ECONOMIC RESEARCH
FEDERAL RESERVE BANK OF ST. LOUIS

WORKING PAPER SERIES

Government Response to Mortgage Distress: Lessons from the Great Depression

Authors	Cletus C. Coughlin, and David C. Wheelock
Working Paper Number	2008-038A
Creation Date	October 2008
Citable Link	https://doi.org/10.20955/wp.2008.038
Suggested Citation	Coughlin, C.C., Wheelock, D.C., 2008; Government Response to Mortgage Distress: Lessons from the Great Depression, Federal Reserve Bank of St. Louis Working Paper 2008-038. URL https://doi.org/10.20955/wp.2008.038

Federal Reserve Bank of St. Louis, Research Division, P.O. Box 442, St. Louis, MO 63166

Government Response to Home Mortgage Distress: Lessons from the Great Depression

David C. Wheelock*
Federal Reserve Bank of St. Louis

Abstract

The Great Depression was the worst macroeconomic collapse in U.S. history. Sharp declines in household income and real estate values resulted in soaring mortgage delinquency rates. According to one estimate, as of January 1, 1934, fully one-half of U.S. home mortgages were delinquent and, on average, some 1000 home loans were foreclosed every business day. This paper documents the increase in residential mortgage distress during the Depression, and discusses actions taken by state governments and the federal government to reduce mortgage foreclosures and restore the functioning of the mortgage market. Many states imposed moratoria on both farm and nonfarm residential mortgage foreclosures. Although moratoria reduced farm foreclosure rates in the short run, they appear to have also reduced the supply of loans and made credit more expensive for subsequent borrowers. The federal government took a number of steps to relieve residential mortgage distress and to promote the recovery and growth of the national mortgage market. The Home Owners Loan Corporation (HOLC) was created in 1933 to purchase and refinance delinquent home loans as long-term, amortizing mortgages. Between 1933 and 1936, the HOLC acquired and refinanced one million delinquent loans totaling $3.1 billion. The HOLC refinanced loans on some 10 percent of all nonfarm, owner-occupied dwellings in the United States, and about 20 percent of those with an outstanding mortgage. The Great Depression experience suggests how foreclosures might be reduced during the present crisis.

JEL classification numbers: G21, G28, N22

Keywords: Mortgage foreclosures, foreclosure moratoria, Home Owners Loan Corporation, Great Depression

*This paper was prepared for "The Subprime Housing Crisis: Interdisciplinary Policy Perspectives," Public Policy Center, University of Iowa, October 10-11, 2008. The author thanks Craig P. Aubuchon for research assistance. The views expressed in this paper do not necessarily reflect official positions of the Federal Reserve Bank of St. Louis or the Federal Reserve System.

After rising rapidly for several years, U.S. house prices fell sharply in many markets during 2007 and 2008. Falling house prices brought a sharp rise in mortgage delinquencies and foreclosures, which prompted numerous proposals to relieve distress in mortgage markets. On July 30, 2008, President Bush signed the Housing and Economic Recovery Act of 2008, which, among other provisions, included a $300 billion increase in FHA loan guarantees to encourage lenders to refinance delinquent home mortgages. Other proposals then under consideration included (i) directing Fannie Mae and Freddie Mac, the two main government-sponsored enterprises that purchase and securitize home mortgages, to refinance subprime mortgages; (ii) permitting states to refinance loans at risk of foreclosure through the issuance of federal tax-exempt mortgage revenue bonds; and (iii) creating a new federal corporation to purchase distressed mortgages from investors and convert them to long-term fixed-rate mortgages.[1]

The creation of a new federal corporation to purchase distressed mortgages would mimic a similar agency, the Home Owners' Loan Corporation (HOLC), that was established in 1933 to purchase delinquent home mortgages during the Great Depression. Between 1933 and 1936, the HOLC purchased and refinanced more than 1 million delinquent home loans. Additional steps by the federal government to ease mortgage market pressures during the 1930s included the creation of the Federal Home Loan Bank System to mobilize funds for home lending, the introduction of FHA mortgage insurance,

[1] Senator Charles Schumer proposed (i) and (ii) in remarks entitled "A Call to Action on the Subprime Mortgage Crisis: Putting Common Sense Ahead of Ideology," delivered at the Brookings Institution on December 19, 2007. Proposals for the creation of a Federal Homeownership Preservation Corporation were discussed in hearings before the U.S. Senate Banking Committee on January 31, 2008. See Barr (2008) and Pollock (2008).

and the creation of the Federal National Mortgage Corporation to purchase FHA-insured loans.

State and local governments also responded to mortgage foreclosures during the Depression, mainly by changing state laws governing foreclosure. Several states enacted temporary foreclosure moratoria. Others made permanent changes that limited the rights or incentives of lenders to foreclose on mortgaged property. In 2008 a number of U.S. states considered similar steps to reduce mortgage foreclosures, and legislation for a national moratorium was introduced in the U.S. Congress.

This paper takes a look back at the Great Depression experience and identifies differences and similarities with the current period of distress in housing and mortgage markets.[2] As with the current episode, the increase in mortgage defaults during the Depression was preceded by a period of extensive home building and rising house prices and an increasing use of debt to finance house purchases. Defaults rose sharply in the early 1930s when house prices and household incomes collapsed. This paper documents the severity of housing and mortgage market distress during the Great Depression and describes major initiatives by state and federal governments to deal with the crisis. The paper focuses in particular on the moratoria imposed by 27 states to limit foreclosures, and on the activities of the HOLC, which was the principal vehicle by which the federal government sought to resolve delinquent home mortgages.

MORTGAGE DISTRESS DURING THE GREAT DEPRESSION

The Great Depression was a cataclysmic event. Between 1929 and 1933, U.S. personal income declined 44 percent, real (i.e., inflation-adjusted) output fell by 30 percent, and the unemployment rate climbed to 25 percent of the labor force. U.S. real

---

[2] This paper extends and draws extensively from Wheelock (2008a, 2008b).

estate markets were already showing signs of distress before the Great Depression began. House prices peaked in 1926 and the number of nonfarm residential real estate foreclosures doubled between 1926 and 1929. With the onset of the Depression, house prices began to fall rapidly and the number of foreclosures rose still higher, from 134,900 in 1929 to 252,400 in 1933.[3] The foreclosure rate, shown in Figure 1, increased from 3.6 per 1,000 home mortgages in 1926, the first year data are available, to a high of 13.3 per 1,000 mortgages in 1933. In that year, on average 1,000 home mortgages were foreclosed every day (Federal Home Loan Bank Board, 1937, p. 4). Many more homes were at risk of foreclosure—as many as half of urban home mortgages were delinquent on January 1, 1934 (Bridewell, 1938, p. 172).[4]

The sharp increase in mortgage distress during the Great Depression was the result of precipitous declines in income and real estate values following a period of rapid growth in mortgage debt outstanding (Wheelock 2008a). A rising level of debt does not necessarily pose a problem for borrowers, provided their incomes and wealth are sufficient to make loan payments. However, between 1929 and 1932, personal disposable income and nonfarm residential wealth fell 41.0 percent and 25.7 percent, respectively, whereas the value of nonfarm residential debt fell a mere 6.8 percent. As shown in Figure 2, nonfarm residential mortgage debt increased sharply relative to nonfarm residential wealth during the 1920s and continued to rise until 1932. Moreover, falling house prices, shown in Figure 3, meant that homeowners who were having difficulty

---

[3] *Historical Statistics of the United States, Earliest Times to the Present: Millennial Edition* (2006), series Dc1255.

[4] Farm mortgage foreclosures also increased sharply during the Depression, rising to a peak rate of 3.9 percent in 1933. See Alston (1983) for data and analysis of farm foreclosures during the 1930s.

making their mortgage payments were increasingly unlikely to sell their homes for more than the outstanding balances on their loans.

