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The Creation of Homeownership: How New Deal Changes in Banking Regulation Simultaneously Made Homeownership Accessible to Whites and Out of Reach for Blacks

ABSTRACT. The Federal Government, in creating the section 203(b) mortgage insurance program during the New Deal, transformed homeownership in America into the main way that middle-class households build wealth. In the first three decades of the program's existence, however, this wealth-building opportunity was not shared with African-Americans. This Note reveals a pervasive, previously ignored regulatory system at both the state and federal level that gave the section 203(b) program a monopoly in offering the kinds of loans that first-time homebuyers needed. These statutes meant that even nongovernmental entities could not offer most African-Americans the opportunity to become homeowners.

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INTRODUCTION

From 1920 to 1960, the rate of owner occupancy in the American housing market rose from 46% to 62%.¹ These numbers, however, explain only a small part of the significance of the federal government's New Deal intervention in the housing market. The creation of the Federal Housing Administration (FHA) to insure lenders against the risk of default on single-family mortgages fundamentally transformed what it meant to own a house in America. Prior to the 1930s, owner-occupied housing was a good held primarily for reasons of consumption—not investment—and usually acquired late in life.² Through New Deal reforms, homeownership became the primary mechanism that middle-class Americans use to build assets.³ Today, 60% of the total assets of middle-class Americans are held in owner-occupied homes.⁴

Transforming America's housing market required a legal revolution, one that previous commentators have not fully explained. In order to make homeownership affordable to most Americans over the majority of their working lives, lenders had to accept far lower down payments than they ever had before—saving up for the pre-New Deal standard of one-third or more of the value of the home could take many years. And they had to allow homebuyers to spread out loan payments over far longer terms than they had before—the prior practice of making a mortgage to a homebuyer for only five to seven years made it impossible for most people to ever fully own their homes. State and federal banking law prohibited lenders from lowering down payment requirements and lengthening terms, and for good reason. Such changes would pose genuine threats to lenders' "safety and soundness" because they would expose lenders to greater risks of default.⁵

Despite the risk involved, the FHA decided that it would insure low-down-payment, long-term mortgages in order to promote homeownership. Once the FHA had made that decision, it needed to change dozens of federal and state laws to make those mortgages legal. It had a very good argument for doing so: The increased rate of default on such loans would not threaten lenders' safety and soundness because the FHA, as an insurer, would take over payments in

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1. 2 BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, HISTORICAL STATISTICS OF THE UNITED STATES: COLONIAL TIMES TO 1970, at 646 (corrected reprint 1989) [hereinafter BUREAU OF THE CENSUS, HISTORICAL STATISTICS].
 2. See *infra* Section I.A.
 3. See *infra* Section I.B.
 4. Edward N. Wolff, *Recent Trends in Wealth Ownership, from 1983 to 1998*, in ASSETS FOR THE POOR 34, 46 (Thomas M. Shapiro & Edward N. Wolff eds., 2001). This is the rate for the middle three quintiles of Americans by wealth.
 5. See *infra* Section II.A.

case of default. This Note illuminates for the first time how the FHA convinced all federal bank regulators and all forty-eight state legislatures to make exceptions to safety-and-soundness regulations for loans that it insured.⁶

I argue that these policies, while logical and benign on the surface, in fact produced devastating results for African-Americans. As historian Kenneth Jackson and others have described, the FHA's core insurance program, section 203(b), systematically discriminated against African-Americans.⁷ The FHA produced underwriting guidelines based on an economically and historically flawed understanding of a "natural" progression of neighborhood racial change from all-white (with high property values) to all-black (with low property values). These guidelines rated a neighborhood's suitability for insurance based on racial composition, encouraged or mandated racial covenants as a condition for insurance, and discouraged integrated neighborhoods.

Commentators such as Paul Boudreaux and Robert Ellickson have downplayed the importance of the FHA's racial discrimination, instead arguing that personal preferences have driven racial segregation.⁸ Underlying their skepticism of the FHA's importance is the reasonable question: "If substantial numbers of African-Americans would have taken out insured mortgages, why didn't businesses develop to serve that market?" This Note answers that question for the first time. Congress and state legislatures granted exemptions to bank safety-and-soundness regulations only for FHA-insured mortgages – not for mortgages insured by the private sector. Thus, if the FHA would not insure a particular borrower, that borrower could not get a low-down-payment, long-term mortgage from any source.⁹ The FHA's discretionary guidelines effectively became binding law, giving whites a generation's head start on accumulating wealth through homeownership, a fact reflected in concrete data from the census and land records.¹⁰ This reality suggests that government policy fostered segregated housing patterns to a greater degree than many commentators have previously thought.

I argue that the integration of section 203(b) forty years ago through an Executive Order by President Kennedy¹¹ did not sufficiently remedy the pervasive system of FHA discrimination against African-Americans. Simply making FHA-insured loans available to blacks did not compensate for the dramatic advantage that whites had enjoyed for decades in the homebuying

6. See *infra* Sections II.B-D.

7. See *infra* Section III.A. Section 203(b) was originally passed as part of the National Housing Act, Pub. L. No. 73-479, § 203, 48 Stat. 1246, 1248 (1934).

8. See *infra* Section III.C.

9. See *infra* Section II.A.

10. See *infra* Sections II.E, III.B.

11. See *infra* Section IV.A.

market, an advantage that may explain why the median white household has ten times as much wealth as the median black household today.¹² In addition, the end of discrimination in the FHA program failed to eliminate the view of neighborhood racial transition and composition that the FHA's insurance guidelines cemented in the American mind: that whites could prosper only by living separately from blacks, and that blacks moving into a neighborhood signified imminent price decline. The past acceptance of these empirically faulty characterizations as official federal policy may help account for why American metropolitan areas remain highly segregated by race.¹³

I end this Note by briefly considering potential remedies to housing segregation and racial disparities in wealth that others have proposed. I do not explicitly endorse these remedies or exhaustively describe their constitutional implications. Because this Note fully explains for the first time the regulatory base that girded the FHA's discretionary administrative actions, I simply wish to suggest areas in which my research may help build a stronger case for action to remedy past discrimination and ongoing inequalities.¹⁴

Much of my data and examples derive from Connecticut records, particularly those covering New Haven. However, the patterns I describe could be seen in any metropolitan area, and I cite national data and statutes from all states to show that Connecticut's experience mirrored those of other states.

I. CREATING AN ASSET CLASS: HOW THE NEW DEAL REDEFINED HOMEOWNERSHIP

A. *Why Early Homebuying Did Not Result in Asset Building*

Today, Americans think of buying a home as a way to build stability—one that provides both a guaranteed place to live for years to come (as long as the mortgage payments are met) and a way to build assets. And, for most homebuying Americans, the system actually provides stability: As of March

12. Thomas M. Shapiro & Jessica L. Kenty-Drane, *The Racial Wealth Gap*, in *AFRICAN AMERICANS IN THE U.S. ECONOMY* 175, 177 (Cecilia A. Conrad et al. eds., 2005). This disparity persists even when adjusting for income: White earners in the top 20% of households have a median net worth of \$133,600, while blacks in that category have a median net worth of \$43,800. *Id.* The common methodology in this field includes, when calculating net worth, principal residence, liquid assets, pension accounts (though not Social Security), stock, and business equity. See Wolff, *supra* note 4, at 37, 46. Generally, the wealth disparity between the races is much greater than the income disparity.

