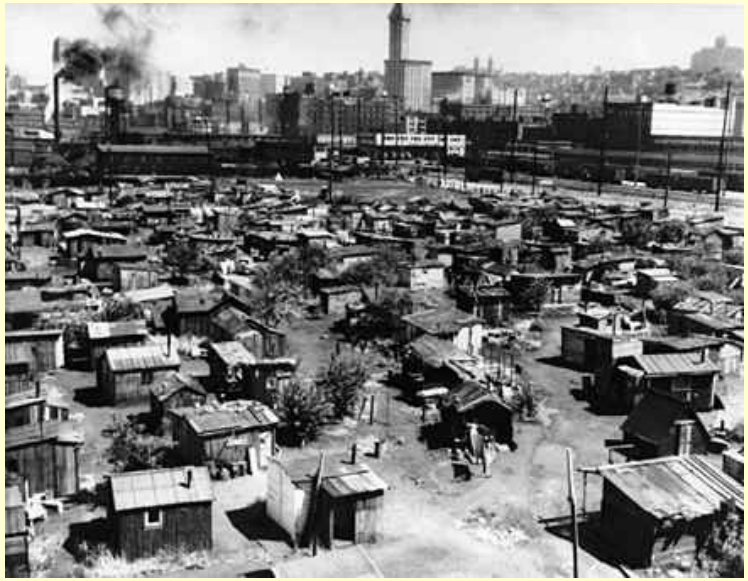
Government Response to Home Mortgage Distress:

Lessons from the Great Depression



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