Many home mortgages in the 1920s and 1930s were short-term, nonamortizing loans that typically were refinanced on maturity.[5] Refinancing usually was easily accomplished during the 1920s, when household incomes and property values were generally rising, but next to impossible during the Depression. Falling incomes made it increasingly difficult for borrowers to make loan payments or to refinance outstanding loans as they came due. The failure of thousands of banks and other lenders made refinancing difficult even for good borrowers; customer relationships were severed and the costs of credit intermediation rose (Bernanke, 1983). The mix of falling household incomes and property values and short-term, nonamortizing loans resulted in soaring mortgage delinquency and foreclosure rates.[6]

FORECLOSURE RELIEF LEGISLATION

The first attempts to reduce foreclosures during the Great Depression focused on encouraging lenders and borrowers to renegotiate loan terms through mediation boards and other voluntary arrangements. However, the clamor for compulsory foreclosure moratoria grew louder as the Depression worsened and the number of foreclosures rose. On February 8, 1933, Iowa became the first state to enact a moratorium on mortgage

---

[5] Mortgage lending terms varied considerably across lenders. Savings and loan associations typically made long-term, amortizing mortgage loans. However, banks and life insurance companies often made short-term, nonamortizing (or only partly amortizing) loans. See Morton (1956) for more information about the mortgage market and loan characteristics during the 1920s and 1930s.

[6] Federal agencies created during the 1930s to rescue and reform the mortgage market encouraged the use of long-term, amortizing mortgage loans—so-called conventional loans. Nonamortizing, unconventional loans have become more common in recent years, however, which some analysts contend has contributed to the increase in mortgage loan delinquencies and foreclosures since 2006.

foreclosures. Over the subsequent 18 months, a total of 27 states and the federal government enacted legislation to limit or halt foreclosures (Skilton, 1944, p. 78).[7]

The specific details of moratoria legislation varied widely across states. A few states imposed blanket moratoria that temporarily prohibited most foreclosures of farm and nonfarm home mortgages contracted before a specified date. However, most states limited their moratoria to specific situations. For example, some states granted relief only for borrowers who were current in the payment of interest and taxes but delinquent in the payment of loan principal. For example, a New York statute enacted in 1933 specified that "No action for the foreclosure of a mortgage on real estate solely on account of default in payment of principal…shall be brought before July 1, 1937" (Central Housing Committee, 1936, p. A-18). Foreclosures were permitted, however, against borrowers who had ceased to pay interest and taxes, as well as principal.

Several states directed their state courts to grant moratoria in deserving cases, but little guidance was provided to the courts about how to determine which borrowers deserved relief. For example, in Iowa, the court was authorized to grant a borrower's request for relief from pending foreclosure unless "good cause is shown to the contrary" (Skilton, 1944, p. 82). Similarly, an Arizona statute specified that "In pending or future real estate mortgage foreclosure suits, the court may order a two-year continuance unless good cause to the contrary is shown" (Central Housing Committee, 1936, p. A-3). Not surprisingly, the extent to which courts granted relief to delinquent borrowers varied

---

[7] The federal moratorium applied to farm mortgage foreclosures. The Frazier-Lemke Farm Bankruptcy Act of 1934 authorized federal courts to grant a five-year moratorium on foreclosure and to scale down a farmer's debt to the current value of his property. The act was declared unconstitutional by the Supreme Court in 1935. Subsequently, Congress enacted the Frazier-Lemke Farm Mortgage Moratorium Act of 1935, which modified and limited the terms of the moratorium. The constitutionality of the latter act was upheld by the Supreme Court in 1937.

widely, even within a state. Many courts determined that it was pointless to grant relief to borrowers who had no hope of refinancing their mortgage or making payments or who did not act in good faith toward their lender (Skilton, 1944, pp. 98-106). In addition, courts often required borrowers to pay rent or interest to the lender, as well as taxes, as a condition for halting foreclosure proceedings.

In conjunction with a foreclosure moratorium, several states extended the period during which a mortgagor could redeem his property after foreclosure. Again, however, any extension of the redemption period was often left to the court's discretion. In Kansas, for example, "the period for redemption on real estate may be extended for such additional time as the court shall deem it just and equitable" (Central Housing Committee, 1936, p. A-10). In a few states, the legislation was more specific. For example, North Dakota legislation specified that "The period within which a mortgagor or judgment debtor may redeem from a mortgage foreclosure or execution sale of real estate…is extended for a period of two years…" (Central Housing Committee, 1936, p. A-21).

Several states also modified their statutes to limit deficiency judgments. Some states restricted judgments to the difference between the outstanding loan balance and a "fair" or "reasonable" value of the mortgaged property, rather than the difference between the loan balance and the price received at a foreclosure sale. For example, a 1933 Idaho statute specified that "no deficiency judgment may be entered in any amount greater than the difference between the mortgage indebtedness, plus the cost of foreclosure and sale and the reasonable value of the property" (Central Housing Committee, 1936, p. A-7). Other states permitted courts to invalidate foreclosure sales for less than fair value. Most states left the determination of fair value to the discretion of a local appraisal board or court rather than attempt to define "fair value" in statutes.

Several states imposed new limits on the length of time that a lender could seek a deficiency judgment after a foreclosure sale. For example, Iowa and Ohio enacted legislation limiting deficiency judgments to two years after a foreclosure sale (Skilton, 1944, p. 130). Other states abolished the right of lenders to seek deficiency judgments altogether. For example, a 1935 Montana statute specified that "Deficiency judgments are abolished in all actions for foreclosure of mortgages for balance of purchase price of real property" (Central Housing Committee, 1936, p. A-16).[8]

The 27 states that adopted foreclosure moratoria during 1933 and 1934 are listed in Table 1, and the geographic distribution of states with moratoria is shown in Figure 4. Moratoria were especially common among states in the Midwest and Great Plains, but they also were imposed by several states in the Northeast and Far West. Foreclosure moratoria were less common in New England, the Southeast, and Mountain West.[9]

Foreclosure moratoria generally applied to both farm and nonfarm residential mortgages. However, the pressure for foreclosure moratoria was particularly intense in midwestern states where farm foreclosure rates were especially high (Figure 5). Moratoria were less common in states with relatively low farm foreclosure rates, though a few, including New Hampshire, Pennsylvania, and Vermont, also imposed moratoria, and

[8] See Central Housing Committee (1936), Poteat (1938), or Skilton (1944) for additional information about the provisions of moratoria and other legislation affecting the rights of mortgagors and lenders enacted in different states during the Depression.

[9] The source for Table 1 and Figure 4 is Skilton (1944, p. 78), which lists 27 states as having had a moratorium. Other sources omit Oregon, where a moratorium was authorized by a joint resolution of the state legislature, rather than by statute (Poteat, 1938), or omit both Oregon and Arkansas (Alston, 1984).

according to Skilton (1944), some states imposed moratoria in response to high numbers of nonfarm home mortgage foreclosures.

Alston (1984) investigates why some, but not all, states imposed foreclosure moratoria during the Depression. He estimates a logit regression model that includes a state's farm foreclosure rate, percentage of farms mortgaged, and percentage of farm mortgages held by federal land banks as explanatory variables. Alston argues that a state was more likely to impose a moratorium the higher its farm foreclosure rate, the higher its percentage of mortgaged farms, and the lower the percentage of mortgages held by federal land banks (which were less likely to foreclose than other lenders).[10] He finds that the farm foreclosure rate had the strongest impact on a state's decision to impose a moratorium.[11]

ECONOMIC IMPACT OF FORECLOSURE MORATORIA

Governments cause both immediate and long-term effects when they rewrite the terms of contracts between private parties. The immediate impact is redistribution of wealth between the parties of the affected contracts. The temporary foreclosure moratoria and most other changes in state mortgage laws enacted during the 1930s favored borrowers over lenders. These actions interfered with the rights of lenders to seize collateral pledged by borrowers to guarantee payment of their mortgages. Several states also enhanced the rights of borrowers to redeem foreclosed property and limited the rights of lenders to sue for deficiency judgments.