13. See *infra* Section IV.B.

14. See *infra* Section IV.C.

2005, only 1.12% of all home loans are currently in the foreclosure process,¹⁵ and homes make up the core of most households' asset base.¹⁶

Buying a home in America in the early twentieth century did not provide similar stability. Homeowners rarely ended up owning their home clear of any further obligation to make mortgage payments. Instead, they took out a mortgage from a bank or other lender that was often only partly amortized—i.e., that did not result in the buyer owning the home outright at the end of the mortgage.¹⁷ When the loan became due in five to seven years, the homebuyer would generally have to find another mortgage for a several-year period. If she could not do so (due to factors such as rising interest rates), she would have to sell her home.¹⁸ Thus, buying a home still presented a substantial risk that, within a decade, a buyer would be forced to move.

Because buyers had to save substantial sums of money before buying a home, homeownership for most people only became accessible in old age, leaving them with too little time to use their homes to build assets. Lenders generally provided first mortgages for only up to half of the value of a home.¹⁹ If a prospective buyer had not saved up enough funds to pay for half of the value of the house, she might seek a second mortgage,²⁰ either from an anxious seller, from individuals, or from other nonbank entities specializing in second mortgages.²¹ But these second mortgages would finance only half of the

15. Press Release, Mortgage Bankers Ass'n, Residential Mortgage Delinquencies and Foreclosures Down from Last Year, According to MBA National Delinquency Survey (Mar. 17, 2005), <http://www.mortgagebankers.org/news/2005/pro317.html>. I do not mean to discount the pain that those in foreclosure experience, or the rising foreclosure rates that many attribute to predatory lending. See, e.g., Margot Saunders, *The Increase in Predatory Lending and Appropriate Remedial Actions*, 6 N.C. BANKING INST. 111 (2002). I simply seek to point out that these problems are faced by a relatively small minority of homebuyers as compared with one hundred years ago, when almost all homebuyers faced uncertainty about how long they could hold onto their homes.

16. See Wolff, *supra* note 4, at 46 tbl.2.5.

17. DOROTHY ROSENMAN, *A MILLION HOMES A YEAR 21-22* (1945). Today the near-universal practice is full amortization, in which a homebuyer gets a mortgage, usually for thirty years, by the end of which she is the full owner of the home.

18. I generally use “she” when describing homeowners because my research using the New Haven Land Records revealed that early-twentieth-century home titles were often held by women.

19. ROSENMAN, *supra* note 17, at 23.

20. *Id.*

21. Lisa Marshall found that these second mortgages generally came from nonbank sources. See Lisa Marshall, *New Haven's Mortgage Markets in an Era of Urbanism 65-66* (2004) (unpublished manuscript, on file with author). This structure was at least partly due to regulatory restrictions. See *infra* Part II.

remaining purchase price,²² still leaving the homebuyer in need of a down payment of one-fourth to one-third of the value of the home.

It appears that this savings requirement presented a significant barrier to homeownership early in life. While in 1920 only 35% of households headed by thirty-five-year-olds owned homes, the comparable rate for households headed by those over sixty was more than 60%.²³ This system of homeownership for a short duration at the end of one's life meant that homeownership presented few asset-building opportunities, because the owner had less time to enjoy appreciation before death.²⁴

B. How Mortgage Market Collapse Produced New Deal Reforms

As a result of the Great Depression, home mortgage foreclosures rose from sixty-eight thousand per year in 1926 to one thousand homes per day in early 1933, when half of all mortgages in the United States were in default.²⁵ As urban historian Kenneth Jackson has pointed out, these foreclosures affected not just the poor, but also middle-class families. The wide range of people affected fostered demand for federal action from unexpected sources, including from Republican congressmen who otherwise opposed President Roosevelt's government expansion.²⁶

The federal government first reacted to the situation by buying up defaulted loans from banks under the auspices of the Home Owners' Loan Corporation (HOLC) and refinancing them on more favorable terms.²⁷ But

22. Marshall, *supra* note 21, at 66.

23. Mark J. Stern, *The Un(credit)worthy Poor: Historical Perspectives on Policies To Expand Assets and Credit*, in *ASSETS FOR THE POOR*, *supra* note 4, at 269, 282 tbl.8.2. Overall homeownership rates hovered between 45% and 48% from 1900 to 1930, perhaps indicating a limit to the potential for ownership with these early forms of financing. BUREAU OF THE CENSUS, *HISTORICAL STATISTICS*, *supra* note 1.

24. The owner's heirs might benefit, but because of the short terms of ownership, property rarely ended up "free and clear" of mortgages for bequest. Heirs could continue to make payments on a mortgage if they could afford to do so, or recoup through sale some of the last generation's savings and, possibly, a small amount of appreciation generated over the few years of homeownership.

25. KENNETH T. JACKSON, *CRABGRASS FRONTIER: THE SUBURBANIZATION OF THE UNITED STATES 193* (1985). Jackson's study of New Deal housing policy is the work legal scholars and historians most frequently cite on New Deal housing policy, particularly the racial discrimination by the federal government discussed *infra* Part III.

26. *Id.* at 196.

27. HOLC was created by the Home Owners' Loan Act of 1933, Pub. L. No. 73-43, § 4(a), 48 Stat. 128, 129. Many statutes in this Note are cited only for their historical importance and are no longer enforced. The current status of such laws is not indicated unless relevant in the context of this Note.

HOLC did not have a long-term effect on the American housing market. HOLC often proved unable to collect payments from homeowners already in financial trouble,²⁸ and Congress only created HOLC as a short-term, stop-gap measure, phasing it out of existence by 1936.²⁹

The federal government's next move, however, was of profound and lasting importance. The Federal Housing Administration (FHA), created by the National Housing Act of 1934,³⁰ restarted the slow lending market, limiting the risk of future foreclosures for lenders by insuring them against default on mortgages. Borrowers paid a premium of a half-percent on top of the standard interest rates paid to the lender,³¹ which went into a reserve fund held by the FHA that indemnified lenders in case of default.³² In addition, in case the reserve fund ran out of money, the federal government promised to pay lenders from general funds.³³ In effect, the federal government enabled lenders to provide home mortgage credit without any risk of loss—a vital guarantee given how much money those lenders had lost in the foreclosures of the early Depression.

The FHA did far more than simply restart a lending industry that had faltered at the onset of the Depression. Through guidelines that specified which loans would be eligible for insurance, the FHA fundamentally transformed the mortgage market. The FHA standards allowed mortgages with low down payments—initially 20%, then 10%, and by the mid-1960s, 3%.³⁴ Moreover, these mortgages extended for long terms—initially twenty years, soon twenty-five, and then thirty.³⁵ At the end of those terms, the homeowner fully owned the home and did not need another mortgage.³⁶ The FHA thus allowed younger households to buy homes with the assurance that they would not be forced out of those homes at the end of a short-term

28. One out of five properties that HOLC financed ended up in foreclosure, despite HOLC's relatively generous policies. C. LOWELL HARRISS, *HISTORY AND POLICIES OF THE HOME OWNERS' LOAN CORPORATION* 71 (1951).

29. Home Owners' Loan Act § 4(d).

30. Pub. L. No. 73-479, 48 Stat. 1246 (1934).

31. *The Financial Health of the Federal Housing Administration's Single Family Mutual Mortgage Insurance Fund: Hearing Before the Subcomm. on Hous. and Cmty. Opportunity of the H. Comm. on Fin. Servs.*, 107th Cong. 73 (2001) (statement of Susan Gaffney, Inspector General, Department of Housing and Urban Development).

