fact, proclaimed—that the Home Owners’ Loan Corporation was an “instrumentality of the United States” thereby assuming its constitutionality.¹³⁹

Although a majority of the Supreme Court allowed state taxation on employees of the HOLC, the Corporation itself was insulated from paying state transfer taxes on the recording of its mortgages in *Pittman v. Home Owners’ Loan Corporation of Washington*.¹⁴⁰ The court took the opportunity again in this unanimous decision to “assume . . . that the creation of the Home Owners’ Loan Corporation was a constitutional exercise of the congressional power,” relying on *Graves*.¹⁴¹

¹³² *Id.* at 486.

¹³³ *Id.* at 475–77.

¹³⁴ *Id.* at 477.

¹³⁵ 300 U.S. 379 (1937).

¹³⁶ *Graves v. New York ex rel. O’Keefe*, 306 U.S. 466, 492 (1939) (Butler, & McReynolds, JJ., dissenting).

¹³⁷ *Id.* at 480, 486 (majority opinion).

¹³⁸ *Id.* at 492 (Butler, & McReynolds, JJ., dissenting). The Justices relied on several cases, including *New York ex rel. Rogers v. Graves*, 299 U.S. 401 (1937), and *Brush v. Commissioner*, 300 U.S. 352 (1937), both from the previous term, and *Dobbins v. Commissioners of Erie County*, 41 U.S. 435 (1842). *Id.*

¹³⁹ *Id.*

¹⁴⁰ 308 U.S. 21 (1939).

¹⁴¹ *Id.* at 32. Justice Butler took no part in the decision. *Id.* at 33.

While one challenge to the constitutionality of certain aspects of the Home Owners' Loan Act would be successful,¹⁴² the Corporation as a whole was held to be a constitutional entity by both liberal and conservative justices alike. So, although the Supreme Court did not ignore the constitutional issues regarding the HOLC, invariably its existence was protected and its constitutionality assumed. In light of the greater struggle over the New Deal, the seeming indifference of the Supreme Court is remarkable. However, considering the HOLC was criticized—with more than some truth—as corporate welfare, Supreme Court compassion for the agency is not surprising. In fact, the economic philosophy inherent in the Home Owners' Loan Corporation, bailing out lenders with massive capital which would in turn help borrowers, fits squarely within the pro-business Supreme Court philosophy made famous in *Lochner v. New York*.¹⁴³ Indeed, the four horsemen may have found, in the pro-business Home Owners' Loan Act, legislation that even they supported.

The lending record of the Home Owners' Loan Corporation exhibits its pervasiveness in 1930s American society. The Corporation received 1,886,491 applications for home mortgage refinances between June 13, 1933, and June 27, 1935, which was the last day for applications.¹⁴⁴ Over 50 percent of these loans were closed by the HOLC with a total outlay of mortgage money exceeding \$3 billion.¹⁴⁵ To place the impact of the HOLC in perspective, of the “nonfarm owner-occupied dwellings in the country” that were mortgaged at the outset of 1933, “the Corporation made loans on more than one out of every five.”¹⁴⁶ Thus, 20 percent of all eligible homes

¹⁴² On one occasion, the Supreme Court found one section of the Home Owners' Loan Act unconstitutional—or at least interpreted the act so as to avoid constitutional conflict. *Hopkins Fed. Sav. & Loan Assoc. v. Cleary*, 269 U.S. 315 (1935). In that case, the banking commission of Wisconsin brought suit against the Hopkins Street Building and Loan, attempting to annul the conversion of that entity into a federal savings and loan. *Id.* at 327–28. Conversion was authorized by the Home Owners' Loan Act, 48 Stat. 128, 132 (1933). *Id.* at 330–331. The petitioners argued that this “transmutation” did not require state authorization. *Id.* at 330. The state argued it was implied in the Act that “no conversion was to be permitted in contravention of local laws” otherwise, that section of the act was “void under the Tenth Amendment as an unconstitutional trespass upon the powers of the state.” *Id.* at 332. In an opinion drafted by Justice Cardozo, the Court sided with the state, citing the Tenth Amendment argument. *Id.* at 327, 335, 343.

¹⁴³ 198 U.S. 45 (1905).

¹⁴⁴ HARRISS, *supra* note 30, at 21–22 tbl.2.

¹⁴⁵ *Id.* at 29. The most common reason for rejecting applications was “inadequate security” meaning the home did not appraise at a high enough value to justify the loan. *Id.* at 24 tbl.3. An additional 90,000 applications were withdrawn by the homeowner, probably as a result of a restructuring of the debt by the borrower and lender. *Id.*

¹⁴⁶ *Id.* at 31. The average loan amount was \$3,093.00. *Id.* at 30 tbl.4. The Corporation reached its peak lending month in June, 1934 when it closed 82,000 loans. *Id.* As far as disbursement of HOLC

in the United States were mortgaged to the Home Owners' Loan Corporation.

The Home Owners' Loan Corporation impacted 1930s society and the future of the American mortgage in significant ways. From the perspective of the day, the contributions of the HOLC were very real. The statistic of one in five eligible homes in America that received a HOLC mortgage represented one million families that did not suffer the economic tragedy, public humiliation and emotional turmoil of forcible eviction from a home.¹⁴⁷ The magnitude to which the lives of these one million families were touched by this organization cannot be discounted. One million families were not afraid to receive their mail each day for fear of the eviction notice; one million families did not suffer the humiliation of carrying furniture and belongings out of their homes as neighbors watched; one million families were not forced to move to a different neighborhood, into cramped houses with relatives and to transfer children to new schools; one million families did not have their credit destroyed and a sense of utter failure and the corresponding depression, addictions and petty crimes that often followed.

From the perspective of history, the Home Owners' Loan Corporation is one of the great success stories of the New Deal. Although historically inconspicuous¹⁴⁸ and overshadowed by more prominent New Deal agencies and the federal mortgage organizations that followed, the HOLC holds an important place in American mortgage history. As historian Kenneth T.

mortgage money throughout the United States, the state of Ohio saw the most loans made, while New York received the most money in terms of dollars. *Id.* at 32 tbl.5. The HOLC made loans in all of the 48 states, the District of Columbia, and the territories of Alaska, Hawaii and Puerto Rico. *Id.* at 32–33 tbl.5.

¹⁴⁷ *Id.* at 29. Obviously, some of the mortgages issued by the HOLC were foreclosed. Upon liquidation in 1951, 19.1 percent of the HOLC-issued mortgages were foreclosed, representing 194,134 properties. *Id.* at 75. (Table 19). Regardless, nearly 81 percent of formerly distressed mortgages were successfully saved, and countless others were renegotiated by the original lenders in response to the HOLC. *Id.*

¹⁴⁸ The HOLC is not quite as inconspicuous since the subprime mortgage market tumult. The 2008 financial crisis has politicians and financial observers climbing up to the New Deal attic, dusting off and revisiting the Home Owners' Loan Corporation like at no other time in history. Senator Hillary Clinton "proposed a new Home Owners' Loan Corporation" in an Op-Ed letter to the Wall Street Journal entitled "Let's Keep People in Their Homes." Hillary Rodham Clinton, *Let's Keep People in Their Homes*, WALL ST. J., Sep. 25, 2008, available at <http://online.wsj.com/article/SB122230767702474045.html>. "The original HOLC returned a profit to the Treasury and saved one million homes. We can save roughly three times that many today." *Id.* HOLC nostalgia is bi-partisan; Senator John McCain championed Senator Clinton's proposal during his presidential campaign. Jackie Calmes, *Long History for Proposal by McCain on Mortgages*, N. Y. TIMES, Oct. 8, 2008, available at <http://www.nytimes.com/2008/10/08/us/politics/08mortgage.html>.

Jackson has identified, the HOLC “introduced, perfected and proved in practice the feasibility of the long-term self-amortizing mortgage with uniform payments spread over the whole life of the debt.”¹⁴⁹ The HOLC showed that amortization would prevent, or at least reduce the likelihood of a future mortgage money crunch. Additionally, standardized appraisal practices established by the HOLC would become the model for national land appraisal standards throughout the United States.¹⁵⁰ Remarkably, the Home Owners’ Loan Corporation achieved all of this with little cost to the federal budget. Upon congressionally-ordered liquidation in 1951 and a final accounting, the HOLC ultimately turned a slight profit.¹⁵¹

The Home Owners’ Loan Corporation achieved an even more intangible transformation, although no less significant. This unassuming Corporation showed the federal government that it could successfully take over, manage, and even originate mortgages. Standardized procedures unknown in 1933 arose out of necessity in the day-to-day housekeeping of a federal mortgage company. Boilerplate form mortgages, assignments and satisfactions were created.¹⁵² Procedures were established for originating loans, foreclosing loans and managing foreclosed properties. These practices and policies developed in a trial and error sort of way typical of the New Deal.¹⁵³ These experiences opened minds to the potential of future federal

¹⁴⁹ JACKSON, *supra* note 16, at 196.