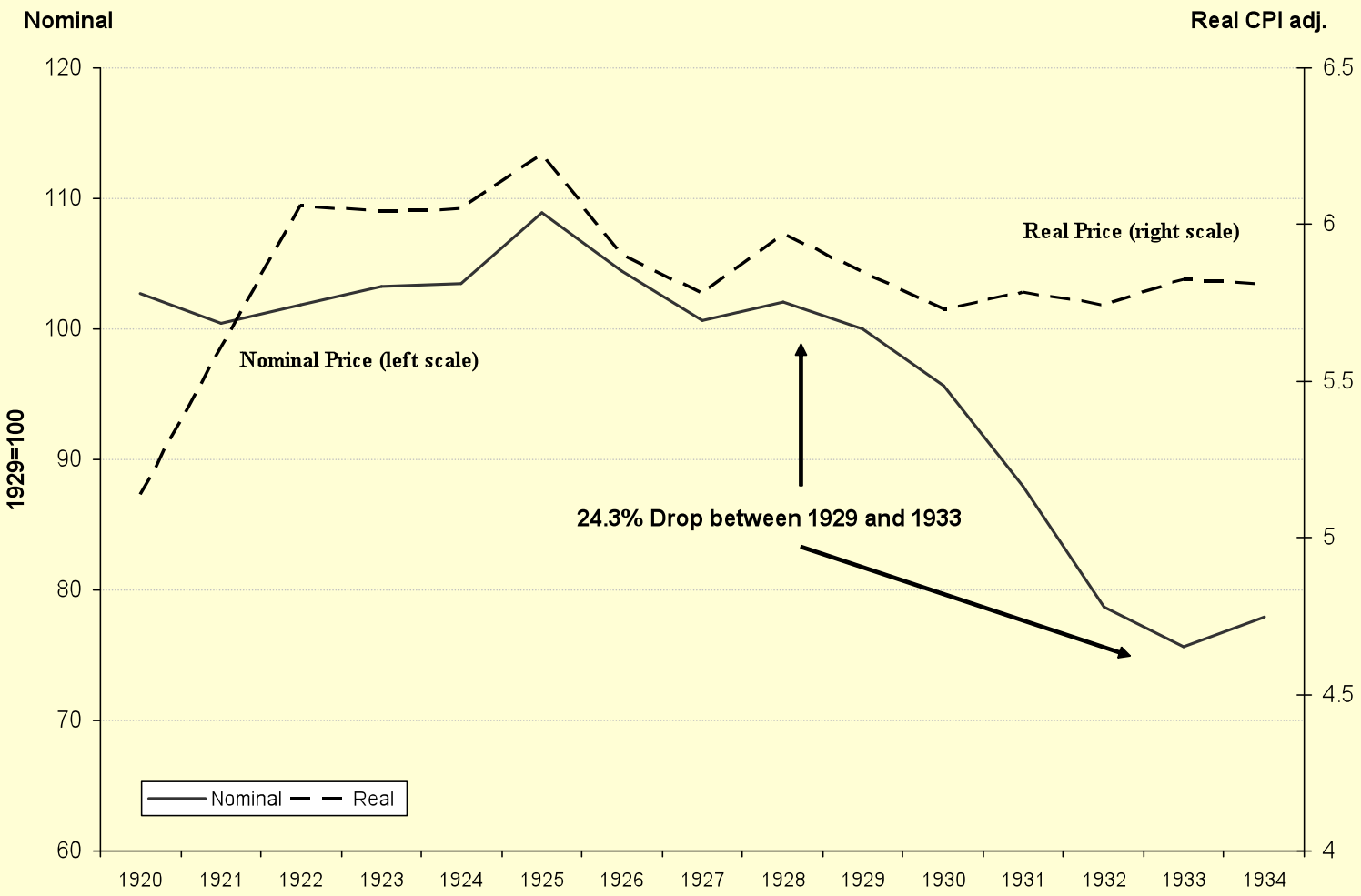
*Views expressed are not necessarily official positions of the Federal Reserve Bank of St. Louis or the Federal Reserve System.