---

[10] The Federal Farm Loan Act of 1916 established 12 regional federal land banks to increase the supply of farm mortgage loans. See www.fca.gov/about/history/historyFCA_FCS.html.

[11] Unfortunately, state-level data on nonfarm real estate foreclosures are not available for the early 1930s to test directly the impact of nonfarm foreclosures on moratoria adoption. Nevertheless, regional differences in farm foreclosure rates and the adoption of moratoria suggest that nonfarm foreclosures or other considerations may have influenced the decision to impose moratoria in some states. See Wheelock (2008b) for additional discussion and evidence on the decision of states to impose moratoria.

One immediate effect of mortgage relief legislation during the Depression was reduced farm foreclosure rates (Rucker and Alston, 1987).[12] However, critics argue that foreclosure moratoria induce lenders to restrict the supply of loans and raise interest rates to compensate for the possibility that their right to foreclose on delinquent loans or to collect deficiency judgments will be constrained. Hence, over the longer run, foreclosure moratoria and other changes in mortgage laws may have made loans costlier or more difficult to obtain. According to a 1936 federal government report,

> Statutes which provide a lengthy, expensive, complicated or otherwise burdensome foreclosure procedure, or which interpose a long period of redemption before title and possession to the mortgaged property can be obtained, have a tendency to increase interest rates and security requirements throughout the jurisdiction, since prospective lenders naturally take into account the procedure available for realizing the debt out of the security when determining the conditions on which they will be willing to make loans. (Central Housing Committee, 1936, p. 3)~~.~~

The same report noted that in 1933-34 many states elected to disregard such objections because it was widely believed that "unrestricted foreclosure of farm and home mortgages under the circumstances prevailing at the time would have deprived large numbers of persons of essential shelter and protection, and would have left them without the necessary means for earning a living. Such wholesale evictions might have seriously endangered basic interests of society" (Central Housing Committee, 1936, p. 2). Hence, in many states, the societal costs of widespread foreclosures were viewed as

[12] I am unaware of any research on the effects of relief legislation on nonfarm home mortgage foreclosure rates.

exceeding the costs of reduced loan supply and higher interest rates borne by prospective borrowers. Even lenders may have benefited from foreclosure moratoria in the short run. Although individual lenders had an incentive to foreclose to recoup losses on delinquent mortgages, a high number of foreclosures in an area could reduce property values and thereby cause still more foreclosures. Thus, a foreclosure moratoria might halt a downward spiral in property values that could benefit lenders as a whole.[13]

Although the economic and societal benefits of lower foreclosure rates are difficult to measure, research shows that the foreclosure moratoria of the Great Depression did impose costs on future borrowers. Alston (1984) investigates the impact of foreclosure moratoria in an empirical model of the farm mortgage market. He argues that foreclosure moratoria encouraged lenders to reduce the supply of loans, resulting in fewer loans made and, possibly, higher average interest rates. Consistent with this hypothesis, Alston (1984) finds that private lenders made significantly fewer loans in states that imposed moratoria and tended to charge higher interest rates on the loans they did make.

Rucker (1990) extends Alston's (1984) study to investigate differences in the impact of mortgage relief legislation on the supply of loans offered by different types of private lenders. In the 1930s, most farm mortgages were issued by local commercial banks, private individuals, insurance companies, and federal land banks. Insurance companies tended to be larger and more diversified and to have a lower cost of funds than did banks and individual lenders. Their size and cost advantages enabled insurance

---

[13] Kahn and Yavas (1994) examine the short- and long-run effects of changes in foreclosure laws (especially how they affect borrower and lender behavior and borrower welfare) in a simple theoretical model of the mortgage market in which renegotiation of loan contracts is possible. Jaffe and Sharp (1996) describe the economics of foreclosure moratoria in the context of alternative legal theories of contracts.

companies to attract lower-risk borrowers and, consequently, experience lower delinquency rates. Insurance companies generally were also more willing to grant extensions to delinquent borrowers. Hence, the costs imposed by mortgage relief legislation should have been lower for insurance companies than for other private lenders. Rucker (1990) finds that, indeed, mortgage relief legislation led to significantly larger reductions in the supply of loans from commercial banks and individual lenders than from insurance companies.[14] Both Alston (1984) and Rucker (1990) conclude that mortgage relief legislation caused significant reductions in the aggregate supply of loans in states that enacted such legislation.

The findings of Alston (1984) and Rucker (1990) on the effects of mortgage relief legislation during the 1930s are consistent with other studies that find significant effects of state mortgage laws on local lending markets. Meador (1982), for example, finds that loan interest rates tend to be higher in states with lengthy or costly foreclosure processes or those that prohibit deficiency judgments. More recently, Pence (2006) finds that mortgage loans are, on average, some 3 to 7 percent smaller in states in which foreclosure requires a court action than in states with nonjudicial foreclosure processes, again consistent with the hypothesis that the supply of loans is lower in states in which foreclosure is more costly.[15]

FEDERAL RELIEF

During the Depression, foreclosure moratoria were widely viewed as expedients to buy time for the economy to recover and for the federal government to initiate

[14] In his econometric analysis, Rucker (1990) treated legislation that limited deficiency judgments or enhanced redemption rights for borrowers, as well as foreclosure moratoria, as forms of relief legislation, whereas Alston (1984) focused exclusively on moratoria.
[15] Pence (2006) compares bordering census tracts located in different states and controls for a variety of borrower, policy, and other census tract characteristics.

programs to refinance delinquent mortgages (Skilton, 1944, pp. 73-77). The federal government took many steps to combat the Depression, several of which affected housing and financial markets directly or indirectly. For example, legislation was enacted to stabilize the banking system and reform securities market practices. Under the National Industrial Recovery Act of 1933, the federal government established a temporary program for the construction of low-cost housing. The United States Housing Act of 1937 replaced this program with a system of federal subsidies for local government housing projects (Doan, 1997, pp. 39-42).

In addition to programs aimed at providing affordable housing, the federal government took several steps to alleviate distress in mortgage markets. Table 2 lists the major agencies created during the 1930s to provide liquidity for home lenders, reduce the number of home loan foreclosures, and reform the mortgage market. The agency most directly responsible for reducing the number of mortgage delinquencies and foreclosures was the Home Owners' Loan Corporation (HOLC).

The Home Owners' Loan Corporation (HOLC) was created as an agency of the Federal Home Loan Bank Board by an act of Congress in 1933. The HOLC was authorized for a period of three years to purchase and refinance delinquent home mortgages, including mortgages that had recently been foreclosed. The HOLC had an initial capitalization of $200 million and was authorized to issue up to $2 billion (later increased to $4.75 billion) of bonds to purchase mortgages on 1- to 4-family properties that were in default or that had resulted in foreclosure during the previous 24 months.