32. JACKSON, *supra* note 25, at 204.

33. *Id.*

34. CHESTER RAPKIN ET AL., *THE PRIVATE INSURANCE OF HOME MORTGAGES: A STUDY OF MORTGAGE GUARANTY INSURANCE CORPORATION* 15 (1967); ROSENMAN, *supra* note 17, at 38.

35. RAPKIN ET AL., *supra* note 34, at 14.

36. JACKSON, *supra* note 25, at 204.

mortgage, and granted them an opportunity to build significant assets through homeownership.

The FHA pursued these policy objectives even though they made providing insurance more risky. Lowering down payment requirements meant that, all other things being equal, foreclosure was more likely because the buyer had less equity in the house. Thus, if home values declined even a small amount, it would make economic sense for the borrower to walk away from the home instead of continuing payments on her mortgage.

Similarly, longer terms meant that banks received smaller payments each month than they would have with a short-term loan of the same size. A long term also includes more turns of the business cycle, making borrower defaults (and FHA payouts) more likely. Finally, for the entire term, the same amount of money remained unavailable for making other loans, creating the additional risk that the bank would not be able to either take advantage of better business opportunities as they came up or adjust to higher-interest-rate environments.³⁷

These changes are what fundamentally transformed homeownership from a short-term, consumption-driven experience for a minority of Americans to the main tool that most Americans use for asset building over the long term. Being able to borrow larger sums over longer terms made homeownership radically more affordable.³⁸ The federal government took on significantly more risk in its insurance program in order to satisfy mounting public pressure to increase affordable homeownership opportunities. This pressure came not just from citizens, but, perhaps even more vehemently, from developers and related businesses hit hard by the Depression.³⁹

II. HOW CHANGES IN BANKING LAW GAVE THE FHA A MONOPOLY ON AFFORDABLE MORTGAGES

A. *Why FHA-Insured Loans Were Illegal*

In order for the FHA to insure high loan-to-value-ratio (LTVR), long-term loans, it had to change dozens of state and federal laws so that lenders could make these loans in the first place. At the time, Congress and state legislatures

37. Mortgages were issued with fixed rates of interest. The adjustable-rate mortgage, which varies the interest rate with the prime rate and thus reduces risk to the lender due to rising interest rates, did not become widely available until the early 1980s. John L. Cullhane, Jr. & D. Edwin Schmelzer, *Variable Rate Credit*, 37 BUS. LAW. 1391, 1391 (1982).

38. See *infra* Section II.E.

39. Florence Wagner Roisman, *National Ingratitude: The Egregious Deficiencies of the United States' Housing Programs for Veterans and the "Public Scandal" of Veterans' Homelessness*, 38 IND. L. REV. 103, 118 (2005).

strictly regulated permissible uses of banks' assets, regulations that (in much diminished form) still survive today. Those regulations generally limited LTVRs on first mortgages to levels much lower than the 90% allowed by the FHA because of the added risk low-down-payment mortgages entailed. They also limited loan terms to periods far shorter than the periods allowed by the FHA, again manifesting a genuine concern about the risk to banks' depositors.

As a result, the FHA needed Congress and state legislatures to waive hundreds of regulations, at least for the loans that it insured. Previous commentators have failed to understand this critical fact about the FHA. While one commentator has noted that the FHA requested changes in law from state legislatures,⁴⁰ and another has mentioned that the federal government changed its own regulations for national banks,⁴¹ no one has yet explained that this legislation constituted a massive transformation of American mortgage regulation.

The FHA had a compelling economic case for requesting such waivers: Treating insured loans differently from uninsured loans made sense from a safety-and-soundness standpoint. From the banks' perspective, insurance balanced out the risks of lower-down-payment, longer-term loans by guaranteeing that, even if the property value went down and the buyer quit making payments, or if the buyer defaulted twenty years into a twenty-five-year loan, the bank would be made whole by the insurance fund. These assurances and the political pressure for new ways to support homeownership led Congress and every state legislature to rapidly pass the requisite exemptions from bank safety-and-soundness laws.⁴²

These exemptions applied only to mortgages insured by the FHA—not to those insured by private insurers. And it was certainly possible for private insurers to play a significant role in the market. Private mortgage insurance was a big business in the 1920s. Because lenders often were limited by statute to lending within a concentrated geographic area,⁴³ they had a particular risk of multiple concurrent defaults. One plant closing in a small city, for example, could adversely affect a bank's entire portfolio. The mortgage insurers helped lenders hedge against this risk. Centered in New York to take advantage of a favorable regulatory environment, the industry grew in the boom times of the 1920s from a total of \$529 million of mortgages insured in 1920 to \$2.8 billion

40. MARC A. WEISS, *THE RISE OF THE COMMUNITY BUILDERS* 154 (1987).

41. CHARLES M. HAAR, *FEDERAL CREDIT AND PRIVATE HOUSING: THE MASS FINANCING DILEMMA* 59 n.5 (1960). Note that Haar incorrectly implies that state legislatures did not make similar amendments to safety-and-soundness regulations.

42. See *infra* Sections II.B-D.

43. See, e.g., CONN. GEN. STAT. § 3999 (1930) (limiting mortgages by Connecticut savings banks to homes in Connecticut and a few counties in neighboring states).

in 1930. But the regulatory environment proved too permissive, leading to a collapse during the Depression that ended with the State of New York taking over the remaining companies in 1933 and banning private mortgage insurance in 1934.⁴⁴

These insurers had never been granted the exemptions from safety-and-soundness statutes,⁴⁵ and they were not granted exemptions when the FHA received its exemptions. One might speculate that legislatures simply determined that the private mortgage insurance industry was no longer viable after the New Deal collapse, especially after New York banned the practice. But evidence exists to the contrary; for example, California passed new authorizing legislation allowing private mortgage insurers in 1935.⁴⁶ In fact, the evidence suggests that the FHA proposed exemptions for itself and not others and got Congress and state legislatures to rapidly respond. Those legislatures often adopted form language, perhaps proposed by the FHA,⁴⁷ apparently without considering the disparity created between the FHA and other potential insurers.

In the following two Sections, I examine the regulatory changes on the federal and state levels and demonstrate the broad reach of these regulatory changes to lending institutions regulated by numerous federal agencies and all forty-eight states. I then use census data to show the truly massive effect of these regulations. The data are clear: Those who could get an FHA-insured loan got far more valuable houses than those who could not, even though they made roughly the same monthly mortgage payment.

B. Federal Banking Regulation: National Banks

In the 1930s, as now, the banking industry was divided into two parallel systems:⁴⁸ national lending institutions established under the National Bank Act of 1863⁴⁹ and the Home Owner's Loan Act of 1933,⁵⁰ and state banking

44. Mortgage insurance companies failed because they held insurance company investments in mortgages (thus, if the value of mortgages declined, so would the value of the investments needed to pay out the companies' obligations) and granted mortgages based on poor appraisals. Close financial ties between the insurance companies and banks they insured also contributed to these failures. See RAPKIN ET AL., *supra* note 34, at 24, 27, 37.

45. Looking at the banking statutes discussed *infra* Sections II.B-D, one finds no mention of these firms.

46. Insurance Code, div. 2, pt. 6, ch. 2, 1935 Cal. Stat. 496, 747.

47. See *infra* text accompanying note 70.

48. See JONATHAN R. MACEY ET AL., BANKING LAW AND REGULATION 12 (3d ed. 2001).

49. Pub. L. No. 37-58, 12 Stat. 665 (1863).

50. Pub. L. No. 73-43, § 5, 48 Stat. 128, 132 (1933).

institutions chartered under state law. Both national and state lending institutions' investments were tightly regulated for safety and soundness in order to protect depositor assets.