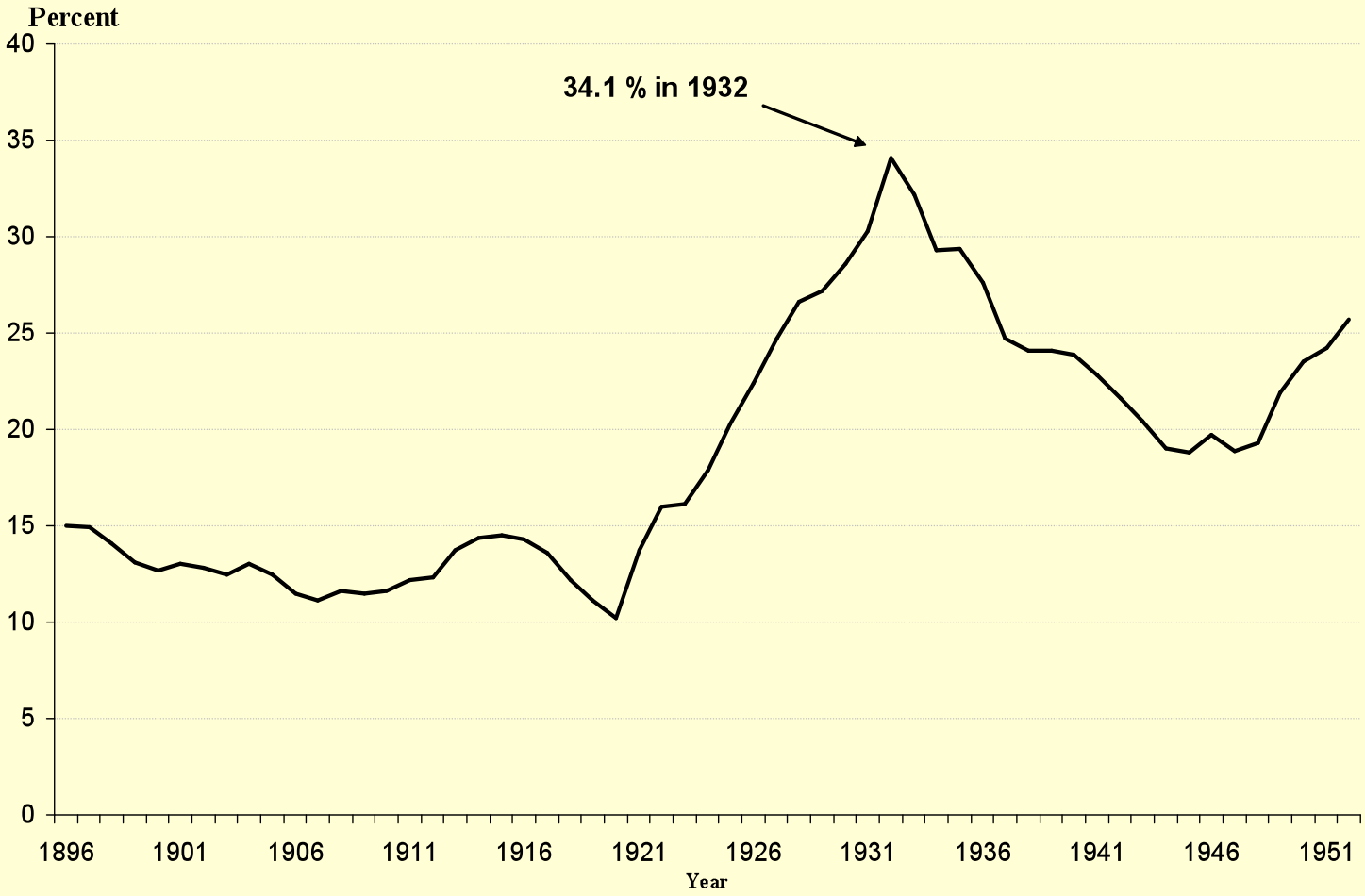
How Bad Was the Great Depression?