¹⁵⁰ *Id.* at 197. David Kennedy likens the standardization of appraisal methods by the HOLC to the SEC’s standardization of accounting procedures in the securities industry. KENNEDY, *supra* note 1, at 369.

¹⁵¹ HARRISS, *supra* note 30, at 6, 159–62 (estimating that the HOLC profited \$14 million). Of course, numerous factors impacted this estimate. *Id.* at 160–62. For example, the original \$200 million capital advance from the U.S. Treasury came at no cost to the Corporation. *Id.* at 160. Additionally, the HOLC enjoyed many free services as a government agency, such as postage, and did not make Social Security payments. *Id.* at 161–62. However, had Congress not pressured the HOLC to sell its loans to private institutions, the Corporation would have enjoyed still greater profits.

¹⁵² Copies of the form documents used by the HOLC can be found in the land records of counties across America. For just one example, look no further than the premises located at 1244 East 94th Street, Brooklyn, New York—the home of “Muriel A. Maas and Charles F. Maas, her husband.” On September 25, 1935, the Maas’s mortgaged their home for the sum of \$3,533.54 to the Home Owners’ Loan Corporation, with offices at the New Post Office Building in Washington, D.C. A copy of this refreshingly succinct, four-page (19 paragraphs) mortgage, recorded on Oct. 4, 1935, can be found in the Kings County Clerk’s Office in reel 5961 page 1807. If you are wondering what happened to this mortgage (HOLC loan number 30A-43958), it was assigned to the Dime Savings Bank of Brooklyn on Jan. 27, 1950. (The assignment was recorded in the Kings County Clerk’s Office on Apr. 23, 1950, in reel 5961 page 1815). The HOLC assigned this mortgage, and thousands of others to local banks at this time, in anticipation of the corporation’s liquidation in 1951. Fear not—this mortgage story has a happy ending. Mr. and Mrs. Maas paid off their mortgage and received a satisfaction on Apr. 3, 1950. (The satisfaction was recorded in the Kings County Clerk’s Office on Apr. 23, 1950, in reel 5961 page 1844).

¹⁵³ For more on these procedures, see HARRISS, *supra* note 30, at 14, 71, 101.

mortgage enterprises in that golden age of government-sponsored economic experimentation.

V. THE NATIONAL HOUSING ACT OF 1934

The May 15, 1934, issue of *The New York Times* published the "Text of President Roosevelt's Bill for Building and Repair of Homes to Aid Recovery."¹⁵⁴ By now, readers of the *Times* were familiar with the weekly output of New Deal legislation passed to quell the tide of the Depression, unemployment, and impending financial ruin. This new law was no ordinary stopgap solution to relieve the crisis. It seems unlikely that commuters on the New York City subway or Washington's senators and congressmen all reading their morning papers understood that this piece of legislation would revolutionize the way in which their children and grandchildren would buy homes for the next seventy years. This new bill, "The National Housing Act,"¹⁵⁵ was the birth certificate for the Federal Housing Administration (FHA) and the blueprint for a national mortgage market. The Federal Housing Administration—along with other New Deal institutions such as Social Security, the Federal Deposit Insurance Corporation and the Securities and Exchange Commission—would become so entrenched in American society that it is inconceivable to imagine an America without it.

Historian Kenneth T. Jackson identified the task assigned to the draftsmen of the National Housing Act by FDR was to create legislation that would "stimulate building without government spending and that would rely instead on private enterprise."¹⁵⁶ Home ownership was of great importance to President Roosevelt.¹⁵⁷ Thus, FDR assigned top members of his Brain Trust to achieve the task.¹⁵⁸ Their goals were laid out in the preamble to the National Housing Act: "to improve conditions with respect to home financing . . . and to eliminate the necessity for costly second

¹⁵⁴ *Text of President Roosevelt's Bill for Building and Repair of Homes to Aid Recovery*, N.Y. TIMES, May 15, 1934, at 36.

¹⁵⁵ *National Housing Act Hearings of 1934*, *supra* note 28.

¹⁵⁶ JACKSON, *supra* note 16, at 203.

¹⁵⁷ Historian Jordan A. Schwarz has written: "Roosevelt had a passionate interest in homeownership, viewing it as a 'right' for the individual American and 'a guarantee of social and economic stability' for the nation." SCHWARZ, *supra* note 1, at 86.

¹⁵⁸ JACKSON, *supra* note 16, at 203 (identifying the draftsmen of the National Housing Act as Winfield Riefler, Miles Lanier Colean, Francis Perkins, Marriner Eccles, Averell Harriman, and Henry Wallace). Much time was spent analyzing potential solutions to the housing problems: "The President's Emergency Commission on Housing spent much of 1933 and early 1934 studying the problem." OLSON, *supra* note 1, at 96.

mortgage financing.”¹⁵⁹ How would these New Dealers create a national mortgage market with little cost to the government? Building on their experience with the Home Owners’ Loan Corporation, the National Housing Act draftsmen constructed their plan around five intertwined concepts.¹⁶⁰

Entered into the record at the outset of the National Housing Act hearings before the Senate Banking and Currency committee was a study of the American “debt problem” titled “The Internal Debts of the United States.”¹⁶¹ Accompanying the pamphlet was a letter from John H. Fahey, chairman of the Federal Home Loan Bank Board and former head of the HOLC, which predicated a “return to prosperity” on solving “the urban mortgage problem.”¹⁶² The pamphlet summarized the five central concepts behind the National Housing Act.¹⁶³

The first step toward recovery in the national mortgage market was to bring immediate relief to unemployment in “the building trades.”¹⁶⁴ To that end, the pamphlet proposed “a Nationwide program of home modernization” consisting of an advertising campaign to encourage home improvements and a government corporation to insure loans made from private banks so homeowners could pay to finance home improvement projects.¹⁶⁵ These projects would increase the value of homes and create jobs for the multitudes of unemployed carpenters, plumbers, electricians, cement workers, plasterers, latherers, painters, and roofers, just to name a few of the trades sitting on the sidelines awaiting employment. The pamphlet recognized the home improvement encouragement proposal was only a

¹⁵⁹ *National Housing Act Hearings of 1934, supra note 28.*

¹⁶⁰ *Id.* at 14.

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ *See id.*

¹⁶⁴ *Id.* Several witnesses, particularly those involved with drafting the legislation, highlighted unemployment as the key problem causing the Depression and that the new legislation hoped to ameliorate it. Marriner S. Eccles began his testimony concerned with “the unemployment problem” and opined: “Practically every other problem goes back to that problem.” *Id.* at 153. Secretary of Labor, Frances Perkins, testified on behalf of the Department of Labor “merely to canvass the need for this bill.” *Id.* at 166. She stressed that unemployment relief, “one of the most essential features of the recovery program,” was the goal of this new legislation. *Id.* at 166. Harry L. Hopkins, the Federal Emergency Relief Administrator focused on the unemployment problem as well. *Id.* at 177–80. “Somewhere between one third and one fourth of all the families on relief represent workers in the building trades. We are not going to get these people to work unless we can get some of the private money out.” *Id.* at 177. Hopkins recognized “[t]he modernization program itself . . . will immediately put a great many people to work.” *Id.* at 178.

¹⁶⁵ *Id.* at 14.

temporary “stimulant” to the unemployment problem.¹⁶⁶ Re-employment was an attractive justification for legislation and a favorite of congressmen since it was simple to understand and explain to voters. Perhaps the Housing Act draftsmen used it as an enticement to pass the bill which contained their ultimate plan—revolutionizing the home mortgage industry.