Interest on securities issued by the HOLC was exempt from federal, state, and local income taxes, and the payment of interest was guaranteed by the federal government.[16]

The HOLC was permitted to acquire delinquent mortgages on properties with an appraised value of up to $20,000.[17] HOLC loans were limited to 80 percent of the appraised value of the underlying property or a maximum of $14,000, whichever was less. The HOLC sometimes permitted junior liens (second mortgages) on properties against which it held the first mortgage, but refused to permit the total obligations on a property to exceed 100 percent of the appraised value. Further, the HOLC made loans only to those homeowners it deemed likely to have sufficient income to make their loan payments (Home Owners' Loan Corporation, 1936, p. 10). Nearly half of the loan applications received by the HOLC were rejected or withdrawn (Harriss, 1951, p. 1). Although many home loans at the time were short-term loans with little or no amortization of principal, the HOLC restructured the loans it acquired as 15-year, amortizing loans at a fixed maximum interest rate of 5 percent.[18]

The HOLC was authorized to conduct its own property appraisals and did so based on three considerations: (i) market value at the time of the appraisal, (ii) the cost of a similar plot of land at the time of the appraisal plus the reproduction cost of the building minus depreciation, and (iii) the value of the premises, by capitalizing the reasonable monthly rental value over a 10-year period immediately preceding the appraisal date (Harriss, 1951, p. 41). Harriss (1951, pp. 41-42) reports that appraisals were often

---

[16] A 1934 amendment extended the government guarantee to the principal on HOLC bonds. See Harriss (1951, pp. 152-56) for information about HOLC borrowing operations.
[17] For comparison, $20,000 in 1933 prices is equivalent to approximately $320,000 in 2007 prices, as adjusted by the consumer price index.
[18] Initially, interest-only terms were granted for the first three years of a loan. Beginning in 1936, these loans were reamortized as 12-year fully amortizing loans (*Fourth Annual Report of the Federal Home Loan Bank Board*, 1936, p. 30).

generous, reflecting more the appraiser's view about the long-run value of a property than its current, depressed value.

Although private lenders from whom the HOLC purchased loans often suffered a loss on the nominal value of their original loans, the HOLC's liberal appraisals ensured that lenders preferred to sell many delinquent loans to the HOLC rather than attempt to recoup their losses through foreclosure. Between August 1933 and June 1935, the HOLC received nearly 1.9 million loan applications. By June 1936, the HOLC made just over one million loans totaling $3.1 billion. For comparison, the value of the private U.S. residential housing stock in 1933 is estimated to have been $89.7 billion.[19] The average HOLC loan amount was $3,039, and 75 percent were for less than $4,000. By value, the HOLC accounted for 12 percent of all new mortgages on 1- to 4-family homes in 1933, 71 percent in 1934, 26 percent in 1935, and just 6 percent in 1936—the last year it accepted applications for new loans.[20] The HOLC provided refinancing for some 10 percent of all nonfarm, owner-occupied dwellings in the United States and about 20 percent of those carrying a mortgage.

Figures 6 and 7 show the distribution of new and outstanding home mortgages across major groups of lenders for each year from 1925 to 1941.[21] Although the HOLC did not accept new applications after 1936, it continued to make loans in later years on property that it foreclosed on and later resold. The stock of outstanding mortgage debt

---

[19] *Historical Statistics of the United States, Earliest Times to the Present: Millennial Edition* (2006), Series Dc55.

[20] *Historical Statistics of the United States, Earliest Times to the Present: Millennial Edition* (2006), series Dc983-989.

[21] In the figures, institutional lenders include loans made (or held) by commercial banks, mutual savings banks, S&Ls, insurance companies, the Federal National Mortgage Association, and other institutional lenders. Non-institutional lenders include individuals, mortgage brokers, construction companies, trust departments of commercial banks, and others. Data for new and outstanding mortgages are from *Historical Statistics of the United States, Earliest Times to the Present: Millennial Edition* (2006), series Dc983-989 and series Dc914-921, respectively.

held by the HOLC reached a peak in 1935, when it held nearly 19 percent of all mortgage debt outstanding on 1- to 4-family homes. Thereafter, the HOLC share of outstanding debt gradually declined as the economy and private lenders continued to recover. Still, as late as 1941, the HOLC held about 10 percent of the value of outstanding residential mortgage debt.

Of the approximately one million loans made by the HOLC, some 20 percent ended in foreclosure or voluntary transfer of the underlying property to the HOLC. Foreclosures peaked during the recession of 1937-38. The HOLC was not quick to foreclose on delinquent loans, being "as considerate of delinquent but deserving borrowers as its responsibility to the Federal Government and the taxpaying public will permit" (*Third Annual Report of the Federal Home Loan Bank Board*, 1935, p. 600). The HOLC often counseled delinquent borrowers and readjusted payment schedules rather than moving quickly to foreclosure when borrowers fell behind on their payments. On average, HOLC loans were delinquent for two years before foreclosure (Harriss, 1951, p. 73).

Because the HOLC refinanced distressed loans, its foreclosure rate was higher than that of other lenders. For example, the foreclosure rate on loans made by life insurance companies during 1933-36 was a mere 2.6 percent, compared with nearly 20 percent for the HOLC (Harriss, 1951, p. 71). The limitation that HOLC loans not exceed 80 percent of a property's appraised value probably held down the agency's foreclosure rate, as did its policy of lending only to those borrowers who had a reasonable prospect of being able to service their loan. Furthermore, most HOLC loans were made somewhat after the trough of the business cycle, and rising household incomes helped to limit loan default rates.

It is difficult to determine the extent to which the HOLC contributed to a rebound in the housing market, let alone to the macroeconomic recovery. One study of county-level data found little association between HOLC lending and changes in housing values or homeownership rates between 1930 and 1940 (Fishback, Horrace, and Kantor, 2001). Nevertheless, in helping to clear a million delinquent loans from the books of private lenders, the HOLC undoubtedly contributed to the resumption of private mortgage lending.

The HOLC was liquidated in 1951. After 1936, the bulk of its activities consisted of managing the loans it had made during 1933-36, disposing of property acquired through foreclosure—including making new loans to assist in that process—and funding its operations. The HOLC never received a Congressional appropriation other than its initial \$200 million capitalization.[22] HOLC loans were funded by the agency's bond issues and operating income (interest, property rental income, etc.). Over its life, the HOLC had a net cumulative operating income of \$352 million, against a cumulative capital loss of \$338 million, principally from defaults on mortgage loans it had made. While the rapid growth in household incomes and property values from the mid-1930s through the 1940s held down the default rate on HOLC loans, falling interest rates

[22] Like other government agencies, however, the HOLC received free government services, such as free use of the postal system, and was exempt from paying Social Security taxes and overtime wages (Harriss, 1951, p. 161).

reduced the HOLC's cost of funds, thereby boosting its profit margin on outstanding loans.[23]

CONCLUSION

The recent distress in the U.S. home mortgage market has parallels in the experience of the Great Depression. Like the recent episode, the increase in mortgage delinquencies and foreclosures during the Depression coincided with a sharp decline in house prices after a period of rapid gains. Also like the recent experience, mortgage delinquencies during the Depression were more prevalent on mortgages with unconventional terms, such as short-term, non-amortizing loans. Furthermore, according to Saulnier (1956, p. 10), mortgage underwriting standards deteriorated before the downturn of the 1930s, as they did toward the end of the recent housing boom. However, unlike the recent experience, the main cause of mortgage loan distress during the 1930s was the sharply contracting economy and falling price level. One estimate is that, on January 1, 1934, about half of all mortgages on urban, owner-occupied houses were delinquent.[24] Not surprisingly, this level of distress prompted numerous local, state, and federal actions to relieve and reform mortgage markets.

The earliest calls for mortgage relief were in farming regions, and states with high farm foreclosure rates were more likely to impose foreclosure moratoria, though urban mortgage distress or other factors appear to have influenced the decision to impose moratoria in some states. For example, in New York, lobbying by commercial real estate

[23] The HOLC issued both short-term debt and callable long-term bonds. The average interest rate paid by the HOLC on its outstanding debt fell from 3.6 percent in 1934 to 2.1 percent in 1939, and to 1.1 percent in 1945-49 (Harriss, 1951, pp. 152-56). HOLC loans carried a contract interest rate of 5 percent, which was reduced for all borrowers to 4.5 percent in October 1939 (Harriss, 1951, p. 5).
[24] Bridewell (1938, p. 172).

interests helped shape legislation for a broad moratorium covering farm, urban residential, and commercial real estate mortgage foreclosures.

In most states, foreclosure moratoria were limited to borrowers who had some chance of paying or refinancing their loans. Relief often was denied to borrowers judged to have little prospect of ever paying off their mortgage.