- 80% decline in stock market (30% Oct.'07– Oct.'08)
- 29% decline in real GDP (+2.2% 2007:Q2 – 2008:Q2)
- 25% unemployment rate (6.1% Aug. 2008)
- 7000 bank failures (Fannie, Freddie, Bear Stearns, IndyMac, Lehman, AIG)
- House prices fell 24% between 1929 and 1933 (18% 2006:Q2 – 2008:Q2 (S&P); 6% April 2007 – July 2008 (OFHEO))
- Nonfarm mortgage debt reached 34% of household wealth in 1932 (19% 2008:Q2)

House Price Trends, 1920-34



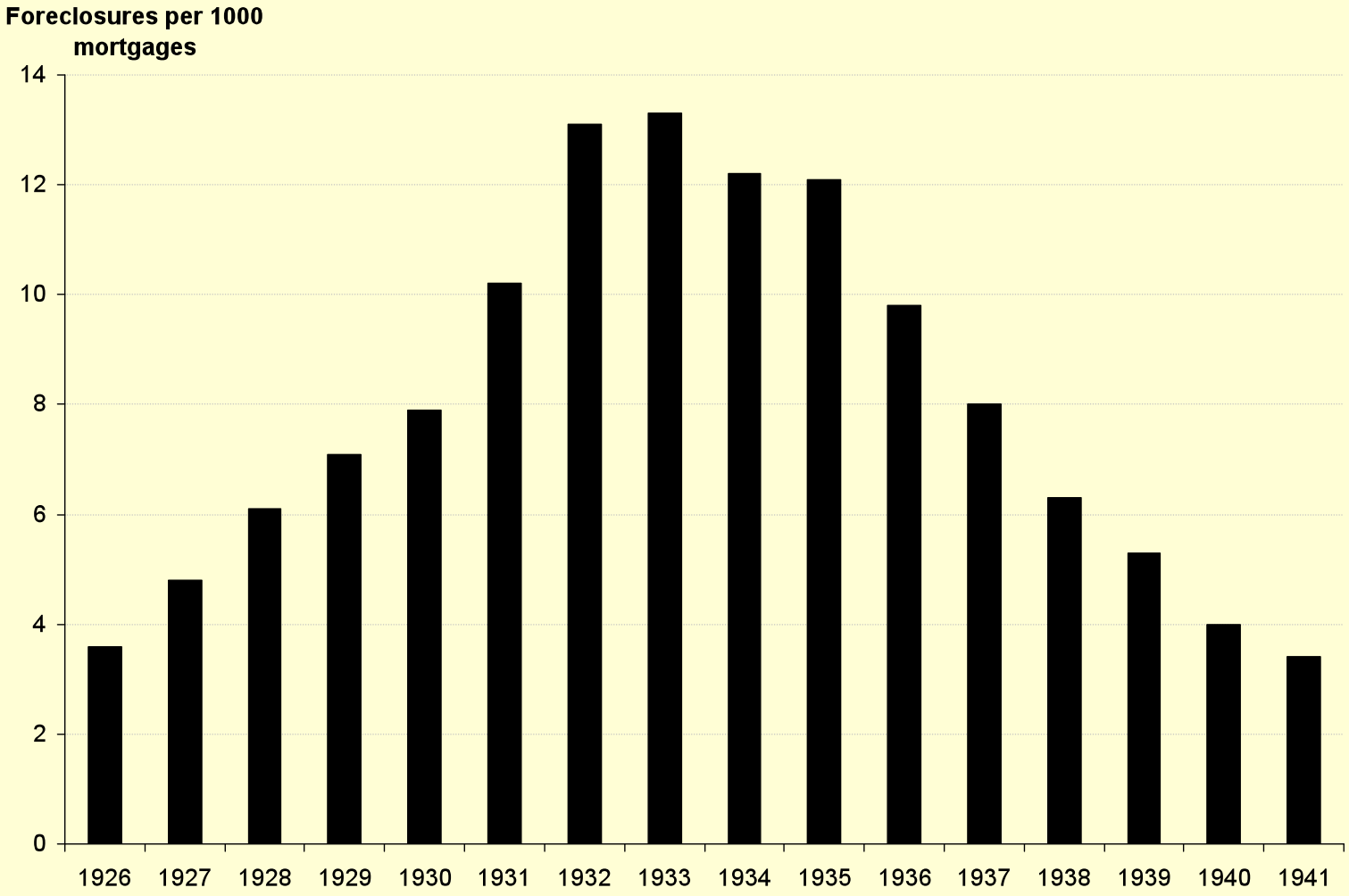
Nonfarm Mortgage Debt (% of Household Wealth)