The second step in the plan was to encourage the creation of “a sound [mortgage] instrument” with amortization, or “periodic” payments of the entire mortgage balance over a long period of time.¹⁶⁷ Borrowers could thereby gradually pay off the loan from their monthly salaries without confronting a balloon payment every few years, and an ensuing scramble to refinance the expiring mortgage.¹⁶⁸ Steady, equal payments similar to rent reduced the likelihood of mortgage foreclosures because homeowners would grow accustomed to the mortgage payment as one of their usual household expenses. Creating a fixed monthly mortgage payment as a part of a homeowner’s budget would enhance the certainty lenders felt that full satisfaction of the mortgage debt would follow. Thus, lenders could risk issuing larger mortgages on higher percentages of the value of homes and thereby lend to an increasing number of Americans who had less money for their down payment. The confidence banks felt in the return on their loans would bring more banks into the field of mortgage lending.¹⁶⁹

The third step was to increase the security lenders felt in the soundness of their mortgage investments. Thus, the National Housing Act created a federal agency, called the Home Credit Insurance Corporation¹⁷⁰ to “insure amortized mortgages . . . on owner occupied homes . . . when presented by approved financial institutions.”¹⁷¹ This corporation would insure mortgages that met certain requirements, such as amortization, maximum interest rates, and a minimum amount of money down toward the overall value of the premises.¹⁷² The insurance would guarantee a return on lenders’ investments in the event of foreclosure.¹⁷³ In theory, the corporation would pay for this insurance through premiums charged to the borrowers; thus, it

¹⁶⁶ *Id.* at 16.

¹⁶⁷ *Id.* at 17.

¹⁶⁸ *Id.*

¹⁶⁹ For more on improving mortgage terms, see generally Peter M. Carrozzo, *Marketing the American Mortgage: The Emergency Home Finance Act of 1970, Standardization and the Secondary Market Revolution*, 39 REAL PROP. PROB. & TR. J. 765 (2005).

¹⁷⁰ *National Housing Act Hearings of 1934*, *supra* note 28, at 1.

¹⁷¹ *Id.* at 2.

¹⁷² *Id.*

¹⁷³ *Id.*

would be of minimal cost to taxpayers.¹⁷⁴ A fourth step in this plan, and a clear corollary of the third step was to continue the work already begun by the HOLC appraisers to establish a national system of real estate appraisal.¹⁷⁵ The concept of definite appraisal standards, along with federal insurance against financial loss in the event of foreclosure, would increase the security and certainty lenders felt in their investments and bring more lenders into the field.¹⁷⁶

The fifth and final step in overhauling the American mortgage industry was “to introduce the element of liquidity.”¹⁷⁷ The National Housing Act allowed for the creation of “national mortgage associations” which were private mortgage lending institutions that would engage in “purchasing, selling[,] and otherwise dealing in credit instruments secured by such mortgages.”¹⁷⁸ Sound mortgage instruments would be “safe and acceptable investments for mortgage associations . . . [who would] purchase such insured mortgages from local institutions at a favorable price and thus release fresh funds for local investment.”¹⁷⁹

This last step is, perhaps, the most revolutionary proposal in the legislation. These mortgage associations were the first national institutions to engage in the business of buying and selling mortgages as traded commodities. The concept of a mortgage market embodied in these national mortgage associations ultimately would liberate and reinvent mortgages as new investment vehicles; a deluge of new money would flood the mortgage industry and democratize home ownership, making it accessible to an unprecedented number of Americans.¹⁸⁰ Safe investment opportunities would be created for upper- and middle-class Americans whose savings would be invested in packaged mortgages.¹⁸¹ This commoditization of the American mortgage and the corresponding democratization of home ownership, ushered in by the National Housing Act, are still felt today in our nation of homeowners and inexpensive mortgages allowing Americans to live in and on their greatest asset.

¹⁷⁴ *Id.* “Such insurance . . . [would] be self-supporting and involve no greater cost to mortgagors or mortgagees than that needed to cover the risk involved plus necessary administration expenses.” *Id.* at 2–3.

¹⁷⁵ *Id.* at 16.

¹⁷⁶ *Id.* at 16–17.

¹⁷⁷ *Id.* at 19.

¹⁷⁸ *Id.*

¹⁷⁹ *Id.*

¹⁸⁰ See generally Carrozzo, *supra* note 169, at 799–805. The balance of the twentieth century, and beyond, saw this movement towards commoditizing mortgages. *Id.*

¹⁸¹ *Id.*

This five-step plan would create “a sound mortgage market.”¹⁸² The enormity of the mortgage problem was recognized: “Mortgage debts comprise one of the largest single classifications in our national-debt structure.”¹⁸³ The Home Owners’ Loan Corporation, intended merely to handle “extreme emergency cases” could not be looked to as a permanent solution unless the federal government intended “to take the radical step of assuming the entire mortgage-debt burden.”¹⁸⁴ This ambitious five-step plan of the National Housing Act was nothing short of a complete overhaul of the flawed mortgage system in existence at the outset of the Depression.

The genius of FDR’s mortgage policies was in his appreciation of the need for federal spending that would assist big business. Similar to the HOLC, the NHA brought relief to lenders. In fact, every phase in the plan brought direct assistance for the lending institutions, with indirect benefits to borrowers. The mortgage insurance system and national appraisal standards would reduce the risk assumed by banks in lending money. A market for mortgages would increase lenders’ liquidity. By directly assisting banks by reducing the cost of doing business, the National Housing Act would indirectly help borrowers by reducing the cost and increasing the availability of mortgage money.¹⁸⁵ This New Deal for America’s banks is an unappreciated and inconspicuous aspect of President Roosevelt’s legacy.¹⁸⁶

The various steps worked best together, since they were mutually dependent in several ways. The plan to purchase mortgages forced the market to bring about improved mortgage instruments because only long-term amortized mortgages of no more than 80 percent of the value of the home would be purchased.¹⁸⁷ The creation of the mortgage associations finished an interdependent assembly line process of mortgage lending;

¹⁸² *National Housing Act Hearings of 1934*, *supra* note 28, at 16.

¹⁸³ *Id.* A table cited in the pamphlet listed the current American home mortgage debt at \$21 billion, just \$5 billion short of the entire federal debt. *Id.*

¹⁸⁴ *Id.* Horace Russell of the Federal Home Loan Bank Board agreed: “Unless these results are accomplished the pressure for an indefinite extension of the Home Owners’ Loan Corporation to absorb the whole home-mortgage field . . . will be almost irresistible.” *Id.* at 71.

¹⁸⁵ Stewart McDonald, the first administrator of the Federal Housing Authority, explained the benefit to home buyers quite well in hearings before the House Committee on Banking and Currency in 1937: “I would say the greatest beneficiary [of the FHA] is the individual home buyer, whether he is buying a new home or one that has already been built. He is able to buy it on terms that are less harsh than ever before in the history of this country.” *Extension of Debentures Issued by Federal Housing Administration: Hearings on H.R.J. Res. 127 Before the H. Committee on Banking and Currency, 75th Cong. 6 (1937)* [hereinafter *National Housing Act Hearings of 1937*].

¹⁸⁶ For an excellent work that focuses on the manner in which the New Deal aided private businesses, including the banking industry, through such under-appreciated agencies as the Reconstruction Finance Corporation, *see generally* OLSON, *supra* note 1.

¹⁸⁷ *National Housing Act Hearings of 1934*, *supra* note 28.

available mortgage money would be used to originate sound mortgages that would be insured and then sold to mortgage associations to create new mortgage money, thus continuing the mortgage lending cycle in perpetuity.¹⁸⁸ This five-part plan created the “market for insured mortgages.”¹⁸⁹ The real benefits of this market would be felt when spread across the entire nation. The “Internal Debts” pamphlet describes “the inadequacy of local savings for mortgage financing in growing communities,” and the potential of a national market to funnel investment money from “settled communities . . . where there is less economic demand . . . [and] consequently a large available supply of mortgage funds.”¹⁹⁰

The prescience of the “Internal Debts” pamphlet,¹⁹¹ which laid out this plan, and the similarities between it and the proposed National Housing Act leads one to conclude that the authors of the pamphlet were either the same individuals who drafted the NHA, or at least very familiar with the draftsmen. The testimony that followed during the next week of NHA hearings would expand upon the simple yet revolutionary central themes of the pamphlet and the proposed housing bill: assisting employment through home improvement loans, creating a sound mortgage instrument, enhancing lender confidence through insurance for mortgages and a national appraisal system, and increasing liquidity by creating a market for these sound, safe, and (thus) tradable mortgages.

Testimony from several of the act’s draftsmen expanded upon the five-step plan behind the National Housing Act. Frank C. Walker, the Executive Director of President Roosevelt’s National Emergency Council was the first to testify.¹⁹² The National Emergency Council was directed to draft legislation that would “coordinate” the government’s attempts to remedy the “frozen condition” in the “mortgage market.”¹⁹³ Mr. Walker said the focus was “to stimulate private capital . . . [with] as little cost to the Government as possible.”¹⁹⁴

¹⁸⁸ *Id.* at 19–20.

¹⁸⁹ *Id.* at 19.

¹⁹⁰ *Id.* at 20.

¹⁹¹ *Id.* at 14.