Foreclosure moratoria resulted in both winners and losers. Although the rights of lenders to foreclose on collateral or to seek deficiency judgments were restricted, relief legislation did apparently contribute to a reduction in farm failures. The extent to which moratoria limited declines in property values and therefore the total number of mortgages at risk of foreclosure is unknown, however. Research has found that future borrowers bore some of the cost of debtor relief in the form of reduced loan supply and higher interest rates. The evidence from the use of foreclosure moratoria during the Great Depression demonstrates how legislative actions to reduce foreclosures can impose costs that should be weighed against potential benefits.

The federal government tackled the problem of delinquent mortgage loans directly by creating the Home Owners' Loan Corporation, which purchased delinquent loans from their originators. The HOLC purchased some one million loans, which it refinanced as long-term, fixed-rate, amortizing loans payable in monthly installments. Arguably, the HOLC was highly successful. Despite acquiring only delinquent loans, the HOLC ended up foreclosing on fewer than 20 percent of the loans it refinanced. Furthermore, the HOLC operated without a direct taxpayer subsidy (other than its initial $200 million capitalization, which it eventually repaid, and free access to government services). The HOLC did, however, refuse many loans on the grounds that the borrower lacked the income to make loan payments. The HOLC also loaned no more than 80 percent of the appraised value of the underlying property, though its appraisals were often higher than the current depressed market values. The HOLC also benefited financially from an expanding economy, rising house prices, and falling interest rates, which lowered its funding costs, especially during World War II.

The sharp increase in mortgage delinquencies and foreclosures in 2007 and 2008 prompted numerous calls for government intervention in housing and mortgage markets, including the creation of an HOLC-like agency to purchase delinquent mortgages. Any government response to mortgage distress would entail some cost. A full assessment of the benefits and costs of government programs to alleviate mortgage distress during the Depression requires further research. There is scant evidence that the acquisition of delinquent mortgages by the HOLC during the 1930s encouraged risky lending. However, the Great Depression experience may not be especially relevant for addressing how a taxpayer bailout of delinquent borrowers and their lenders would affect behavior today because of differences in the underlying causes of mortgage distress during the two periods. Conceivably, a bailout would more likely encourage risky behavior in the present situation (in which lax underwriting was an important cause of the increase in defaults) than during the Depression (when a sharp decline in economic activity was the main cause of defaults). Thus, while the federal response to mortgage distress during the Great Depression provides insights about how the government might respond to the current wave of defaults, the very different conditions underlying mortgage distress during the two periods warns against drawing strong conclusions from the historical experience for the current episode.

References

Alston, Lee J. "Farm Foreclosures in the United States During the Interwar Period." *Journal of Economic History*, December 1983, 43(*4*), pp. 885-903.

Alston, Lee J. "Farm Foreclosure Moratorium Legislation: A lesson from the Past." *American Economic Review*, June 1984, 74(*3*), pp. 445-457.

Barr, Michael S. Testimony before the United States Senate Committee on Banking, Housing, and Urban Affairs hearing on "Strengthening our Economy: Foreclosure Prevention and Neighborhood Preservation." Washington, DC: January 31, 2008.

Bernanke, Ben S. "Nonmonetary Effects of the Financial Crisis in the Propagation of the Great Depression." *American Economic Review*, June 1983, *73*(3), pp. 257-76.

Bridewell, David A. *The Federal Home Loan Bank Board and its Agencies: A History of the Facts Surrounding the Passage of the Creating Legislation, The Establishment and Organization of the Federal Home Loan Bank Board and the Bank System, The Savings and Loan System, The Home Owners' Loan Corporation, and the Federal Savings and Loan Insurance Corporation*. Washington, DC: Federal Home Loan Bank Board, 1938.

Central Housing Committee. "Special Report No. 1 on Social and Economic Effects of Existing Foreclosure Procedure and Emergency Moratorium Legislation." Horace Russell, Chairman. Submitted April 2, 1936.

Doan, Mason C. *American Housing Production 1880 to 2000: A Concise History*. Lanham, MA: University Press of America, 1997.

Federal Home Loan Bank Board. *Annual Report of the Federal Home Loan Bank Board*, various years.

Fishback, Price V.; Horrace, William C. and Kantor, Shawn. "The Origins of Modern Housing Finance: The Impact of Federal Housing Programs During the Great Depression." Working paper, September 2001.

Grebler, Leo; Blank, David and Winnick, Louis. *Capital Formation in Residential Real Estate: Trends and Prospects*. Princeton, NJ: Princeton University Press, 1956.

Haar, Charles M. *Federal Credit and Private Housing: The Mass Financing Dilemma*. New York: McGraw Hill, 1960.

Harriss, C. Lowell. *History and Policies of the Home Owners' Loan Corporation*. New York: National Bureau of Economic Research, 1951.

Jaffe, Austin J. and Sharp, Jeffery M. “Contract Theory and Mortgage Foreclosure Moratoria.” *Journal of Real Estate Finance and Economics*, January 1996, 12(*1*), pp. 77-96.

Kahn, Charles M. and Yavas, Abdullah. “The Economic Role of Foreclosures.” *Journal of Real Estate Finance and Economics*, January 1994, 8(*1*), pp. 35-51.

Meador, Mark. “The Effects of Mortgage Laws on the Home Mortgage Rates.” *Journal of Economics and Business*, 1982, 34(*2*), pp. 143-48.

Morton, Joseph Edward. *Urban Mortgage Lending: Comparative Markets and Experience*. Princeton, NJ: Princeton University Press, 1956.

Pence, Karen M. “Foreclosing on Opportunity: State Laws and Mortgage Credit.” *Review of Economics and Statistics*, 2006, 88(*1*), pp. 177-82.

Pollock, Alex J. Testimony before the United States Senate Committee on Banking, Housing, and Urban Affairs hearing on “Strengthening our Economy: Foreclosure Prevention and Neighborhood Preservation.” Washington, DC: January 31, 2008.

Poteat, J. Douglass. “State Legislative Relief for the Mortgage Debtor During the Depression.” *Law and Contemporary Problems*, 1938, *5*, pp. 517-44.

Rucker, Randal R. “The Effects of State Farm Relief Legislation on Private Lenders and Borrowers: The Experience of the 1930s.” *American Journal of Agricultural Economics*, February 1990, 72(*1*), pp. 24-34.

Rucker, Randal R. and Alston, Lee J. “Farm Failures and Government Intervention: A Case Study of the 1930s.” *American Economic Review*, September 1987, 77(*4*), pp. 724-30.

Saulnier, R. J. *Urban Mortgage Lending: Introduction*. Princeton, NJ: Princeton University Press, 1956, pp. 3-13.

Skilton, Robert H. *Government and the Mortgage Debtor (1929 to 1939)*. PhD Dissertation, University of Pennsylvania, Philadelphia, 1944.

Wallace, E.S. “Survey of Federal Legislation Affecting Private Home Financing Since 1932.” *Law and Contemporary Problems*, 1938, pp. 481-509.

Wheelock, David C. “The Federal Response to Home Mortgage Distress: Lessons from the Great Depression.” *Federal Reserve Bank of St. Louis Review*, May/June 2008a, 90(*3*), pp.133-48.

Wheelock, David C. “Changing the Rules: State Mortgage Foreclosure Moratoria During the Great Depression.” *Federal Reserve Bank of St. Louis Review*, November/December 2008b, 90(6), forthcoming.

Table 1

State Mortgage Moratoria during the Great Depression

States imposing moratoria	**States not imposing moratoria**
Arizona	Alabama
Arkansas	Colorado
California	Connecticut
Delaware	Florida
Idaho	Georgia
Illinois	Indiana
Iowa	Kentucky
Kansas	Maine
Louisiana	Maryland
Michigan	Massachusetts
Minnesota	Missouri
Mississippi	New Jersey
Montana	New Mexico
Nebraska	Nevada
New Hampshire	Rhode Island
New York	Tennessee
North Carolina	Utah
North Dakota	Virginia
Ohio	Washington
Oklahoma	West Virginia
Oregon	Wyoming
Pennsylvania	
South Carolina	
South Dakota	
Texas	
Vermont	
Wisconsin	

SOURCE: Skilton (1944, p. 78).