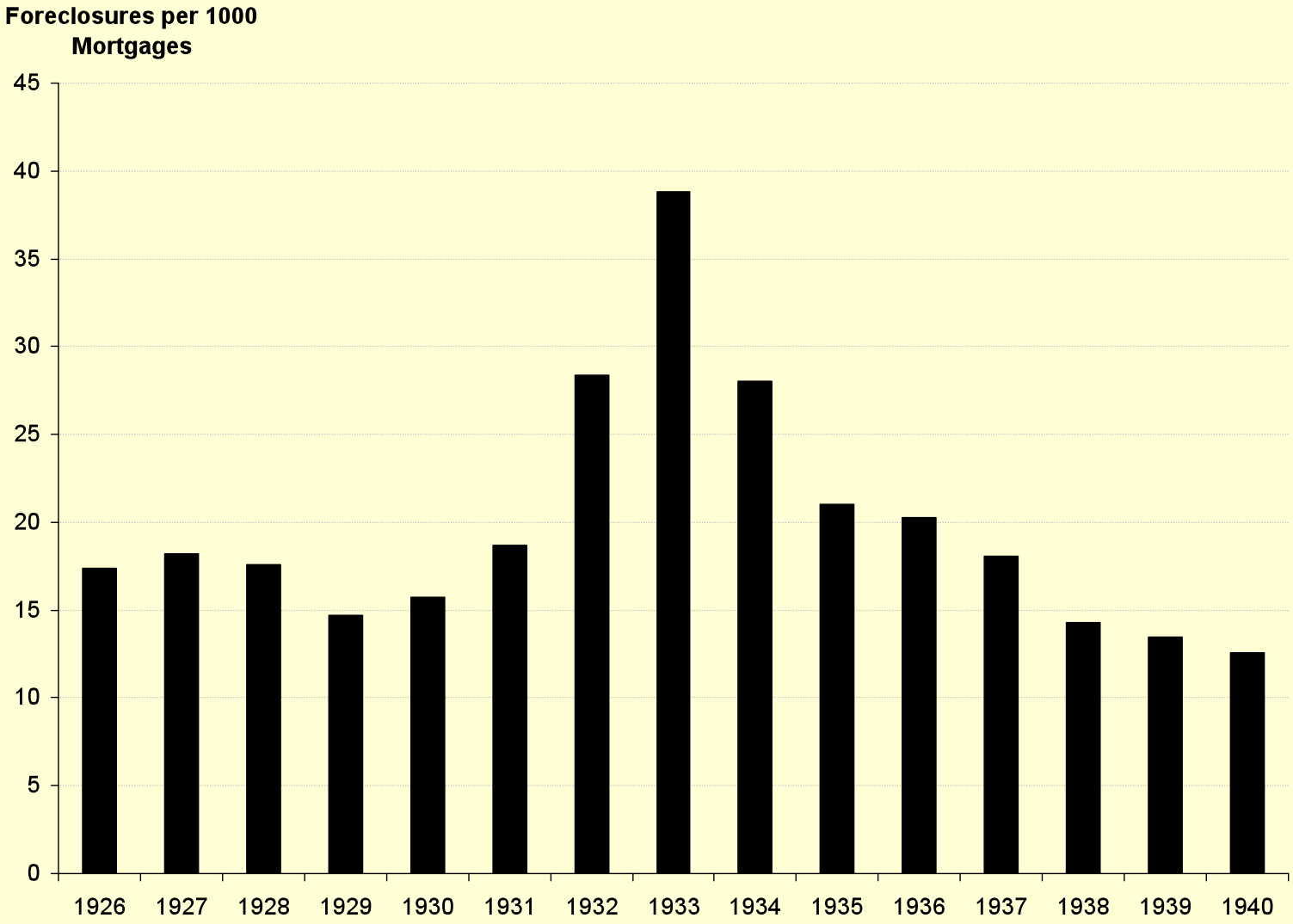
Mortgage Distress

- Many mortgages were short-term, non-amortizing – Hard to refinance during the Depression
- 50% of mortgages were delinquent (4.5% of mortgages were seriously delinquent in 2008:Q2)
- But, foreclosure rates were similar to those now (1.4% in 1933 vs. 2.5% in 2008:Q2).