¹⁹² *Id.* at 21. The National Emergency Council was created by President Roosevelt through Executive Order 6433-A, November 17, 1933. John T. Woolley and Gerhard Peters, The American Presidency Project [online]. Santa Barbara, CA: University of California (hosted), Gerhard Peters (database). Available from World Wide Web: <http://www.presidency.ucsb.edu/ws/?pid=14557>.

¹⁹³ *National Housing Act Hearings of 1934*, *supra* note 28, at 21.

¹⁹⁴ *Id.* at 22.

Winfield W. Riefler, economic advisor to FDR's Executive Council¹⁹⁵ and a draftsman of the National Housing Act, testified with intimate knowledge on the practical workings of the new law, focusing on the second phase of the plan, the creation of a sound mortgage document.¹⁹⁶ Mr. Riefler was a member of the Federal Reserve Board of Governors since 1923, on temporary loan to the Executive Council, who therefore understood the flaws in American mortgage lending.¹⁹⁷ After identifying the problems with the mortgage document as it existed at the outset of the Depression, Mr. Riefler explained the goals for the new legislation: "the introduction of a mortgage instrument which will be the soundest thing in the market . . . [and] to create a market for that kind of mortgage."¹⁹⁸

Mr. Riefler's description of a "model home mortgage instrument" involved several factors. Lenders originating these new mortgages must be "satisfactory to the board that is running this."¹⁹⁹ Mortgages must be amortized "not more than [twenty] years" on "owner-occupied" dwellings held by borrowers "who [are] of good financial standing in relation to the loan" and with limits on the interest rate "not more than 5 [percent]."²⁰⁰ These types of mortgages would qualify for the government insurance which Mr. Riefler went on to describe.²⁰¹ The "insurance feature" would be of no cost to the government.²⁰² Instead, it would be paid for by the borrower to the lender, who would then "transmit on to the insurance corporation a charge of usually 1 percent on the original outstanding value of the mortgage

¹⁹⁵ The Executive Council was a temporary body created by FDR under Executive Order 6202-a on July 11, 1933. John T. Woolley and Gerhard Peters, *The American Presidency Project* [online]. Santa Barbara, CA: University of California (hosted), Gerhard Peters (database). Available from World Wide Web: <http://www.presidency.ucsb.edu/ws/?pid=14478>. It may seem redundant to have an Executive Council and National Emergency Council with similar powers. However, President Roosevelt typically presided over a Byzantine system of agencies with overlapping powers. It is surprising the word "multi-tasking" did not arise in the 1930s to describe FDR's style of governing. Eventually, the redundancy was resolved by Executive Order 6889-A which consolidated the National Emergency Council and Executive Council, basically terminating the latter and moving both its members and duties under the umbrella of the former. John T. Woolley and Gerhard Peters, *The American Presidency Project* [online]. Santa Barbara, CA: University of California (hosted), Gerhard Peters (database). Available from World Wide Web: <http://www.presidency.ucsb.edu/ws/?pid=14769>. For more on FDR's governing style, see generally KENNEDY, *supra* note 1.

¹⁹⁶ JACKSON, *supra* note 16, at 203.

¹⁹⁷ *National Housing Act Hearings of 1934*, *supra* note 28, at 49.

¹⁹⁸ *Id.* at 50.

¹⁹⁹ *Id.* at 52.

²⁰⁰ *Id.* at 52-53.

²⁰¹ *Id.* at 53.

²⁰² *Id.* at 52.

each year.²⁰³ After payment of the premium, the government corporation “underwrites the whole transaction” until the mortgage is paid off, at which time the borrower gets a “dividend back” of the excess money paid toward the insurance.²⁰⁴ In the event of default, the lender could either foreclose or turn the property over to the government corporation in exchange for a “debenture, guaranteed by the Treasury,” representing payment of the principal and “not more than 3 [percent] interest, and due [three] years after the mortgage would have matured.”²⁰⁵

By paying banks reduced interest on their failed mortgage investments, lenders would not be encouraged to make a profit turning over “bad loans” to the government corporation.²⁰⁶ Lenders would be made whole by the corporation but not stand to profit; otherwise, the system would act as an inducement to “foreclose immediately on any technical delinquency.”²⁰⁷ The new corporation would act only as an “insurance fund” so that a new depression would not create a new mortgage money crash and force lenders out of business by the thousands.²⁰⁸

Ultimately, Mr. Riefler explained these improvements would create a “mortgage instrument . . . so promising that it will attract the lowest rate in the market” and therefore reduce the cost, by way of interest rates, to the borrower.²⁰⁹ Mr. Riefler, focusing on the fifth step of the plan—enhancing liquidity—explained how to maximize the full potential of these safe, standardized, and insured mortgage instruments, and truly create an unprecedented national mortgage market. Mr. Riefler and the other minds behind the NHA anticipated that the proposed “National Mortgage Associations . . . [would] be able to raise funds in the market, where funds are cheapest, selling their securities in the New York Security Market . . . provided those funds are loaned on insured mortgages.”²¹⁰ Only a sound mortgage could qualify for the insurance; once insured these associations could “collateral their bonds or debentures with insured mortgages approved

²⁰³ *Id.*

²⁰⁴ *Id.* at 52–53.

²⁰⁵ *Id.* at 53.

²⁰⁶ *Id.*

²⁰⁷ *Id.* at 54.

²⁰⁸ *Id.*

²⁰⁹ *Id.* at 56.

²¹⁰ *Id.* at 62. This concept of mortgage money moving from regions with a savings surplus to regions where savings and mortgage money were scarce and, thus, interest rates were high, was prevalent throughout the hearings. *Id.* Horace Russell, General Counsel of the Federal Home Loan Bank Board, testified: “This plan also contemplates that these [national mortgage] associations will get money from where it is in the financial centers and lend it where it is needed in other sections of the country.” *Id.* at 67.

under this plan.”²¹¹ Thus, a sound mortgage instrument was the prerequisite for the entire national mortgage market. Ultimately, Mr. Riefler and his advisors were promoting a true commoditized mortgage and the financial liberation of the national mortgage market.

Although Mr. Riefler’s enthusiasm for the revolutionary nature of the national mortgage associations comes through when reading the hearings, it seems the senators missed its potential entirely. His explanation as to how money would be moved on a national level is not met with any response. The witness explained that the current problem is the dependence of interest rates on “whether there is a plethora or a deficiency in local mortgage funds.”²¹² The new market would move funds from the East, where there is less growth “and [an] excess, usually, of funds available for saving[s]” to growing markets in the South and West where rates are high because of “a large proportionate demand for mortgage money, and the local supply of savings is not sufficient to take care of it.”²¹³ Unfortunately, just as Mr. Riefler reached a crescendo in his predictions for the financial potential unleashed by the future mortgage market, Senator Duncan Fletcher, the chairman of the hearings, broke for recess.²¹⁴ One can only wonder whether the assembled senators were focusing on the potential of the national mortgage market or on that day’s lunch menu.

Most of the witnesses that followed expanded on themes identified by Mr. Riefler and the “Internal Debts” pamphlet.²¹⁵ Marriner Eccles, Assistant Secretary of the Treasury, and a draftsman of the legislation, had real-life experience in banking,²¹⁶ he was a banker in Utah who remembered many sleepless nights in 1929 trying to keep his institution open.²¹⁷ The idea behind the legislation was “to induce . . . lending institutions to take up this credit expansion . . . , to get people to borrow.”²¹⁸ For banks to function—in fact, to survive—they needed to make loans, which “is the only way they [banks] can conduct profitable operations”²¹⁹

²¹¹ *Id.* at 62.

²¹² *Id.*

²¹³ *Id.* at 62–63.

²¹⁴ *Id.* at 63.

²¹⁵ *Id.* at 14.

²¹⁶ According to historian James S. Olson, Marriner Eccles “wrote” the National Housing Act. OLSON, *supra* note 1, at 96.

²¹⁷ Mr. Eccles “managed to keep his institution open through an agonizing day of massive withdrawals by depositors only by instructing his tellers to work in slow-motion, deliberately counting out sums in small denomination bills.” KENNEDY, *supra* note 1, at 68.

²¹⁸ *National Housing Act Hearings of 1934*, *supra* note 28, at 155.

²¹⁹ *Id.*

The first step in the strategy, the home improvement mortgage plan, received the attention of several witnesses. Secretary Eccles saw it as an integral part of the NHA targeting an immediate influx of money into the market.²²⁰ The government's role in the national mortgage market would be "to induce lending" through a national education campaign for borrowers regarding the National Housing Act and to increase lenders' comfort in their investment through mortgage insurance.²²¹ Harry L. Hopkins, Federal Emergency Relief Administrator, saw the National Housing Act as "the beginning [of] a great housing program in America . . . which will extend for many, many years."²²² The "modernization [plan]" would be the first step in stimulating the market.²²³ Chairman Fahey of the Federal Home Loan Bank Board identified the origins of the mortgages for home improvements plan.²²⁴ Overseeing the workings of the HOLC, Chairman Fahey saw firsthand the vast number of mortgage applications rejected by the Corporation.²²⁵ Many of these loans were for home improvements. The limited resources of the HOLC were earmarked for saving distressed mortgages and could not be diverted for home improvements.²²⁶ A clear opportunity for lending was lost.