Table 2

Federal Government Agencies Created in Response to Home Mortgage Distress in the 1930s

Federal Home Loan Bank System (FHLB)
- Authorized under Federal Home Loan Bank Act of 1932
- Established 12 regional Federal Home Loan Banks
- Created to provide a stable source of funds to member firms for residential-mortgage and economic-development loans

Home Owners' Loan Corporation (HOLC)
- Established by the Home Owners' Loan Corporation Act of 1933
- Purchased and refinance distressed mortgages on 1- to 4-family homes, subject to income and loan qualifications
- Issued over one million loans between August 1933 and June 1936
- Liquidated in 1951

Federal Housing Administration (FHA)
- Established by the National Housing Act of 1934
- Offers home mortgage insurance on 1- to 4-family homes
- Intended to stabilize mortgage market and improve housing standards and conditions

Federal Savings and Loan Insurance Corporation (FSLIC)
- Established by the National Housing Act of 1934, administered by FHLB
- Provided deposit insurance for savings and loan associations
- Abolished under Financial Institutions Reform, Recovery and Enforcement Act of 1989

Federal National Mortgage Association (FNMA)
- Established in 1938 by the Reconstruction Finance Corporation
- Created to establish a secondary mortgage market by purchasing FHA-insured loans at par and accrued interest
- 1948 National Housing Act amendment gave FNMA a federal charter to become independent of the RFC; FNMA given authority to purchase FHA and Veterans Administration (VA)–insured loans
- 1968 Chartered by Congress as a government-sponsored private corporation

SOURCE: Annual Report of the Federal Home Loan Bank Board (1933, 1934, 1951), Haar (1960), Harris (1951), Fannie Mae website (www.fanniemae.com/about), and Wallace (1938).

Figure 1: Nonfarm Real Estate Mortgage Foreclosure Rate, 1926-41

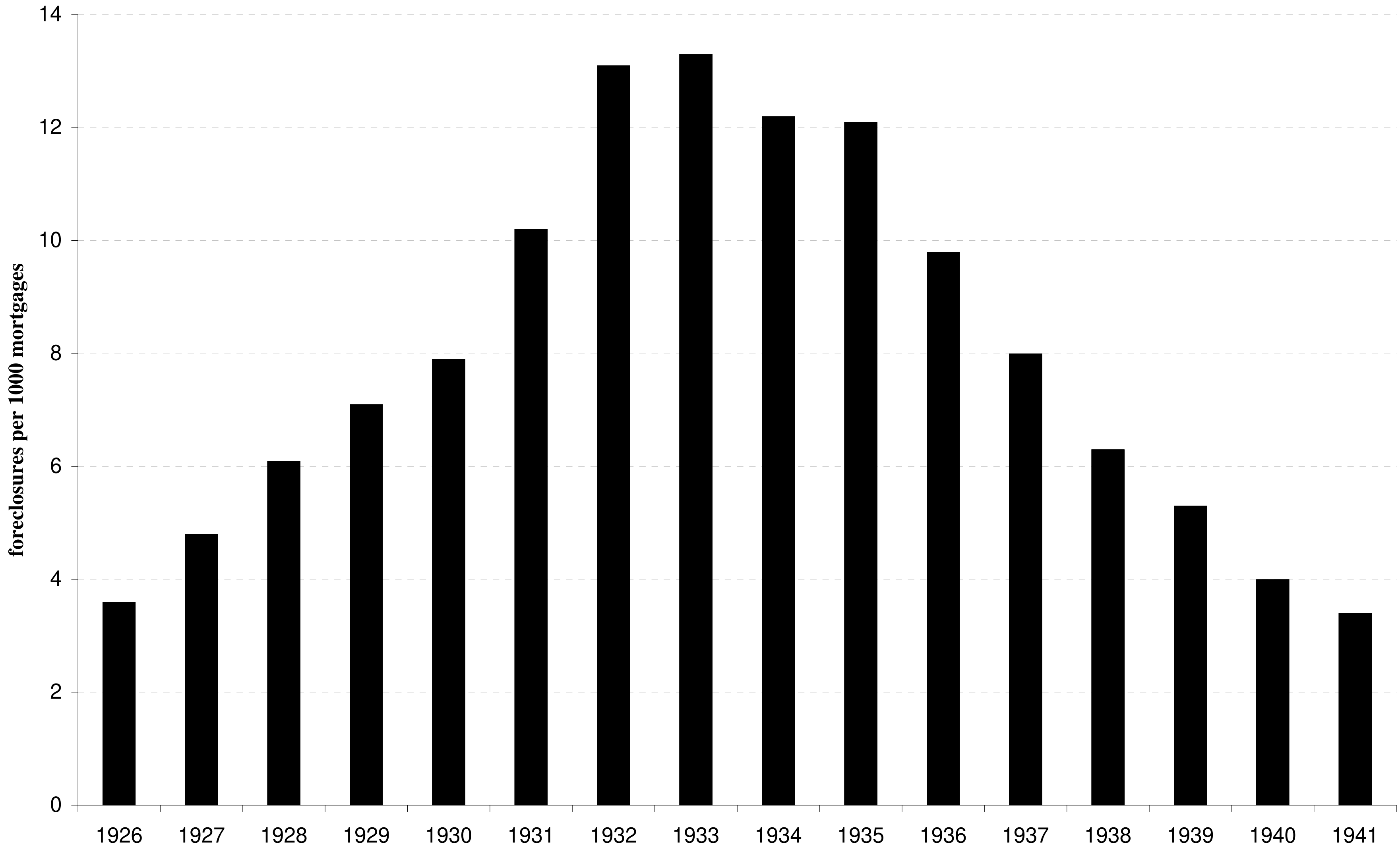
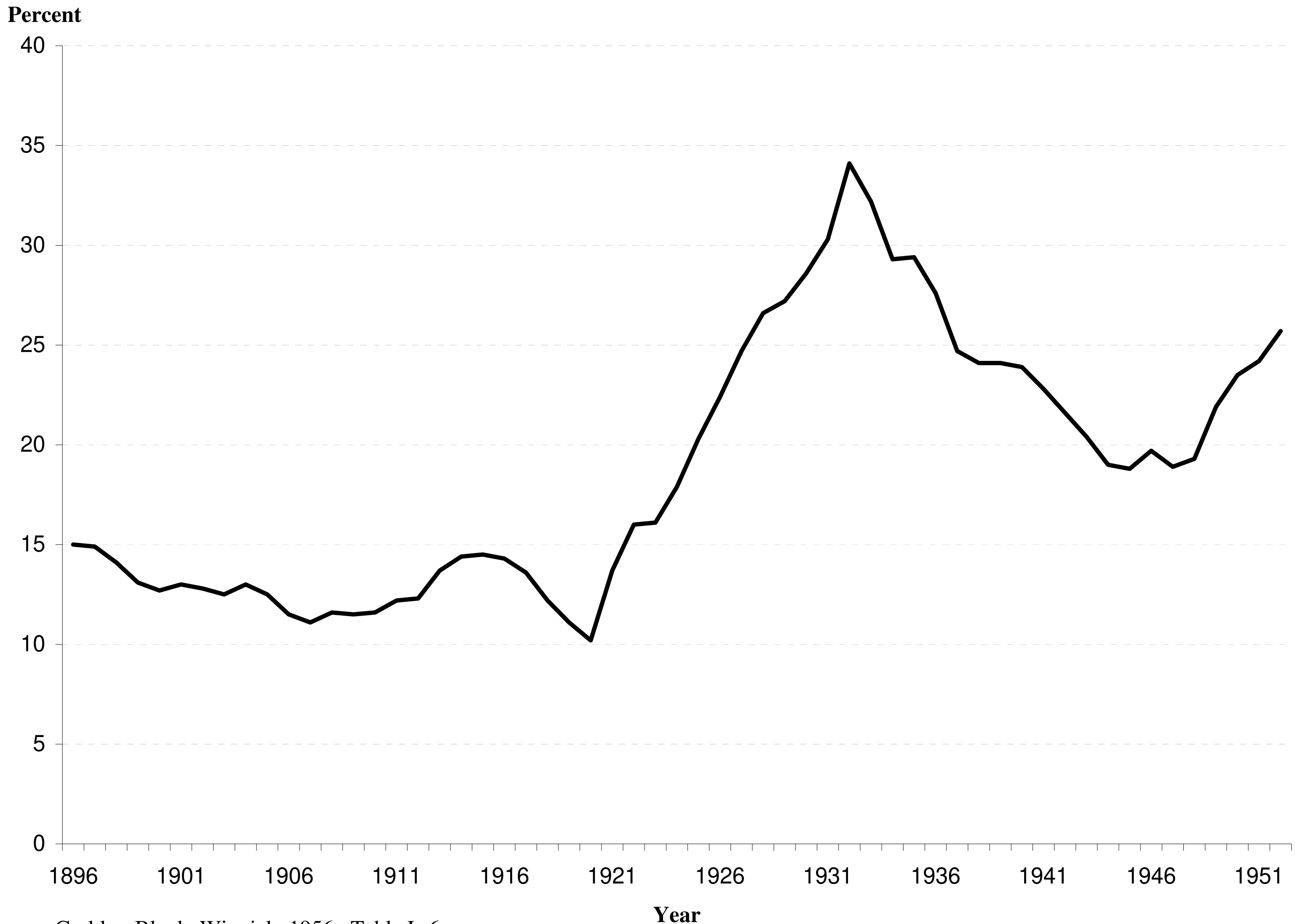