Nonfarm Mortgage Foreclosure Rate



Farm foreclosure rate



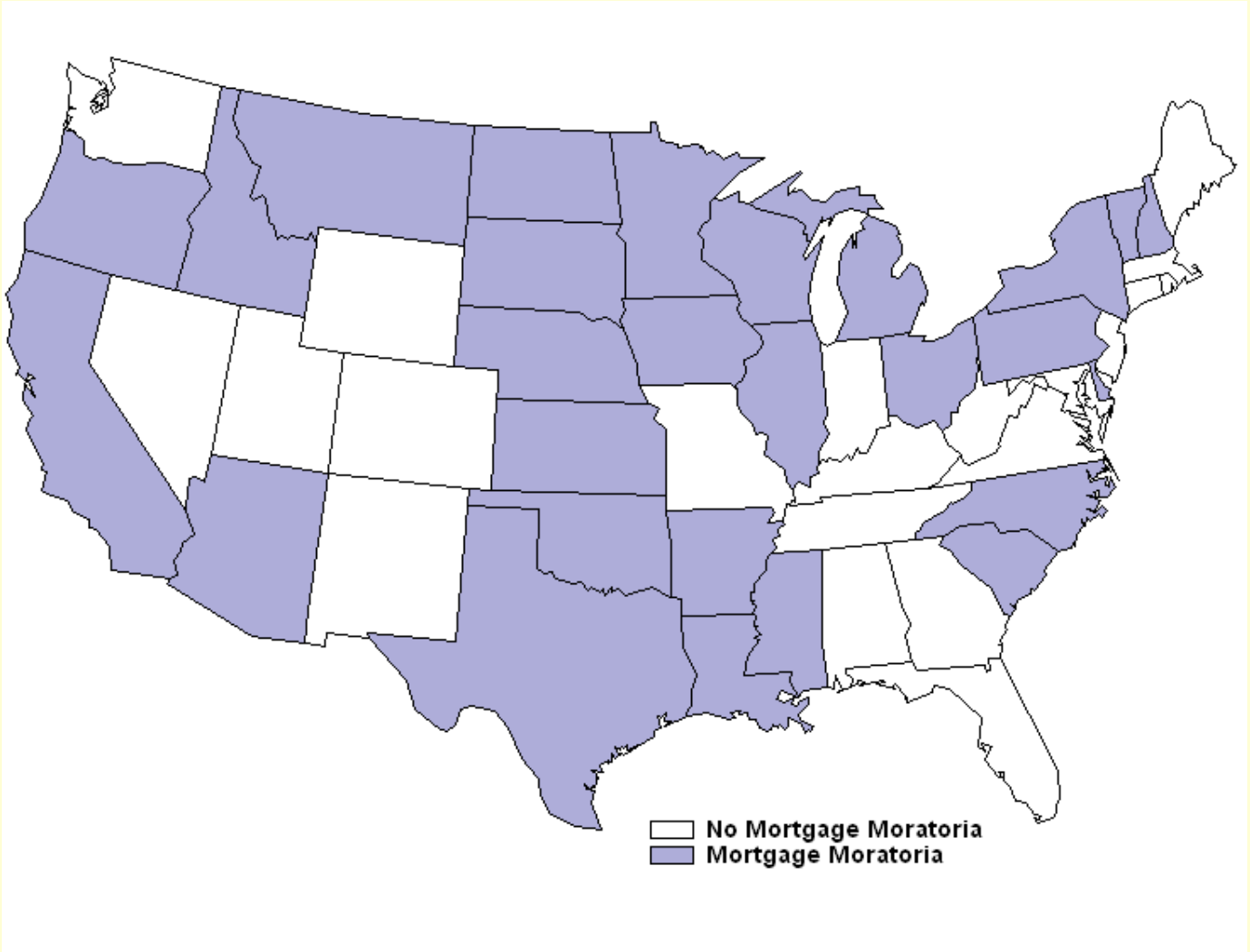
Government Response to Mortgage Distress

- Foreclosure moratoria
- Home Owners' Loan Corp. purchased many delinquent loans
- Permanent reforms – FHA, FNMA (Fannie Mae), FSLIC, FHLB (Fed. Home Loan Banks) helped mobilize funds for home mortgage lending, and made long-term, amortizing loan the standard.

Foreclosure Moratoria

- Frazier-Lemke Acts of 1934-35 imposed a federal moratorium on farm mortgage foreclosures.
- 27 states imposed moratoria on farm and nonfarm mortgage foreclosures in 1933-34 (Iowa was the first).

States with Foreclosure Moratoria



Effects of Moratoria

- Reduced number of foreclosures (moratoria were limited to “deserving” cases)
- Were often combined with other changes that favored borrowers (esp. increased redemption periods and caps on deficiency judgments)
- Reduced loan supply and increased costs for subsequent borrowers