The testimony of bankers and entrepreneurs provided the most fascinating commentaries on the potential of the new legislation. Charles A. Miller, formerly president of the Savings Bank Trust Company in New York City, and a banker since 1890, was manager of the New York Reconstruction Finance Corporation.²²⁷ To Mr. Miller, the key to the new mortgage market was amortization—something he had experience with since the Panic of 1892.²²⁸ In a colorful anecdote emblematic of the potential of amortized loans, Mr. Miller told of a farmer who offered "to buy [me] the best dinner there is to be had in the city of Utica" because the amortized loan he made through Mr. Miller's bank allowed him to eventually own his farm outright—a feat that had evaded this grateful farmer's father.²²⁹ This was Mr. Miller's experience with many customers; amortization gave American borrowers the hope that "in the future . . . although it may be very

²²⁰ See *id.* at 162.

²²¹ *Id.*

²²² *Id.* at 178.

²²³ *Id.*

²²⁴ *Id.* at 193.

²²⁵ *Id.* at 196.

²²⁶ *Id.*

²²⁷ *Id.* at 301.

²²⁸ *Id.* at 303.

²²⁹ *Id.*

slow work, we are going to pay our debts."²³⁰ Mr. Miller believed the myopic greed of lenders interested in the quick money that could be made in refinancing fees prevented amortization to take hold sooner.²³¹

Orrin C. Lester, Vice President of the Bowery Savings Bank in New York City, saw in the National Housing Act "the foundation . . . for building the kind of complete mortgage machinery that we need for the future."²³² He also predicted amortization would be the wave of the future.²³³ Nearly all of the bank officers who testified were unanimous in their support of amortization and their enthusiasm for the future of mortgage lending as a result of the NHA.²³⁴ As would be expected, several critics of the National Housing Act testified as well. Benjamin C. March, Executive Secretary of the People's Lobby, a left-of-center organization, testified in strong opposition to the legislation: "It is nonsense to think that you can resuscitate the building industry by guaranteeing bonds or mortgages."²³⁵ Having studied municipal housing in Europe, he believed the housing problem in America could only be solved if the government took over the building trades and provided the housing directly.²³⁶

I. Friedlander, the president of a savings and building association in Houston and Vice President of the United States Building and Loan League, criticized the threat of government subsidized competition from the new Corporation to the building and loan industry.²³⁷ However, he testified in favor of Title III of the National Housing Act which created the Federal Savings and Loan Insurance Corporation, which would guarantee deposits in savings and loans, just as the FDIC guaranteed deposits in national banks.²³⁸ The savings and loan industry was specifically geared toward lending money from savings. So, Mr. Friedlander argued, by increasing the confidence of people in the security of their deposits, money would flow

²³⁰ *Id.*

²³¹ *Id.*

²³² *Id.* at 312.

²³³ "[T]he tendency is going to be in the future to insist that there shall be a consistent program and plan to amortize all kinds of real-estate mortgages." *Id.* at 316.

²³⁴ Witnesses who held positive views of the National Housing Act included Harold Stone, President of the Onondaga County Savings Bank, in Syracuse, New York: "I like this bill primarily because it uses private money in the first instance and that it does not involve the forming of such a large organization as your Home Owners' Loan Corporation necessarily has to be and necessarily takes a long time to get in operation." *Id.* at 342-43. Also, Roger Steffan, Vice President of the National City Bank in New York City felt strongly about the amortization requirements. *Id.* at 346.

²³⁵ *Id.* at 144.

²³⁶ *Id.* at 146.

²³⁷ *Id.* at 227-28. The United States Building and Loan League was organized in 1892 for the purpose of regulating the Building and Loan industry. *Id.*

²³⁸ *Id.* at 236.

into the savings and loan industry the way it had for 103 years: “on a cooperative basis, accumulating funds into a common fund of savers and investors for the purpose of lending on homes.”²³⁹ The witness felt this was a practical, proven system that should have been bolstered. The HOLC had helped get the building and loan industry back on its feet.²⁴⁰ The witness felt the issuance of debentures in exchange for foreclosed mortgages made by commercial banks would not provide sufficient liquidity to attract investors and would injure the progress made by building and loans under the HOLC.²⁴¹

Likewise, Morton Bodfish, also from the United States Building and Loan League, testified against the formation of the NHA.²⁴² Instead, he proposed the HOLC be further capitalized, allowing it to underwrite the entire building and loan industry.²⁴³ This would allow immediate re-employment because “thousands of existing going institutions, with all the machinery [in place] . . . can make the loans.”²⁴⁴ Mr. Bodfish ominously painted the national mortgage associations as predators “roam[ing] up and down the land.”²⁴⁵ Finally, he predicted the National Housing Act was “the fundamental beginning of the nationalization or socialization of the whole urban mortgage business.”²⁴⁶

On June 28, 1934, President Roosevelt signed the National Housing Act.²⁴⁷ FDR discussed the new piece of housing legislation (“an act which I signed today”) in a fireside chat that evening reviewing the achievements of the Seventy-Third Congress. He identified the new legislation as a “definite step[] toward a national housing program.”²⁴⁸ The President summarized the NHA simply as an act “designed to encourage private capital in the rebuilding of the homes of the Nation.”²⁴⁹ Perhaps families gathered around their RCA radios did not understand the workings or potential of the new legislation. But, the reassuring, aristocratic voice of

²³⁹ *Id.* at 227.

²⁴⁰ *Id.* at 235.

²⁴¹ *Id.* at 236–38.

²⁴² *Id.* at 244.

²⁴³ *Id.* at 251.

²⁴⁴ *Id.*

²⁴⁵ *Id.* at 258.

²⁴⁶ *Id.* at 271. Of course, this distaste for socializing the mortgage industry did not sway Mr. Bodfish from encouraging the HOLC to underwrite the building and loan industry.

²⁴⁷ The American Presidency Project, Franklin D. Roosevelt, Fireside Chat (June 28, 1934) <http://www.presidency.ucsb.edu/ws/?pid=14703> [hereinafter *Fireside Chat*]. See National Housing Act, 12 U.S.C. § 1701 (1934).

²⁴⁸ *Fireside Chat*, *supra* note 247.

²⁴⁹ *Id.*

FDR comforted a nation of hopeful renters and families living with relatives that help, in the form of something called the National Housing Act, was on the way.

The New York Times reported the enactment of “the housing measure . . . designed to encourage the expenditure of [\$3,000,000,000] [three billion dollars] on the construction or renovation of homes.”²⁵⁰ Not coincidentally, the act was passed the same day national lumber dealers announced a 10 percent reduction in the cost of lumber and building materials.²⁵¹ In sum, “[t]he Housing Act” as reported in the Times, “makes possible loans of [\$1,000,000,000] [one billion dollars] by banks, building and loan associations, and other lending agencies for repairs and renovations with a guarantee of 20 percent by the government.”²⁵² An additional one billion dollars of mortgage money would be insured on new home mortgages that “do not exceed [\$16,000] nor 80 percent of the value of the property.”²⁵³

Prior to enactment, The New York Times, in conjunction with “officials of the National Emergency Council,” prepared a “catechism” listing four hypothetical scenarios where people could take advantage of the new legislation.²⁵⁴ The scenarios explained how to borrow money under the NHA for repairs and extensions to existing houses, or construction of new homes, and are particularly helpful in understanding the practical workings of the new legislation.²⁵⁵ One example deals with a building loan for construction of a new home costing \$10,000 for a hypothetical borrower named “George Brown.”²⁵⁶ After construction is complete, George Brown “goes to a building and loan association or a bank and puts a mortgage on his house, paying it off as any other mortgage . . . assisted by the long-term possibilities.”²⁵⁷ Addressing all of the options to borrower and lender alike, the article concludes with the question, “what can the bank do with this mortgage.”²⁵⁸ Although prior to enactment of the NHA, the answer would have been to wait for repayment, now, members of the Federal Home Loan

²⁵⁰ *Housing Bill Signed, Lumber Prices Cut; Early Building Revival is Predicted*, N.Y. TIMES, June 29, 1934, at 1.