From 1864 to 1913, national banks generally were prohibited from "the possession of any real estate under mortgage."⁵¹ Two rationales for this prohibition were that the federal government wanted to keep capital revolving through commerce and that mortgages tied up a bank's capital in property for long periods.⁵² In 1913, the Federal Reserve Act allowed banks to make loans secured by farmland, but only for five-year terms, and at an LTVR of 50% or less.⁵³ It was not until 1927 that national banks could issue any mortgages secured by nonfarm real estate, and even then the five-year term limit and 50% LTVR cap remained in place.⁵⁴

In 1934, upon creation of the FHA section 203(b) program, Congress granted a full waiver of these limits for loans insured by the FHA, but not loans insured by private mortgage insurers.⁵⁵ In 1935 Congress allowed a 60% LTVR and a maximum term of ten years for non-FHA-insured loans.⁵⁶ Regulations were loosened somewhat in 1955—allowing banks to issue twenty-year, 66.7% LTVR loans without FHA insurance⁵⁷—and again in 1959, when the LTVR allowed was raised to 75%.⁵⁸ These terms still fell far short of those for FHA-insured loans, which by the mid-1960s could have a 97% LTVR and a term of thirty (and in some cases forty) years.⁵⁹ It was not until 1970 that anything even close to equivalent was allowed for national banks without FHA insurance.⁶⁰

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51. National Bank Act of 1864, Pub. L. No. 38-106, 13 Stat. 99, 108.
 52. Edward L. Symons, Jr., *The "Business of Banking" in Historical Perspective*, 51 GEO. WASH. L. REV. 676, 716 (1983).
 53. Pub. L. No. 63-43, § 24, 38 Stat. 251, 273 (1913).
 54. McFadden Act, Pub. L. No. 69-639, § 16, 44 Stat. 1224, 1232-33 (1927).
 55. National Housing Act, Pub. L. No. 73-479, § 505, 48 Stat. 1246, 1263 (1934). After 1982, under more liberal lending guidelines, private mortgage insurance would be treated similarly to FHA insurance. Private mortgage insurance was not recognized by statute prior to 1982.
 56. Banking Act of 1935, Pub. L. No. 74-305, § 208, 49 Stat. 684, 706. These limits only applied to fully amortized loans, or those partly amortized loans that had to amortize at least 40% of principal.
 57. Act of Aug. 11, 1955, Pub. L. No. 84-343, § 1, 69 Stat. 633, 633-34.
 58. Act of Sept. 9, 1959, Pub. L. No. 86-251, § 4, 73 Stat. 487, 489.
 59. RAPKIN ET AL., *supra* note 34, at 14-15.
 60. The Emergency Home Finance Act of 1970, Pub. L. No. 91-351, § 704, 84 Stat. 450, 462, allowed 90% LTVR and a thirty-year term for uninsured, fully amortized loans. Subsequent amendments transferred this information from the U.S. Code to regulation by the Office of the Comptroller of the Currency (OCC). See Garn-St Germain Depository Institutions Act

C. *Federal Banking Regulation: Access to Credit for Thrifts*

National banks were never intended to be the most important financial institutions in creating homeownership. That distinction was given to thrift institutions, especially savings and loan associations structured specifically to make home mortgage loans.⁶¹ Nationally, from 1925 to 1965, thrifts had a higher share of the home lending market than any other institutional type, with a market share ranging from 21% to 44%.⁶² Until 1933, thrift institutions were chartered exclusively at the state level.⁶³ New Deal banking reforms created federally chartered thrift institutions with the Home Owner's Loan Act of 1933.⁶⁴ Both the new federal and existing state thrifts could increase liquidity of bank assets through another New Deal reform, the Federal Home Loan Bank Board (FHLBB),⁶⁵ which advanced short-term capital to banks that made long-term obligations like mortgages.

From 1934 to 1982, the FHLBB held markedly different policies for fund advances for FHA-insured and non-FHA-insured loans. The FHLBB would only advance to its members 65% of the unpaid principal balance of a non-FHA-insured mortgage, while it would advance 90% of the unpaid principal balance of an FHA-insured mortgage.⁶⁶ This disparity meant that making FHA-insured loans gave federally supervised thrifts significantly greater liquidity than making uninsured or privately insured loans, which were never allowed to draw from FHLBB funds at the 90% rate. For federal and state thrifts that were part of the Federal Home Loan Bank system, only the FHA insurance program offered a fiscally feasible path to originate high-LTVR, long-term mortgages.

of 1982, Pub. L. No. 97-320, § 403(a), 96 Stat. 1469, 1510. The OCC has adopted liberal rules: "A loan-to-value limit has not been established . . . [F]or any such loan with a loan-to-value-ratio that equals or exceeds 90 percent at origination, an institution should require appropriate credit enhancement in the form of either mortgage insurance or readily marketable collateral." Interagency Guidelines for Real Estate Lending: Supervisory Loan-to-Value Limits, 12 C.F.R. § 34, subpt. D, app. A, tbl. n.2 (2005). These guidelines also apply to nationally chartered lending institutions regulated by the Office of Thrift Supervision, Federal Deposit Insurance Corporation, and the Federal Reserve Board.

61. MACEY ET AL., *supra* note 48, at 15.

62. RAPKIN ET AL., *supra* note 34, at 18.

63. Paul T. Clark et al., *The Regulation of Savings Associations Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989*, 45 BUS. LAW. 1013 (1990).

64. Pub. L. No. 73-43, § 5, 48 Stat. 128, 132 (1933).

65. See Federal Home Loan Bank Act, Pub. L. No. 72-304, § 17, 47 Stat. 725, 736 (1932).

66. National Housing Act, Pub. L. No. 73-479, § 501, 48 Stat. 1246, 1261 (1934) (amended 1982).

D. State Banking Regulation

State banking regulators had similarly restrictive limits on the maximum LTVR and term that banks and thrifts could offer. And, like Congress, state legislatures only carved out exceptions to these regulations for FHA-insured loans. I have researched how all of the then-forty-eight states reacted to the introduction of the FHA insurance program in 1934. Remarkably, forty state legislatures granted exemptions to their safety-and-soundness regulations for FHA-insured loans between January and June 1935.⁶⁷ Another four state legislatures did not meet in 1935; when they reconvened in 1936, all of these states passed similar exemptions.⁶⁸ The final four states passed such exemptions in 1937.⁶⁹ Thirty-one of the forty-eight states⁷⁰ used strikingly broad form language that prevented most state lending laws from applying to FHA-insured loans. For example, the California statute read:

No law of this State, prescribing the nature, amount or form of security or requiring security upon which loans or investments may be made, or prescribing or limiting interest rates upon loans or advances of credit or prescribing or limiting the period for which loans or investments may be made, shall be deemed to apply to loans or investments made pursuant to the foregoing sections of this act.⁷¹

Such language not only prevented any requirements regarding LTVRs or terms from applying to FHA-insured loans, but also appears to have released lenders from other regulations such as usury laws. In effect, state legislatures abandoned their regulatory authority over FHA-insured loans, leaving the FHA to regulate itself. And again, these exemptions did not apply to private mortgage insurance.

I focus on Connecticut as an example of how regulations changed over time. Connecticut granted the most limited exemptions on FHA insurance of any state, retaining an upper limit on LTVRs and terms for FHA-insured loans

67. All states except for the states listed *infra* notes 68-69 passed such exceptions. See *infra* Appendix I for citations and dates of passage.