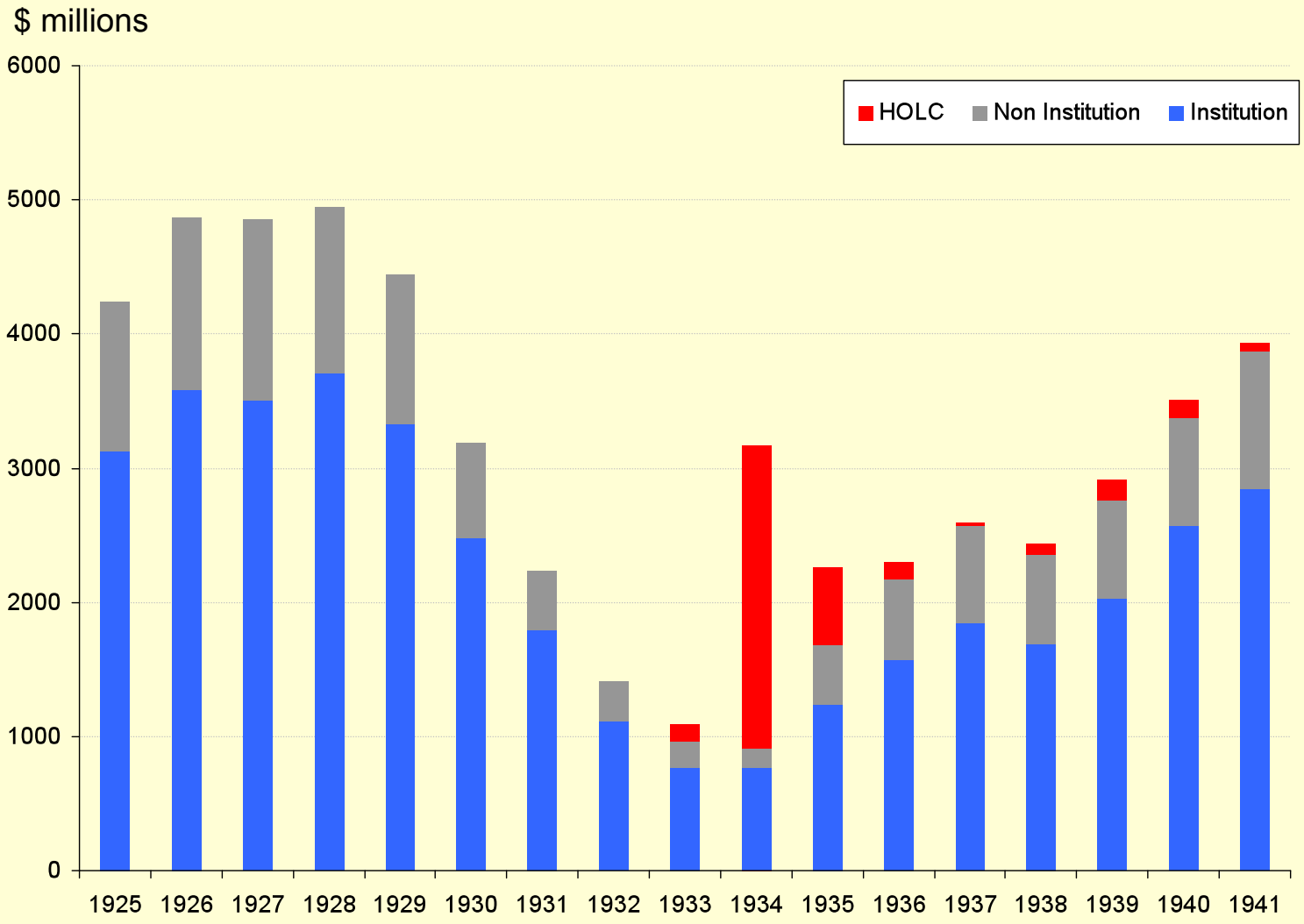
Home Owners' Loan Corp.

- Purchased one million delinquent loans from lenders totaling $3.1 billion ($50 billion 2008 dollars) during 1933-36.
- Equal to 3.4% of value of residential structures in 1933 ($604 billion relative to value of structures in 2007).
- Equal to 13.4% of outstanding nonfarm residential mortgage debt in 1933 ($1,619 billion relative to value of mortgage debt in 2008:Q1).

Home Owners' Loan Corp.

- HOLC-acquired loans were refinanced as 15-year fixed-rate amortizing loans.
- Loans had to qualify (borrower income; 80% max. loan/value).
- HOLC was reasonably successful – it benefited from recovering economy and falling interest rates.
- Still, HOLC foreclosed on 20% of its loans.