Figure 2: Nonfarm Residential Mortgage Debt as a Percentage of Nonfarm Residential Wealth



Source: Grebler, Blank, Winnick, 1956. Table L-6

Figure 3: House Price Index, 1900-34

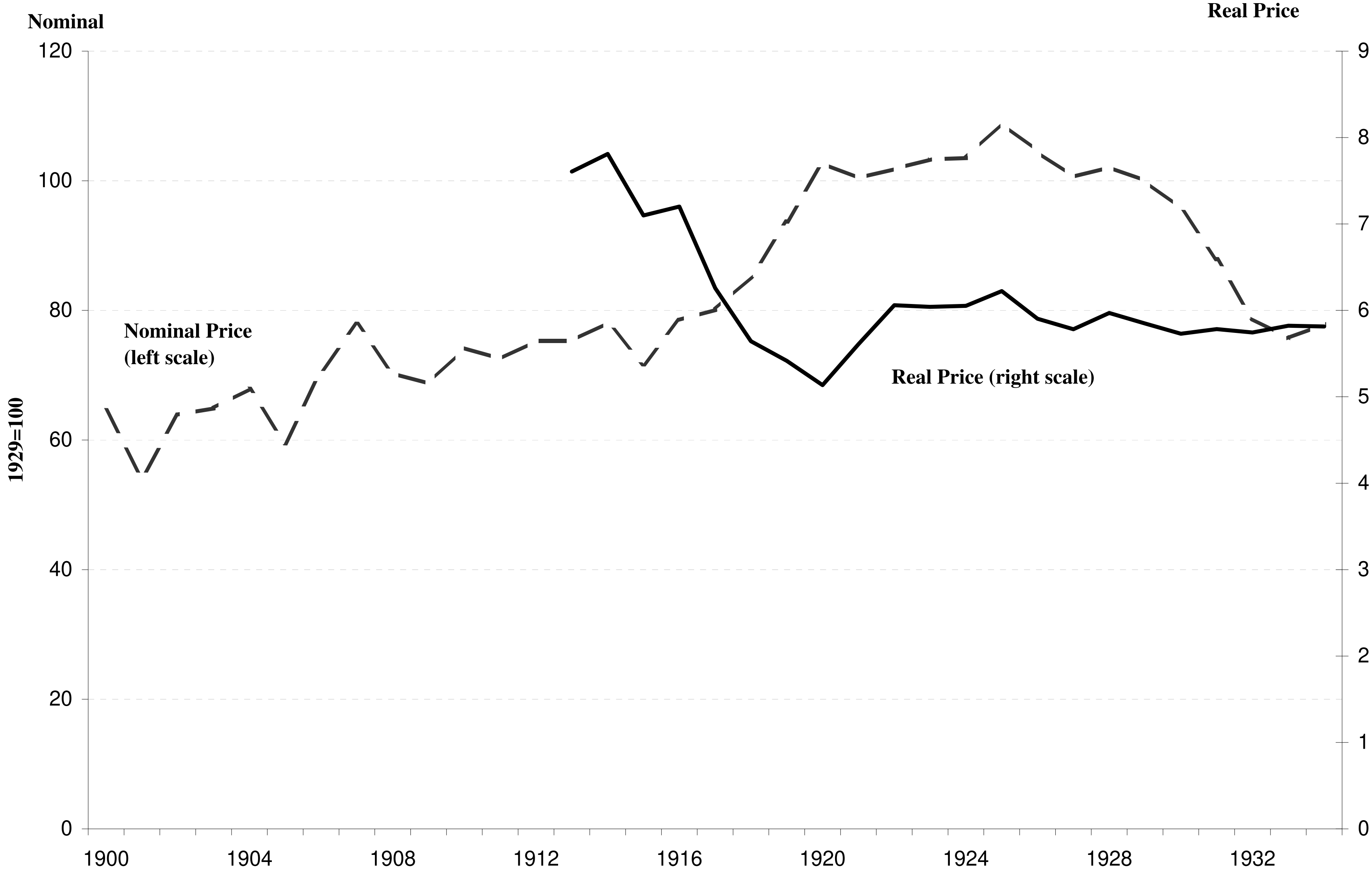


Figure 4: States Imposing Foreclosure Moratoria During the Great Depression

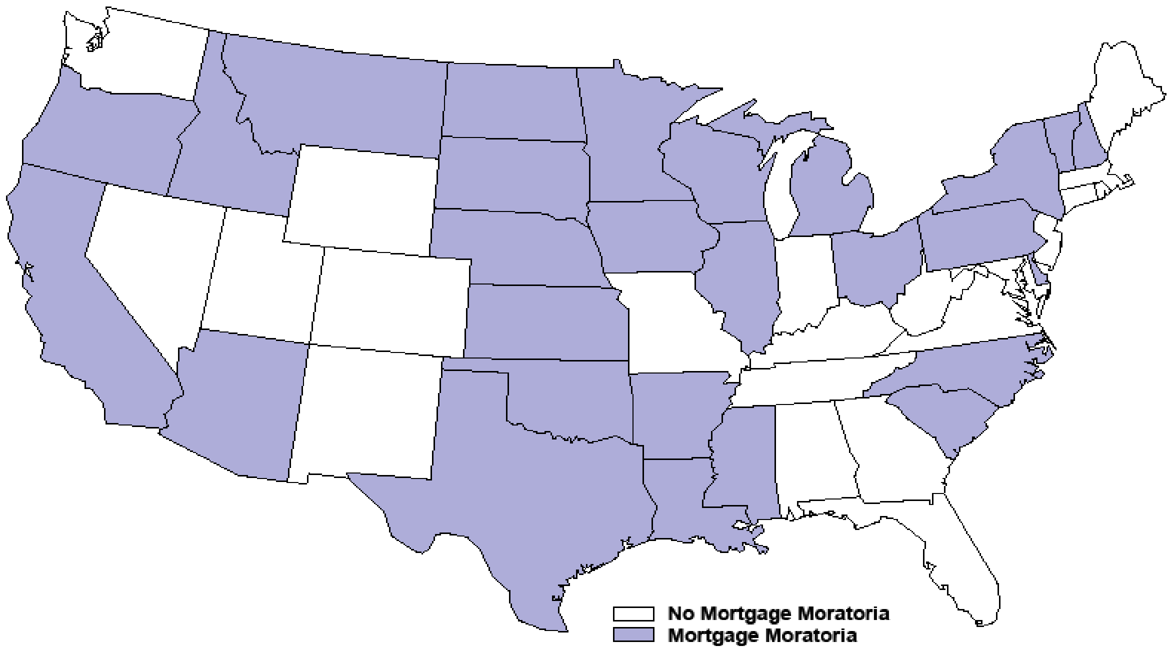