68. Kentucky, Louisiana, Mississippi, and Virginia. See *infra* Appendix I for citations and dates of passage.

69. Georgia, Illinois, Ohio, and Utah. See *infra* Appendix I for citations and dates of passage.

70. Alabama, Arkansas, California, Colorado, Florida, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Michigan, Minnesota, Mississippi, Missouri, Nebraska, Nevada, New Jersey, New Mexico, New York, North Carolina, North Dakota, Oklahoma, Oregon, South Carolina, South Dakota, Vermont, Washington, West Virginia, Wisconsin, and Wyoming.

71. Act of Jan. 30, 1935, ch. 6, § 5, 1935 Cal. Stat. 54, 55. This phrasing is replicated verbatim (or close to it) in the thirty other states.

for many years.⁷² But as I show below, Connecticut-chartered institutions still faced far more favorable regulatory treatment if they made FHA-insured loans instead of conventional loans.

At the beginning of the section 203(b) program, Connecticut building-and-loan societies—Connecticut’s state-chartered thrifts—could make 80% LTVR loans. This LTVR was much higher than any other Connecticut or federal institution could offer, although only available to building-and-loan members.⁷³ But these limits were not generally raised until 1981,⁷⁴ even though building-and-loan societies could make FHA loans at higher LTVRs as early as 1939.⁷⁵

Prior to the introduction of FHA insurance, Connecticut savings banks could make loans of up to a 50% LTVR, with no specifications on term.⁷⁶ By 1939, Connecticut savings banks could make loans of up to twenty-five years at a 90% LTVR if insured by the FHA⁷⁷ and a 66.7% LTVR if not insured.⁷⁸ Starting in 1945, Connecticut savings banks could make a limited number of noninsured loans at an 80% LTVR, but only with a twenty-year term.⁷⁹ Not until 1975 did Connecticut savings banks get general authorization to make an unlimited number of uninsured 80% LTVR loans⁸⁰—still below the 90% LTVR allowed for FHA-insured loans as early as 1939.

Connecticut regulators also took actions to limit loans made by insurance companies.⁸¹ Prior to the introduction of FHA insurance, life insurance companies were only allowed to make loans at a 50% LTVR.⁸² Although by 1939 the Connecticut Legislature had allowed life insurance companies to make

72. All other states deferred to the FHA’s own determination of LTVRs and terms. The only other state that appears to have placed particular restrictions on making FHA-insured loans was Iowa, which limited FHA-insured loans to 25% of bank assets.

73. CONN. GEN. STAT. § 4017 (1930).

74. Act of May 26, 1981, Pub. Act No. 81-193, 1981 Conn. Acts 236 (Reg. Sess.).

75. Undated Act Concerning Powers of Building and Loan Associations, ch. 85, 1939 Conn. Pub. Acts 200.

76. CONN. GEN. STAT. § 3999 (1930).

77. Undated Act Concerning Mortgage Loans Pursuant to the National Housing Act, ch. 43, 1939 Conn. Pub. Acts 107.

78. Undated Act Concerning Mortgages by Savings Banks, ch. 102, 1939 Conn. Pub. Acts 241.

79. Undated Act Authorizing Savings Banks To Invest in Mortgages, ch. 308, 1945 Conn. Pub. Acts 986.

80. Act of May 28, 1975, Pub. Act No. 75-200, 1975 Conn. Acts 163 (Reg. Sess.).

81. State regulations limited the low-risk investments that insurance companies could make, so mortgages often provided attractive investment options. *See, e.g.*, CONN. GEN. STAT. § 4212 (1930) (placing limitations on life insurance company investments); *infra* note 139.

82. CONN. GEN. STAT. § 4210 (1930).

loans at a 66.7% LTVR,⁸³ it had also carved out an exception for any mortgage insured by the FHA.⁸⁴ There do not appear to have been limits on the terms of life-insurance-financed loans.

For over three decades, these exemptions for insured loans only applied to loans insured by the federal government, despite the fact that loans insured by private parties would have protected banks equally. In 1969, the Connecticut legislature finally passed exemptions for loans insured privately.⁸⁵

At the state level as well as at the federal level, in order to take advantage of the most favorable lending laws and open homeownership to the middle class, banks and thrifts had to participate in the FHA insurance program. The tables below summarize how exceptions for FHA insurance evolved at both the federal level and in Connecticut from the introduction of the section 203(b) program in 1933 to 1969.⁸⁶

83. Undated Act Concerning Security for Loans Made by Domestic Life Insurance Companies, ch. 287, 1937 Conn. Pub. Acts 925.

84. Undated Act Concerning Loans Pursuant to the National Housing Act, ch. 146, 1939 Conn. Pub. Acts 357.

85. Act effective Oct. 1, 1969, Pub. Act. No. 265, 1969 Conn. Pub. Acts 277.

86. The tables stop in 1969 because a number of changes to the section 203(b) program in the mid-1960s widely expanded access to FHA loans for previously excluded people (most notably African-Americans) and places (most notably inner-city neighborhoods). See *infra* Section IV.A.

Table 1.
MAXIMUM LOAN-TO-VALUE RATIO, BY LENDER TYPE AND LOAN TYPE⁸⁷

		NATIONAL BANK	THRIFT ADVANCES*	CT SAVINGS BANK**	CT BUILDING- AND-LOAN**
1933	Non-FHA- Insured	50%	60%	50%	80%
	Non-FHA- Insured	60%	65%	50%-67%	80%
1939	FHA- Insured	Agency max***	90%	90%	90%
	Non-FHA- Insured	60%	65%	50%-80%	80%
1949	FHA- Insured	Agency max	90%	90%	95%
	Non-FHA- Insured	75%	65%	67%-80%	80%-90%
1959	FHA- Insured	Agency max	90%	Agency max	95%
	Non-FHA- Insured	80%	65%	75%-90%	80%-90%
1969	FHA- Insured	Agency max	90%	Agency max	Agency max

* This is the percentage of outstanding mortgage principal that the FHLBB would advance to thrifts on security of a mortgage, not the LTVR. For FHLBB members, these limits exacerbated the disparity between FHA-insured and non-FHA-insured mortgages. For example, if a Connecticut building-and-loan originated a non-FHA-insured mortgage at the maximum 80% LTVR, the FHLBB would advance up to 65% of the value of the mortgage—or 52% of the value of the home. If that same building-and-loan originated an FHA-insured loan at the maximum 90% LTVR, the FHLBB would advance up to 90% of the value of the mortgage—or 81% of the value of the home.

87. For material on national banks, see Housing Act of 1964, Pub. L. No. 88-560, § 1004, 78 Stat. 769, 807; and *supra* notes 49-58. For material on thrift advances, see Federal Home Loan Bank Act, Pub. L. No. 72-304, § 10, 47 Stat. 725, 731-32 (1932); and *supra* note 66. For material on Connecticut savings banks, see Act of June 9, 1965, Pub. Act No. 163, 1964-65 Conn. Pub. Acts 180; Act effective Oct. 1, 1963, Pub. Act No. 118, 1963 Conn. Pub. Acts 185; Act of Apr. 29, 1955, Pub. Act No. 39, 1955 Conn. Pub. Acts 37; and *supra* notes 75-78. For material on Connecticut building and loans, see Act effective Oct. 1, 1963, Pub. Act No. 95, 1963 Conn. Pub. Acts 162; Act effective Oct. 1, 1959, Pub. Act No. 500, 1959 Conn. Pub. Acts 881; Undated Act Concerning FHA Mortgages by Building or Savings and Loan Associations, Pub. Act No. 193, 1949 Conn. Pub. Acts 164; and *supra* notes 72, 74.