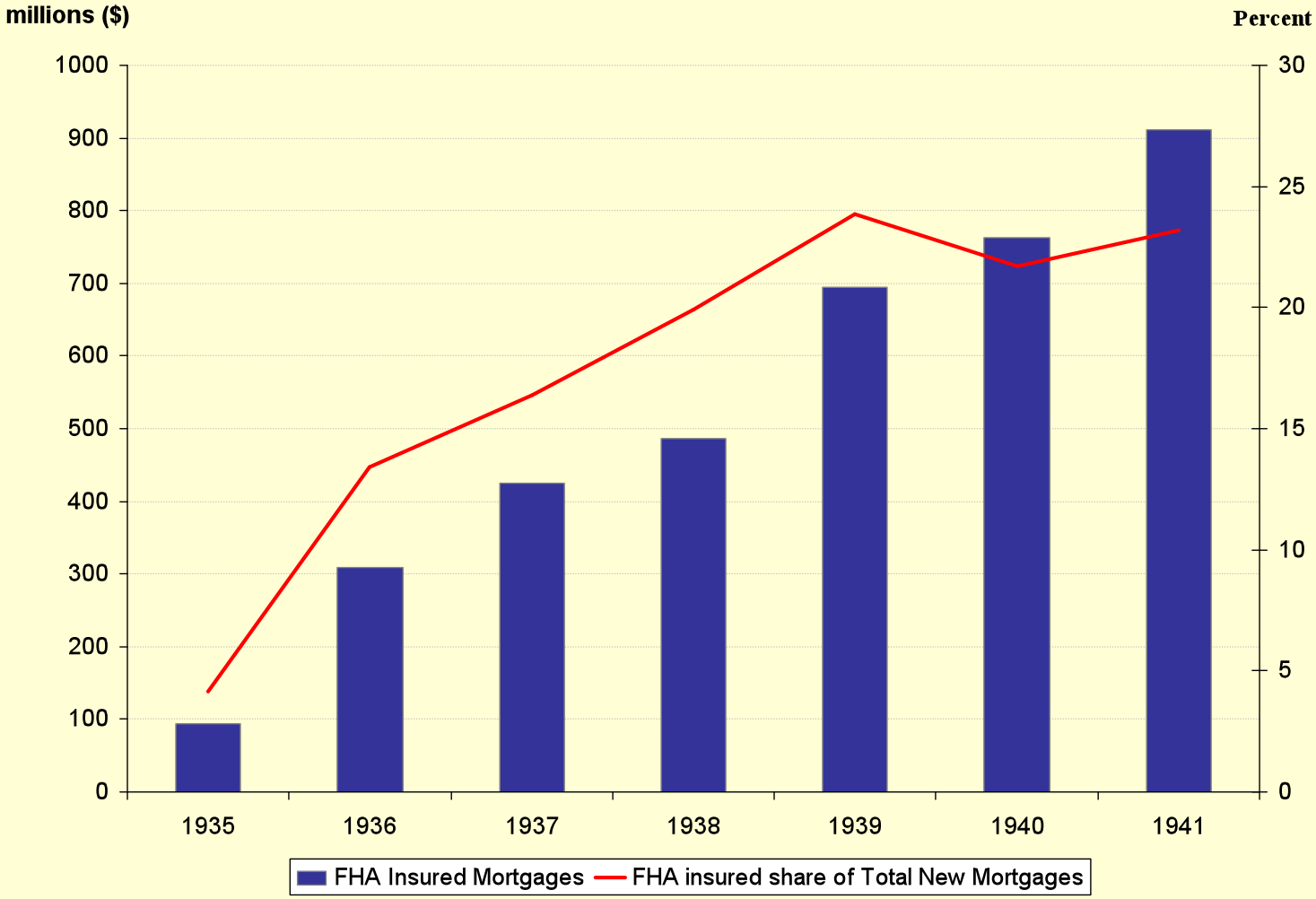
New Mortgages by Lender Type



FHA and FNMA

- Federal Housing Administration established in 1934. Insurance program for qualifying loans.
- FNMA ("Fannie Mae") created in 1938 to purchase FHA-insured loans. Held 1% of home mortgages by 1941.

FHA Insured Mortgages by Dollar Amount, 1935-1941



Lessons?

- Moratoria and HOLC reduced foreclosures and cleared one million delinquent loans off the books of lenders.
- But, neither policy was costless:
  - Moratoria reduced loan supply and increased borrowing costs;
  - HOLC received a taxpayer subsidy
- Long-term reforms (e.g., FHA, Fannie Mae, FSLIC) helped provide a stable, tax payer-subsidized source of funds for mortgage lending until the 1980s and today.