²⁵¹ *Id.*

²⁵² *Id.*

²⁵³ *Id.*

²⁵⁴ *Housing Bill Gives 4 Home Loan Aids*, N.Y. TIMES, June 20, 1934, at 2.

²⁵⁵ *Id.*

²⁵⁶ *Id.* “Q.—George Brown wants to build a \$10,000 house. What does he do? A.—He goes to a member of the Federal Reserve System, authorized under the bill to make constructions loans for six months.” *Id.*

²⁵⁷ *Id.*

²⁵⁸ *Id.*

Bank System “can sell it to a National Mortgage Association . . . [which] can buy up mortgages, permitting banks to make more loans.”²⁵⁹

One article addressing the new legislation labeled it as “the most important mortgage legislation ever adopted by Congress.”²⁶⁰ According to Hugh Potter, president of the National Association of Real Estate Boards, the new legislation “will reorganize the country’s mortgage system along lines of longer-term loans and lower interest rates” and had the potential “to stabilize the flow of private capital into . . . the financing of home ownership.”²⁶¹ An editorial to *The New York Times* a few days before the passage of the NHA predicted the twenty-year amortized loan feature of the act would make payments feel “almost like rent.”²⁶² Ultimately, all of the authorities on the real estate market agreed: “[T]he government is clearly endeavoring to change the mortgage structure into a new form not hitherto in any general use in the United States.”²⁶³

VI. THE FEDERAL HOUSING ADMINISTRATION

Much of the success of the National Housing Act—in fact, of the entire New Deal—was dependent on an effective advertising campaign. President Roosevelt’s administration was the first to fully appreciate and take advantage of mass communication at a time when technology made it possible.²⁶⁴ James A. Moffett, the first director of the new Federal Housing Administration, created by the National Housing Act, announced in August his intention to begin a national campaign to assist lending.²⁶⁵ On August 5, 1934, only thirty-seven days after enactment of the National Housing Act, an article written by FHA director Moffett appeared in *The New York Times* promoting the FHA.²⁶⁶ Believing in the principle “that in the better housing of America lies prosperity and recovery for the American people,” he discussed what the FHA hoped to contribute toward achieving said prosperity.²⁶⁷

²⁵⁹

Id.

²⁶⁰

Mortgage Stability Seen in Housing Act, N.Y. TIMES, June 26, 1934, at 36.

²⁶¹

Id.

²⁶²

Insured Mortgage Serves Vital Need, N.Y. TIMES, July 15, 1934, at RE1.

²⁶³

Id.

²⁶⁴

See, e.g., LAWRENCE W. LEVINE & CORNELIA R. LEVINE, *THE PEOPLE AND THE PRESIDENT: AMERICA’S CONVERSATION WITH FDR* (2002); GRAHAM J. WHITE, *FDR AND THE PRESS* (1979); Betty H. Winfield, *The New Deal Publicity Operation: Foundation for the Modern Presidency*, 61 JOURNALISM QUARTERLY 40, 218 (1984).

²⁶⁵

James A. Moffett, *Vast Federal Housing Program Set Out*, N.Y. TIMES, August 5, 1934, at 21.

²⁶⁶

Id.

²⁶⁷

Id.

Primarily, the mortgage division of the FHA²⁶⁸ would take longer to set up, due to “its wide ramifications and necessity for the most careful preliminary planning.”²⁶⁹ However, once the mortgage division was functioning, “it will enable private capital to make insured loans . . . thus opening up an enormous field of opportunities for investors to utilize profitability and with the utmost of safety.”²⁷⁰ Mr. Moffett believed the current “blockade of the mortgage-money market” was caused primarily by “the fear of loss and the need for liquidity on the part of lenders.”²⁷¹ Without giving the working particulars, he promised: “The Housing Act will break this blockade by assuring safety in lending and providing liquidity.”²⁷² Prophetically, Mr. Moffett believed the FHA would create “the rolling snowball” effect and, ultimately, even those who designed the legislation and worked intimately in the housing industry “hardly can visualize the unprecedented potentialities for good that the Housing Act holds.”²⁷³

In January 1937, after the Federal Housing Administration had been up and running for two years, the House held additional hearings to extend the U.S. guarantee on the FHA debentures that had already been issued.²⁷⁴ Stewart McDonald, the current administrator, began the hearings testifying on the progress achieved by the FHA.²⁷⁵ The FHA had issued debentures in the amount of \$37,000 and insured mortgages in the total amount of \$614,000,000 as of January 1937.²⁷⁶ In two years, foreclosure occurred on only twelve properties in the entire United States, representing the \$37,000 in debentures issued.²⁷⁷ At that point, “approximately 40 [percent] of all new construction in the last [six] months in residential properties . . . has been through the Federal Housing Administration.”²⁷⁸ Some builders and developers were obtaining FHA approval of their projects prior to breaking

²⁶⁸ Mr. Moffett, in an attempt to simplify the makeup of the FHA, broke it down into two divisions: the modernization division and the mortgage (for purchase) division. *Id.*

²⁶⁹ *Id.*

²⁷⁰ *Id.*

²⁷¹ *Id.*

²⁷² *Id.*

²⁷³ *Id.*

²⁷⁴ *National Housing Act Hearings of 1937, supra note 185.*

²⁷⁵ *Id.* at 1.

²⁷⁶ *Id.* at 7.

²⁷⁷ *Id.* at 2. At one point, Administrator McDonald stated the amount was \$36,000, if anyone is concerned. *Id.* Of course, a one thousand dollar mistake in 1937 is much bigger than a one thousand dollar mistake today.

²⁷⁸ *Id.* at 2. Mortgages on new construction made up 54 percent of the FHA's business. *Id.*

ground, to assure FHA loans. This allowed FHA to act as a “policeman on jerry-built houses.”²⁷⁹

Abner Ferguson, chief counsel to FHA, explained how the FHA accomplished this impressive record.²⁸⁰ Once mortgages were insured, if the lender foreclosed due to failure to make payments, the property would be transferred to FHA in exchange for debentures (bearing interest at 3 percent) which matured three years after the mortgage would have matured.²⁸¹ FHA would then have an opportunity to sell the property.²⁸² If sale occurred before the full term of the mortgage, the debentures would be redeemed.²⁸³ Although the FHA was under-capitalized, the guarantee from the U.S. government gave lenders confidence. That guarantee was expiring in July of 1937; the very purpose of these hearings was to extend the guarantee for two more years.²⁸⁴ Ultimately, this system gave lenders security in making loans knowing that, based on the federal entities in place acting as a backstop against mass foreclosure, lenders would not have to carry thousands of foreclosed properties in case of a new crash. Additionally, transferring foreclosed mortgages to the FHA for debentures exchanged real estate with capital and enhanced liquidity—creating funds which could be used to issue new mortgages.

Some congressmen were concerned with granting the two-year extension, for fear the government would be involved in the market indefinitely. Thus, the question was posed frequently whether the FHA was ready to “stand on its own bottom.”²⁸⁵ However, the representatives from FHA did not want to tinker with a system that was working. Besides creating “a kind of mortgage which was not then in existence,” FHA preempted the need, and cost, of a new HOLC in the event of a second crash.²⁸⁶ What the congressmen failed to recognize in their hope that eventually the FHA would not need federal government backing, was the concept of public perception. Lenders and borrowers only felt secure in the FHA if the U.S.

²⁷⁹ *Id.* at 3. As Administrator McDonald stated, common sense dictated that builders get their approval: “[A builder] would be automatically eliminating such a large proportion of the mortgage money in the United States” if he didn’t. *Id.* at 2.

²⁸⁰ *Id.* at 6.

²⁸¹ *Id.*

²⁸² *Id.*

²⁸³ *Id.*

²⁸⁴ *Id.* at 1.

²⁸⁵ *Id.* at 18.

²⁸⁶ *Id.*

government stood behind it.²⁸⁷ Removing that backing would compromise public confidence and risk de-stabilizing the mortgage market.

Representative Edward L. O'Neil, from New Jersey, a home owner with an FHA-insured mortgage and a former employee of the FHA, understood the accomplishments of the two-year-old Administration—and defined the essence of the New Deal for the American mortgage: “It has enabled the average low-income earner to buy and own his home, with some assurance that after a reasonable length of time the mortgage instrument against the property will have been paid off and he will own the property free and clear.”²⁸⁸ Misunderstanding this achievement, Representative Jesse P. Wolcott questioned how “the insurance of your mortgage by the Federal Government increased employment?”²⁸⁹ Democratizing home ownership through amortization, sound mortgages, government guarantees, secure investments to lenders and enhanced liquidity would not translate come election day as well as the simple concept of creating jobs.