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** Where a range is given (here and in Table 2) the institution could make loans at the lower LTVR (or shorter term) without limitation, but could only make loans at the higher LTVR (or longer term) by meeting additional requirements. Also note that prior to the 1950s, Connecticut building-and-loans could only provide non-FHA-insured mortgages for their members.

*** “Agency max” (here and in Table 2) indicates that the legislature allowed the institution to originate a mortgage with any LTVR (or term) permitted by the FHA. By 1945, maximum LTVR was 90%, and by 1969, 97%.

Table 2.
MAXIMUM TERM OF LOAN, BY LENDER TYPE AND LOAN TYPE⁸⁸

		NATIONAL BANK	CT SAVINGS BANK	CT BUILDING-AND-LOAN
1933	Non-FHA-Insured	5	n/a	n/a
	FHA-Insured	Agency max	25	25
1939	Non-FHA-Insured	10	25	25
	FHA-Insured	Agency max	25	25
1949	Non-FHA-Insured	10	20-25	25
	FHA-Insured	Agency max	35	25
1959	Non-FHA-Insured	20	25	25
	FHA-Insured	Agency max	Agency max	25
1969	Non-FHA-Insured	25	30	30
	FHA-Insured	Agency max	Agency max	30

88. For material on national banks, see Housing Act of 1964, Pub. L. No. 88-560, § 1004, 78 Stat. 769, 807; and *supra* notes 49-58. For material on Connecticut savings banks, see Act effective Oct. 1, 1969, Pub. Act No. 223, 1969 Conn. Pub. Acts 231; Act of Apr. 1, 1959, Pub. Act No. 11, 1959 Conn. Pub. Acts 15; Act of Apr. 29, 1955, Pub. Act No. 39, 1955 Conn. Pub. Acts 37; Undated Act Extending the Authorized Maturity of Mortgage Loans by the Federal Housing Authority from Thirty to Thirty-Five Years, Pub. Act No. 97, 1947 Conn. Pub. Acts 73; and *supra* notes 76-79. For material on Connecticut building and loans, see Act effective Oct. 1, 1963, Pub. Act. No. 415, 1963 Conn. Pub. Acts 607; and *supra* notes 72, 74.

E. How Changing Banking Regulation Transformed the National Real Estate Market

The high-LTVR, long-term loans made possible (and legal) through the section 203(b) insurance program transformed mortgage lending and real estate development. The number of new home starts in the country rapidly increased from 93,000 in 1933, to 332,000 in 1937, to 619,000 in 1941.⁸⁹ These new homes met a new market, as the section 203(b) program's lower down payment requirements greatly reduced the number of years of saving needed to buy a home, expanding homeownership to younger age groups. Indeed, the growth in homeownership from 46% in 1920 to 62% in 1960⁹⁰ came almost entirely from purchasers under 60; the rate of homeownership for those over 60 increased by only a few percentage points during this period.⁹¹

In 1950, the census for the first time tracked American home finance in the Residential Finance Survey. The resulting data offered a good sense of just how much of a boon FHA-insured homes were to the homebuyer:

89. JACKSON, *supra* note 25, at 205.

90. BUREAU OF THE CENSUS, HISTORICAL STATISTICS, *supra* note 1.

91. Stern, *supra* note 23, at 282.

Table 3.
 MEDIAN FHA-INSURED AND CONVENTIONAL MORTGAGE, 1950⁹²

	MEDIAN FHA-INSURED MORTGAGE, 1950	MEDIAN CONVENTIONAL MORTGAGE, 1950
Home Purchase Price	\$7900	\$5600
Down Payment	\$1659	\$1904
Loan Amount	\$6241	\$3696
Loan-to-Value Ratio	79%	66%
Interest Rate	4.5%	5%
Term	20 years	11 years
Monthly Payment	\$39.48	\$36.46

The median borrower with an FHA-insured mortgage put less money down for a more valuable home than the average borrower with a conventional mortgage, and then proceeded to make a similar monthly payment. Effectively, FHA-insured buyers got better homes than conventional borrowers without paying anything close to the full cost of the difference in quality. This disparity reflects the regulatory differences that allowed FHA-insured loans to have longer terms and lower down payments. Furthermore, an FHA-insured home was much more likely to be a new home—59% of FHA-insured mortgages outstanding in 1950 had gone for new homes, compared with 23% of conventional mortgages.⁹³ Most of those new homes were in the suburbs, the place that would experience the greatest rate of property-value appreciation in the coming decades and thus enable asset development.⁹⁴ In sum, America had

92. 4 BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, CENSUS OF HOUSING: 1950, pt. 1, at 42, 60, 62 (1952) [hereinafter CENSUS OF HOUSING: 1950]. Monthly payment, loan amount, and down payment figures are based on my calculations using these data. I multiplied the median LTVR by the median purchase price. The resulting number is the loan amount on the chart; the purchase price minus that number is the down payment on the chart. I calculated the monthly payment using the standard function for amortizing a loan of the amount on the chart over the median term.

93. *Id.* at 15.

94. It is quite possible that property-value appreciation in the suburbs was so strong because the “self-fulfilling prophecy” of guaranteed FHA-insured loans built confidence among developers and homebuyers and thus helped create a stronger market for suburban housing than otherwise would have been possible. Suburban developers would often get preapproval for FHA insurance for entire subdivisions and use that as a selling point for homebuyers. *See*

two housing markets from 1934 until the mid-1960s: a conventional market, with tight regulations on loan terms and down payments, and an effectively unregulated market of loans insured by the FHA, allowing extremely liberal loan terms and miniscule down payments.

III. HOW THE BANKING SAFETY-AND-SOUNDNESS CHANGES HURT AFRICAN-AMERICANS AND URBAN NEIGHBORHOODS

A. *Discrimination in Section 203(b)*

These data, and the power of banking regulation in creating separate markets for FHA-insured and conventional mortgages that they demonstrate, raise two critical questions. First, why did the American housing market not comport with the semi-strong form of the efficient capital markets hypothesis,⁹⁵ which predicts that interest rate and down payment differences should have been immediately capitalized into higher home prices?⁹⁶ Contrary to the theory of efficient markets, monthly payments remained lower for FHA-insured homes than for non-FHA-insured homes, even though the FHA-insured homes tended to be newer and of better quality. Second, given the lack of such capitalization, why would anyone choose a conventional mortgage over an FHA-insured mortgage?

Both of these questions hint at the serious problem caused by having safety-and-soundness regulations that, in effect, gave a monopoly to the FHA for most of the American first-time homebuyer market. Many would argue that such a government monopoly is bad enough simply because monopolies generally raise prices and discourage innovation.⁹⁷ But, even worse, the government monopoly created by the FHA refused to offer its product to wide swaths of the American population, thus creating separate mortgage markets in

JACKSON, *supra* note 25, at 205. The phrase “self-fulfilling prophecy” is from a quotation by noted urbanist Jane Jacobs. *Id.* at 214.