Figure 5: Average Farm Foreclosure Rates, 1929-32

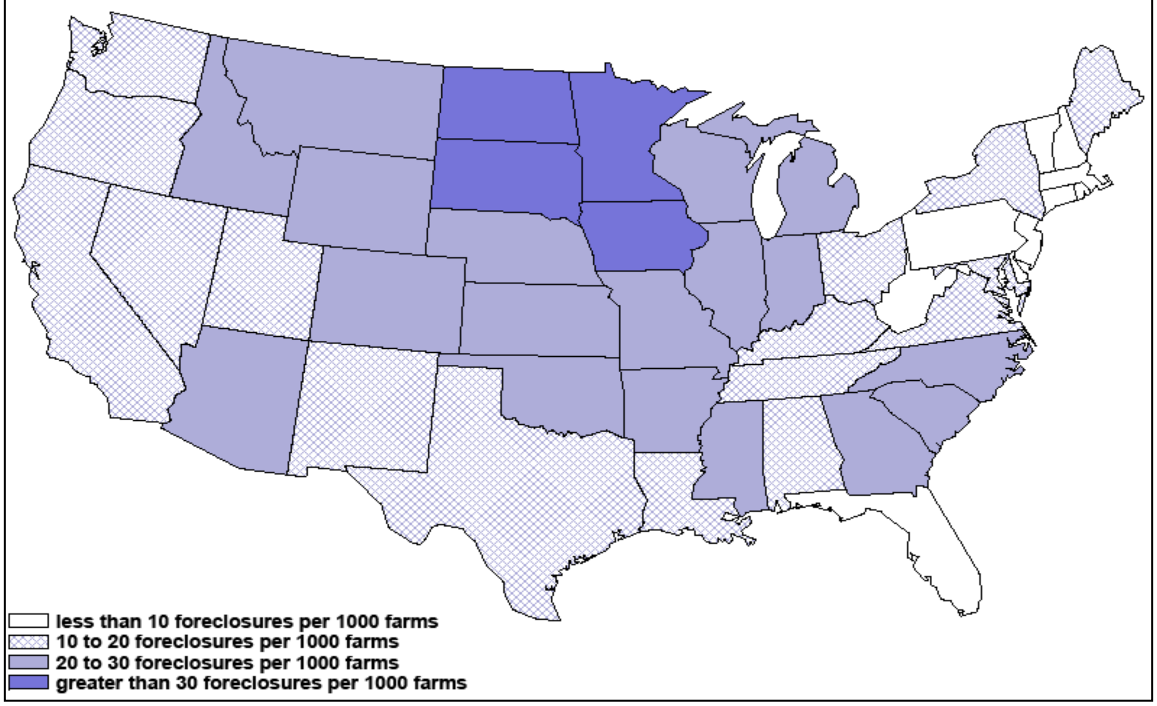
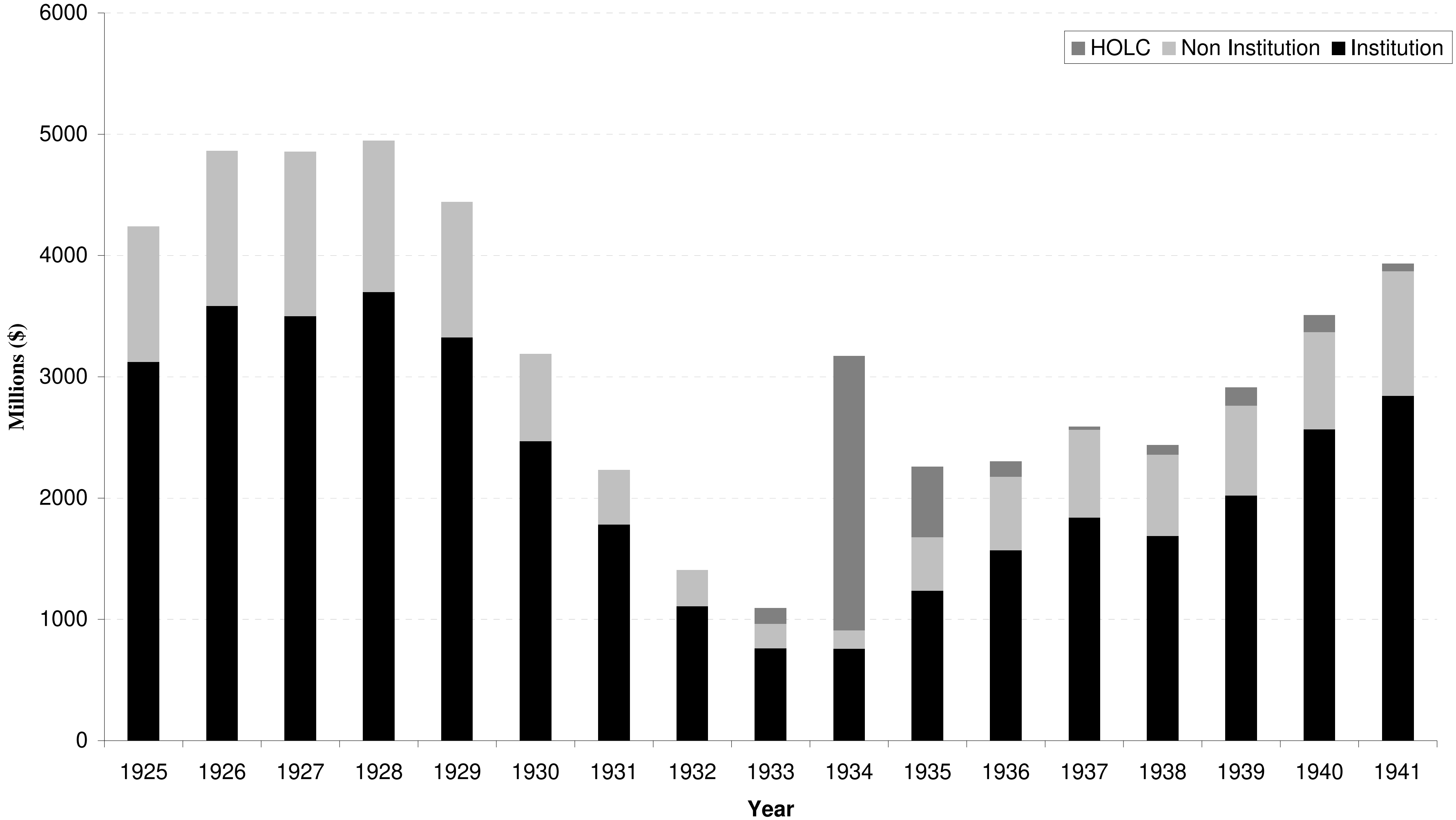


Figure 6: Share of New Mortgages, by Lender



Source: Historical Statistics of the United States, series DC983-989

Figure 7: Outstanding Mortgage Debt by Lender, 1925-1941