VII. FANNIE MAE AND THE BIRTH OF THE NATIONAL MORTGAGE MARKET

At the end of 1937, additional hearings were held regarding certain amendments to the FHA.²⁹⁰ A clearer picture of the success of the young administration was presented. FHA Administrator Stewart McDonald

²⁸⁷ See KENNEDY, *supra* note 1, at 364–65. The essence of the entire New Deal, in Kennedy's philosophy, was security: “achieving security was the leitmotif of virtually everything the New Deal attempted.” This security was to be for all Americans: “security for capitalists and consumers . . . and homeowners and bankers and builders as well.” Instilling in people the belief that there would not be a second depression was the key to recovery. To accomplish that, America needed to rehabilitate its financial institutions (banks through FDIC, the stock market through SEC and the housing market through FHA) in order to re-establish America's trust in the soundness of capitalism. *Id.*

²⁸⁸ *National Housing Act Hearings of 1937*, *supra* note 185, at 21.

²⁸⁹ *Id.* Sometimes, the Congressmen were openly hostile to the FHA. See, e.g., *id.* at 24. Congressman Gifford accused FHA of having “a big propaganda section” which had led to great publicity in the media. *Id.* Of course, Mr. McDonald responded, identifying the work done by their “education department” and explained the good treatment by the media stemmed from the increased advertising money from those building and real estate industries benefited by the FHA. *Id.* A statement from Frank Carnahan of the National Lumber Dealers Association was read into the record commending the FHA for its minimal cost to the government and excellent work towards “rehabilitation” of the lumber industry. *Id.* at 26–27.

²⁹⁰ *To Amend the National Housing Act: Hearings on S. 3055 Before the S. Committee on Banking and Currency, 75th Cong. (1937)* [hereinafter *Hearings to Amend the National Housing Act*]. The amendments included reducing the down-payment from 20 to 10 percent; basing the insurance premium on the outstanding balance of the mortgage rather than the original principal; allowing the FHA to foreclose, rather than the original lender so that FHA would take title at the earliest possible date. *Id.*

testified on the lending history of FHA from January 1, 1935, to December 1, 1937.²⁹¹ “In the [two] years that we have been doing business we have accepted for insurance a little over a billion dollars” all on residential mortgages representing 80 percent of the value of the property.²⁹² Remarkably, in two years FHA took possession of a mere fifty-one houses throughout the United States, with outstanding debentures issued to lenders in the amount of \$164,000.²⁹³ Administrator McDonald explained how the FHA worked to the senators, who did not completely understand the process: “The money is loaned by the individual lending institutions, and they sometimes have delinquencies . . . if they do not [collect], they must foreclose.”²⁹⁴ Through this process, FHA took over the fifty-one properties and, in return, issued the debentures to the foreclosing institutions.²⁹⁵ With one billion dollars of FHA mortgage money insured and only fifty-one properties foreclosed, the success of FHA was astounding.

Administrator McDonald explained the difference in philosophies between the HOLC and the FHA. The former institution was created to “relieve individuals in distress” either because the borrower or lending institution was in financial trouble.²⁹⁶ “But the main object of the Federal Housing Administration has been to assist people to purchase homes on a more favorable basis and with lower interest rates and on easier terms than ever before.”²⁹⁷ In order to continue this important work and entrench the vast improvements in the American mortgage industry in perpetuity, Administrator McDonald discussed an additional amendment sought by the FHA that changed the workings of the expiring government guarantee. “This plan calls for the date of the expiration to be eliminated and the two billion dollars to be a revolving fund as the mortgages are paid off.”²⁹⁸ Thus, the government guarantee would be a permanent fixture of the FHA. This would eliminate a problem Administrator McDonald and his staff experienced in attempting to establish national mortgage associations to purchase FHA-approved mortgages. Businessmen were wary of establishing these associations with the termination of the government guarantee imminent.²⁹⁹

²⁹¹ *Id.* at 18.

²⁹² *Id.*

²⁹³ *Id.* at 19.

²⁹⁴ *Id.*

²⁹⁵ *Id.*

²⁹⁶ *Id.* at 20.

²⁹⁷ *Id.* at 21.

²⁹⁸ *Id.* at 24.

²⁹⁹ *Id.*

Great attention was paid during the course of the December 1937 hearings to the purchase of mortgages from originating lenders and sale of these mortgages as packaged investment vehicles. Jesse H. Jones, chairman of the Reconstruction Finance Corporation (RFC),³⁰⁰ testified on the RFC's early steps in buying and selling FHA mortgages. To date, the RFC purchased close to 11,000 FHA mortgages totaling \$43 million.³⁰¹ Without going into detail as to purchasers, Mr. Jones reported that less than 10 percent of these mortgages had been sold to investors or paid in full.³⁰²

Marriner Eccles, by now considered a national authority on American mortgage lending, testified on the FHA and the potential of buying and selling mortgages. From his perspective, the FHA's purpose "was to create a reform of the mortgage market or modify the financing of homes."³⁰³ This goal could only be achieved "by having the Government sit in the background" thereby improving the confidence of lenders and borrowers alike.³⁰⁴

In the opinion of Mr. Eccles, "the most important feature" of the FHA strategy "is the organization of mortgage associations."³⁰⁵ Although the concept of mortgage associations was in the National Housing Act, these institutions never arose through private enterprise "because of investor fears about the mortgage markets."³⁰⁶ The proposed amendment would create a national mortgage association as an extension of the Reconstruction Finance Corporation.³⁰⁷ The mortgage association proposal allowed for "a market for insured mortgages in those areas of the country where there may not be surplus funds."³⁰⁸ Fresh money would be "siphoned" into communities with a shortage of mortgage money when the mortgage association purchased mortgages from local institutions.³⁰⁹ Thus, local lenders could originate new mortgages with the new funds, which mortgages would then be available for purchase by the mortgage association.

Charles Garrison Meyer, a builder and developer in Queens, New York, agreed with Mr. Eccles on the potential of a national mortgage association.³¹⁰

³⁰⁰ For biographical information of Jesse H. Jones' great work at the RFC, see SCHWARZ, *supra* note 1, at 59-95.

³⁰¹ *Hearings to Amend the National Housing Act*, *supra* note 290, at 34.

³⁰² *Id.*

³⁰³ *Id.* at 165.

³⁰⁴ *Id.*

³⁰⁵ *Id.* at 188.

³⁰⁶ OLSON, *supra* note 1, at 195.

³⁰⁷ SCHWARZ, *supra* note 1, at 87.

³⁰⁸ *Hearings to Amend the National Housing Act*, *supra* note 290, at 188.

³⁰⁹ *Id.*

³¹⁰ *Hearings to Amend the National Housing Act*, *supra* note 290, at 198.

Mr. Meyer proposed the association would take these FHA-insured mortgages they purchased, package them in a "central pool," and "issue[] debentures against them."³¹¹ In the opinion of Mr. Meyer, these desirable debentures would be in rare company: "[Y]ou would have securities that would be next in importance in their quality to the securities of the United States Government."³¹² In this new era of massive government spending to repair the economy, the windfall of this self-perpetuating lending would come at little to no cost to the government: "I do not think this plan would cost the Government a cent."³¹³

Administrator McDonald, following up on his earlier testimony, opined that "unless the mortgage association is formed on a large scale . . . you cannot get the full stimulation which this enterprise deserves."³¹⁴ A national mortgage association would restore the flow of private capital into the American mortgage system. Thousands of insured mortgages would be turned into safe debentures in which "trust funds," "insurance companies," and "the public in small amounts" would invest.³¹⁵ Everyone agreed creating a national mortgage association would be the next logical step in the process of transforming the American mortgage market into an assembly-line system supplying unprecedented capital to lenders throughout the nation. This potential enormous supply of mortgage money would flood the market and lead to an unprecedented multitude of affordable mortgages and a nation of homeowners for generations.³¹⁶

The proposed amendments to the National Housing Act were passed by a large majority in the Senate and House and signed by the President on February 5, 1938.³¹⁷ On February 10, 1938, the National Mortgage Associa-

³¹¹ *Id.*

³¹² *Id.*

³¹³ *Id.* William Green, President of the American Federation of Labor, agreed with this assessment of the great potential of a national mortgage association: "These national mortgage associations will perform an important function as clearing houses for the purchase and sale of insured mortgages, assuring the supply of capital funds to the localities where these funds are most needed." *Id.* at 239-40. In *The New York Times*, Senator Wagner, chairman of the Senate Banking and Currency Committee, called the new proposal to fund national mortgage association "the final link in the Federal Government's chain of housing legislation." *Housing Program Embodied in Bills*, N.Y. TIMES, Nov. 30, 1937, at 13.