95. The efficient capital markets hypothesis generally posits that prices in a market will immediately adjust to reflect available information. The weak form argues that this hypothesis only is true for the most basic information: past market performance of the asset. The semi-strong form of the hypothesis, which is the most accepted version, states that the market price of a good will reflect all publicly available information. The strong form argues that all information, even nonpublic information, is reflected in the price of an asset. *See, e.g.*, STEPHEN A. ROSS ET AL., *CORPORATE FINANCE* 319-35 (5th ed. 1999).
96. *See* WILLIAM A. FISCHEL, *THE HOMEVOTER HYPOTHESIS: HOW HOME VALUES INFLUENCE LOCAL GOVERNMENT TAXATION, SCHOOL FINANCE, AND LAND-USE POLICIES* 45-49 (2001).
97. *See, e.g.*, KEITH N. HYLTON, *ANTITRUST LAW: ECONOMIC THEORY AND COMMON LAW EVOLUTION* 13 (2003) (describing the conventional theory of deadweight loss from monopoly).

urban neighborhoods and for African-Americans. People excluded by the FHA had to find a way to afford the steep down payment and higher monthly payments needed for conventional mortgages, or give up the dream of homeownership.

The discriminatory policies of the FHA in its first three decades of existence are well known. As Kenneth Jackson has described, HOLC rated every urban and suburban neighborhood in America as “A,” “B,” “C,” or “D” quality, color coding maps of every metropolitan area (“D,” or lowest quality, was colored red—the origin of the term “redlining”).⁹⁸ Quality ratings were based on age and type of housing stock, but also very much on race. “A” neighborhoods had to be “homogenous”—meaning “American business and professional men”—and “American”—meaning white and often, native-born.⁹⁹ Predominantly black neighborhoods received a “D” grade.¹⁰⁰ HOLC did not use these categories as major criteria for distribution of its loans; indeed, in many counties HOLC made loans mainly in “C” and “D” areas.¹⁰¹ This wide distribution of loans proved to be a good business decision for HOLC; often, residents of “C” and “D” areas had lower rates of default than residents of “A” and “B” areas.¹⁰²

The FHA, in contrast, used the HOLC system as a basis for developing criteria to select which loans it would insure. It set up a pseudoscientific rating system for neighborhoods, in which 60% of the available points were awarded based on “relative economic stability” and “protection from adverse influences”—both code words for segregation.¹⁰³ “If a neighborhood is to retain stability, it is necessary that properties shall continue to be occupied by the same social and racial classes,” the FHA’s *Underwriting Manual*

98. JACKSON, *supra* note 25, at 197.

99. *Id.*

100. *Id.* at 198.

101. *Id.* at 202. I found that in New Haven, HOLC in its first year of existence made 4.2% of its loans in the “D” rated neighborhood of Dixwell. Grantee Index to Land Records for 1933 (on file with New Haven Hall of Records). This rate is similar to the historical rate of lending by major banks in New Haven in Dixwell. See *infra* text accompanying notes 136-137. Generally, I calculated data in this Note on loans in Dixwell by first examining every mortgage originated by the relevant lender in the stated year. I then determined how many of these mortgages were within the boundaries of the Dixwell neighborhood, as defined by the area bounded by Winchester Avenue, Orchard Street, Henry Avenue, Lake Place, and Goffe Street. I then looked closely at these mortgages in Dixwell to filter out commercial mortgages. Note that the grantee indexes for later years (i.e., all years I examined after 1914) appear to provide somewhat more reliable records in differentiating between new residential mortgages and other transactions. Because I closely screened the mortgages in Dixwell, the percentages for all years are conservative, and likely particularly conservative for 1912-1914.

102. JACKSON, *supra* note 25, at 202.

103. *Id.* at 207.

counseled.¹⁰⁴ The FHA strongly suggested racial covenants as a means of protecting against such transitions.¹⁰⁵ Furthermore, FHA underwriting standards frowned upon homes with rental units or stores¹⁰⁶ (historically most of the homeownership stock in urban neighborhoods), favoring instead single-family homes in single-use neighborhoods.

The FHA's underwriting standards reflected the model of neighborhood change developed by economist Homer Hoyt.¹⁰⁷ In this model, neighborhoods started out new and white. Over time, housing stock deteriorated, and the neighborhood transitioned from white Protestant to Jewish and finally black. The FHA assigned every neighborhood a place somewhere along this supposedly inevitable continuum.¹⁰⁸

The FHA's standards, however, ignored countervailing realities of neighborhood integration and change. In the early twentieth century, as Richard Sander has described, "[a]lthough many cities . . . had 'Negro districts,' most blacks lived outside these districts; . . . [A]s late as 1910, housing segregation was one of the least significant problems facing blacks."¹⁰⁹ And even when neighborhoods did become segregated, their values did not necessarily decline as they transitioned from white to black. A comprehensive study of racial transition in seven cities from 1943 to 1955 that carefully separated race from other factors found that "the entry of nonwhites into previously all-white neighborhoods was much more often associated with price improvement or stability than with price weakening."¹¹⁰ Even Hoyt himself cautioned that race was so often conflated with other neighborhood characteristics that race could not be seen simply as an independent factor driving changes in neighborhood value.¹¹¹

104. *Id.* at 208.

105. *Id.*

106. *Id.* at 207-08.

107. Hoyt published an initial study explaining these theories in 1933. Later, the FHA hired Hoyt to conduct a follow-up study that reiterated these ideas. See CHARLES ABRAMS, FORBIDDEN NEIGHBORS: A STUDY OF PREJUDICE IN HOUSING 160-61 (Kennikat Press 1971) (1955).

108. JACKSON, *supra* note 25, at 198.

109. Richard H. Sander, Comment, *Individual Rights and Demographic Realities: The Problem of Fair Housing*, 82 NW. U. L. REV. 874, 876-77 (1988).

110. LUIGI LAURENTI, PROPERTY VALUES AND RACE: STUDIES IN SEVEN CITIES 47 (1961). As Richard Brooks suggested in a conversation with me, these data may overstate the case because realtors inflated prices as blacks first moved in to some neighborhoods in the 1950s, with prices falling back to true market levels soon after. Still, several additional studies over a range of time periods cast serious doubt on the FHA's assertion that blacks moving in inevitably led to price decline. See *id.* at 53.

111. See ABRAMS, *supra* note 107, at 161.

The FHA ignored these complex realities, making simple racial categorizations both by grading neighborhoods based on racial composition and by encouraging racial covenants. With these brightline rules, the FHA encouraged housing segregation, much as municipal racial-zoning laws mandated segregation before the Supreme Court invalidated these laws in 1917.¹¹²

B. The Results of Discrimination in Section 203(b)

The FHA's underwriting criteria resulted in much lower rates of lending in urban neighborhoods than in suburban neighborhoods. For example, Jackson found that 91% of a sample of homes insured by the FHA in metropolitan St. Louis from 1935 to 1939 were located in the suburbs.¹¹³

In addition, these criteria resulted in much lower rates of lending to nonwhites than to whites, even when compared with the market as a whole. Only 2.3% of FHA-insured mortgages outstanding in 1950 were for nonwhites, while 5.0% of conventional mortgages were for nonwhites.¹¹⁴ Furthermore, the few loans that were made to nonwhites were for properties of below-average value. The median purchase price of nonwhite-purchased properties in the FHA insurance program in 1950 was under \$6000;¹¹⁵ for all properties in the

112. See *Buchanan v. Warley*, 245 U.S. 60 (1917) (holding that such laws violated the Fourteenth Amendment and the Civil Rights Act of 1866). Sander notes that many cities continued to pass such laws throughout the 1920s, and the laws continued to be enforced because few lawsuits were brought challenging them. Sander, *supra* note 109, at 878.