³¹⁴ *Hearings to Amend the National Housing Act*, *supra* note 290, at 212.

³¹⁵ *Id.*

³¹⁶ *See generally* Carrozzo, *supra* note 169, at 799-805.

³¹⁷ National Housing Act, ch. 847, sec. 2-13, §201-514, 52 Stat. 8, 8-26 (1938); *Text of Amendments to National Housing Act as Made Law by President*, N.Y. TIMES, Feb. 5, 1938, at 6. For vote counts see *Homes Bill Voted 324-23 by House*, N.Y. TIMES, Dec. 9, 1937, at 1; *Senate's Version of Housing Voted*, N.Y. TIMES, Dec. 22, 1937, at 5. One additional amendment reduced the loan-to-value on small loans to 90 percent of the purchase price, qualifying more Americans for FHA mortgages.

tion of Washington, D.C., was chartered as a subsidiary of the Reconstruction Finance Corporation.³¹⁸ The name of this association would be changed two months later to the Federal National Mortgage Association (FNMA) or Fannie Mae.³¹⁹ The new association had an immediate impact. As reported in the May 28, 1938, issue of *The New York Times*, "there appears to be a ready market for this new type of investment."³²⁰ The initial response to offerings of Fannie Mae notes by investors was overwhelming.³²¹

Tellingly, Fannie Mae, in its role as "a discount bank by buying and selling mortgages from institutions which originate the loans" was changing the perception of local lending institutions toward mortgages they originated.³²² Fannie Mae's potential market for mortgages "already is understood to have modified the inclination of banks to regard as 'surplus' money many of the mortgages they hold."³²³

VIII. THE NEW DEAL FOR THE AMERICAN MORTGAGE

An interesting perspective on what the New Deal achieved in the field of American mortgages is gained when comparing the philosophies behind the HOLC, FHA, and Fannie Mae with those of the Agricultural Adjustment Administration and the National Recovery Administration. The housing agencies approached mortgage lending from the perspective of increasing the supply and lowering the price of mortgage money whereas agencies like the AAA and NRA embraced reducing production to increase prices. This difference in philosophy was understood at the time. An editorial in *The New York Times* explained the approach: "[In the field of housing,] Mr. Roosevelt does not recommend the production of fewer goods at higher prices. He recommends, instead, the production of more

³¹⁸ A brief overview of the charter of this organization is provided in GEN. SERV. ADMIN. NAT'L ARCHIVES & RECORDS SERV., THE NAT'L ARCHIVES, PRELIMINARY INVENTORY OF THE RECORDS OF THE FEDERAL NATIONAL MORTGAGE ASSOCIATION, (1963) [hereinafter PRELIMINARY INVENTORY]. Jesse H. Jones, chairman of the Reconstruction Finance Corporation, announced the organization of the NMA of Washington D.C. and its initial capitalization in the amount of \$10,000,000. *Housing Loan Body is Set Up by RFC*, N.Y. TIMES, Feb. 11, 1938, at 3.

³¹⁹ PRELIMINARY INVENTORY, *supra* note 318.

³²⁰ Lee E. Cooper, *FHA Due to Proceed Slowly in Approving Applications for New Mortgage Agencies*, N.Y. TIMES, May 28, 1938, at 25.

³²¹ *Id.* "[T]he \$25,000,000 issue of [2 percent] five-year notes of the Federal National Mortgage Association was reported to have shown a subscription total of fifty-two times the amount offered." *Id.* Fannie Mae purchased \$38 million in new FHA mortgages in 1938, its first year of operation. Another entity, an arm of the Reconstruction Finance Corp., called the RFC Mortgage Company, purchased an additional \$36 million in FHA mortgages that same year. OLSON, *supra* note 1, at 202.

³²² Cooper, *supra* note 320.

³²³ *Id.*

goods at lower prices.”³²⁴ The editorial identified the approach as “a new phase in the evolution of the New Deal” and “a radical and fundamental . . . distinction.”³²⁵

An abundance of available mortgage money—in fact, a glut of available funds—would democratize home ownership for the middle class and beyond, bringing prosperity to a multitude of Americans. As a corollary, more borrowers and an overall increase in money loaned meant greater profits for banks. Beyond democratizing home ownership, more home owners meant employment in a vast number of supporting industries: home builders, carpenters, plumbers, electricians, painters, appliance manufacturers, salesmen, bankers, appraisers, lawyers—the list goes on.³²⁶ This concept of investment in housing for the purpose of stimulating the entire United States economy was championed by John Maynard Keynes, the influential twentieth century British economist.³²⁷ In a 1937 letter to Franklin Roosevelt, Keynes highlighted the potential of government investment in housing, calling this approach “the best aid to recovery.”³²⁸

The closest relative to the New Deal’s mortgage agencies, in terms of economic philosophy, is the Electric Home and Farm Administration (EHFA).³²⁹ To help the Tennessee Valley Authority sell electricity in impoverished Southern towns, the EHFA was created to assist rural families in buying appliances to create demand for electricity.³³⁰ The EHFA worked by providing inexpensive loans and promoting cheaper prices from manufacturers.³³¹ So, by subsidizing appliance purchasing, the EHFA was unlike the anti-deflationary philosophy of most other New Deal agencies. Interestingly, as historian Jordan Schwarz noted, the EHFA “pioneered

³²⁴ Lee E. Cooper, *The President’s Program*, N.Y. TIMES, Nov. 30, 1937, at 22.

³²⁵ *Id.*

³²⁶ This list is a summary of the numerous building trades, professionals and suppliers who benefit from the construction, sale, purchase and mortgaging of houses. Really, this list is under-inclusive. For example, consider contractors, plumbers and electricians: they drive trucks to their jobs, thus employing countless persons in the automotive industry. On their way to work, they undoubtedly go to their favorite deli for breakfast and coffee, thus employing members of the food service industry. Attorneys and bankers hire secretaries and clerks. Appliance manufacturers hire truck drivers to deliver the appliances. Truck drivers buy gas, and so on. This principle, called the “Keynesian multiplier,” can go on for volumes, like a continuous news reel from the era. For a straightforward explanation of the Keynesian multiplier see TODD G. BUCHHOLZ, *NEW IDEAS FROM DEAD ECONOMISTS* 218–20 (1989).

³²⁷ KENNEDY, *supra* note 1, at 357.

³²⁸ *Id.* at 357–58. In Keynes’s own words: “I should advise putting most of your eggs in this basket.” *Id.*

³²⁹ SCHWARZ, *supra* note 1, at 236. The author calls the EHFA (the brainchild of New Dealer David Lilienthal) “one of the New Deal’s more ingenious public corporations.” *Id.*

³³⁰ *Id.*

³³¹ *Id.* at 237.

cheap money” before the FHA championed “lower rates, lower down payments, lower payments[,] and longer terms to finance home-buying.”³³²

Ultimately, from 1933 to 1938, the New Deal put in place the mechanisms for the national mortgage market. The system-wide change started with relief legislation for defaulting borrowers and failing banks (under the Home Owners’ Loan Corporation). A few farsighted New Dealers inspired institutional changes in the form of a better mortgage document, mortgage practices, and insured mortgages (ushered in by the Federal Housing Administration). As security in the American economy increased through these changes, liquidity was enhanced when a market was created for these now safe investments (through Fannie Mae).

Over time, the New Deal’s creation of a national mortgage market infrastructure evolved further. In the late 1940s, the GI Bill allowed millions of servicemen to enjoy the benefits of nationally traded mortgages, enjoying less expensive mortgages through enhanced liquidity.³³³ The Emergency Home Finance Act of 1970 expanded the national mortgage market to include all mortgages originated in America, whether from FHA, Veterans Affairs, or conventional lenders.³³⁴ When the pieces were all in place and millions of Americans wanted their own 40 by 100 piece of America, mortgage lending was on the verge of the long-promised democratization of home ownership.³³⁵ The great success of the New Deal for the American mortgage is clear. In 1929, “four Americans in ten lived in their own homes.”³³⁶ In 2004, 69 percent of Americans owned their own home.³³⁷ In a five-year period of New Deal legislation, a revolution in home financing was born.

³³² *Id.* at 239.

³³³ JACKSON, *supra* note 16, at 204.

³³⁴ For a discussion of this next phase in revolutionizing the American mortgage market see Carozzo, *supra* note 169, at 799–805.

³³⁵ KENNEDY, *supra* note 1, at 370.

³³⁶ *Id.*

³³⁷ U.S. CENSUS BUREAU, STATISTICAL ABSTRACT OF THE UNITED STATES, (2005), Table 954, Homeownership Rates by States 1985-2004.