113. JACKSON, *supra* note 25, at 209.

114. See CENSUS OF HOUSING: 1950, *supra* note 92, pt. 1, at 164. This measure did not include loans for which race was not reported, or loans on multifamily units, for which racial data were not provided. Note, however, that over 95% of all FHA-insured loans were on single-family units. See *id.*, pt. 1, at 60, 164. This trend continued in the 1960 census, with only 2.5% of the FHA-insured mortgages going to nonwhite households, even though nonwhites held 5.4% of conventional mortgages overall. See 5 BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, CENSUS OF HOUSING: 1960, pt. 1, at 10 (1963) [hereinafter CENSUS OF HOUSING: 1960]. The trend reversed by 1970. See 5 BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, CENSUS OF HOUSING: 1970, at 77 (1973) [hereinafter CENSUS OF HOUSING: 1970]. The transformation of the FHA program into one that insured above-market levels of mortgages for nonwhites is detailed further below. See *infra* Section IV.A.

115. CENSUS OF HOUSING: 1950, *supra* note 92, pt. 1, at 310. The method of aggregating data does not provide an exact median. The information by race measures only owner-occupied, single-family properties, while the data I have been using otherwise include owner-occupied, multifamily properties; however, the overall median purchase prices for FHA-insured properties in the two categories are the same, probably because only 4% of FHA-insured mortgages on owner-occupied properties went to multifamily homes (as compared with 17.5% of conventionally financed mortgages on owner-occupied properties). *Id.*, pt. 1, at 60.

program, the equivalent value was \$7900.¹¹⁶ This disparity reflects differences in income between white and nonwhite buyers in the FHA program; the median family income of all buyers with outstanding FHA-insured loans in 1950 was \$4400, while the figure for nonwhites was closer to \$3500.¹¹⁷

One might speculate that the disparity between the conventional market's rate of lending to nonwhites and the FHA-insured market's rate of lending to nonwhites reflects discrimination based on income, not race. Because nonwhites on average had lower incomes than whites, discrimination based on income alone would result in fewer nonwhites getting FHA-insured loans.

However, from the limited data available on this point, it does not appear to be the case that the FHA program provided fewer opportunities for lower-income households than the market as a whole. While the median household income of a household receiving a conventional mortgage was lower than the median for a household receiving an FHA-insured mortgage,¹¹⁸ it appears that this gap may have come mostly or entirely from higher rates of lending through the FHA insurance program inside metropolitan areas (as opposed to rural areas).¹¹⁹

Similarly, some might see the FHA's racial policies as solely trying to minimize the risk of default. But faced with the contradictory example of HOLC's program, in which default rates were lower on lower-grade, urban homes,¹²⁰ and the empirical evidence that race alone did not determine home value,¹²¹ such a justification appears tenuous at best. Even if there had been some additional risk in insuring urban homes, or those occupied by blacks, the FHA had already decided that it would be willing to take on the massive additional risks associated with making low-down-payment, long-term

116. See *supra* table accompanying note 92.

117. Compare CENSUS OF HOUSING: 1950, *supra* note 92, pt. 1, at 165 (showing median family income of all buyers with outstanding FHA-insured loans), with *id.* at 310 (showing figures for nonwhites). The figures for nonwhites do not permit an exact median to be calculated, and as such I have given the midpoint of the range in which the median lies. This difference may also reflect the fact that the FHA insured loans for blacks only in black neighborhoods because of its policy of racial stability. See *supra* text accompanying note 104. In some cases, black neighborhoods may have had homes worth less than homes in white neighborhoods.

118. CENSUS OF HOUSING: 1950, *supra* note 92, pt. 1, at 165 (illustrating that the median income for conventional mortgages was \$3700, but for FHA-insured mortgages it was \$4400). In 1960, the median for conventional mortgages was \$6500, but for FHA-insured mortgages it was \$6900. CENSUS OF HOUSING: 1960, *supra* note 114, pt. 1, at 9.

119. For mortgages inside standard metropolitan statistical areas (core urban areas and their surrounding suburbs) in 1960, both FHA-insured mortgages and conventional mortgages served households with a median income of \$7000. CENSUS OF HOUSING: 1960, *supra* note 114, pt. 1, at 39. Similar data are not presented in the 1950 Census.

120. See *supra* text accompanying note 102.

121. See *supra* text accompanying notes 110-111.

loans.¹²² It is hard to characterize the FHA's view of blacks and urban neighborhoods as anything but outright discrimination.

C. *The Combined Effect of Section 203(b) Discrimination and Safety-and-Soundness Regulations*

Historians and legal scholars have debated the effect of discrimination in the section 203(b) program, especially since Kenneth Jackson's research appeared in 1985.¹²³ For some commentators, the fact that the federal government discriminated in the FHA insurance program, and that the program was so massive, already defines it as a major driver of racial differences in asset accumulation¹²⁴ and the racial segregation characteristic of post-World War II America.¹²⁵

But other scholars have asserted that the role of the section 203(b) program has been overblown and that the real forces behind segregation and a lack of asset accumulation for blacks were private discriminatory preferences.¹²⁶ Behind this doubt lies a fundamental question: If there was money to be made in insuring home mortgages against loss for African-Americans, and in urban neighborhoods, why didn't private insurers enter those markets?¹²⁷

Because no strong explanation for the failure of a private market to develop has emerged in the literature to date, these scholars' claims of the limited role of the section 203(b) program have seemed quite plausible to serious

122. See *supra* Section II.B.

123. See, e.g., Daniel J. Hutch, *The Rationale for Including Disadvantaged Communities in the Smart Growth Metropolitan Development Framework*, 20 YALE L. & POL'Y REV. 353, 357 (2002); Michael H. Schill & Susan M. Wachter, *The Spatial Bias of Federal Housing Law and Policy: Concentrated Poverty in Urban America*, 143 U. PA. L. REV. 1285, 1308-09 (1995); David Dante Troutt, *Ghettos Made Easy: The Metamarket/Antimarket Dichotomy and the Legal Challenges of Inner-City Economic Development*, 35 HARV. C.R.-C.L. L. REV. 427, 439 (2000).

124. See *supra* note 12 and accompanying text.

125. Edward L. Glaeser & Jacob L. Vigdor, *Racial Segregation: Promising News*, in 1 REDEFINING URBAN AND SUBURBAN AMERICA: EVIDENCE FROM CENSUS 2000, at 211, 217 (Bruce Katz & Robert E. Lang eds., 2003) (noting that in 2000 the average African-American resident of an urban area in the United States lived in a census tract that was 51% black). While Glaeser and Vigdor find segregation declining overall, they also find that 65% of blacks would still have to move in order for all metropolitan-area census tracts to reflect the same racial composition as metropolitan areas as a whole. See *id.* at 217, 234.

126. See, e.g., Paul Boudreaux, *An Individual Preference Approach to Suburban Racial Desegregation*, 27 FORDHAM URB. L.J. 533, 544 (1999); Robert Ellickson, Professor, Yale Law Sch., Remarks at Panel on Causes of Residential Segregation (Mar. 25, 1988), in THE FAIR HOUSING ACT AFTER TWENTY YEARS: A CONFERENCE AT YALE LAW SCHOOL, MARCH 1988, at 58-59 (Robert G. Schwemm ed., 1989).

127. I thank Professor Ellickson for posing this question to me in conversation.

economists. Some might claim that the FHA's presence in the market represented a government subsidy that blocked the development of a private market. Indeed, no private insurer could match the government's self-insurance capacity: the use of the general treasury to insure against the small, but very expensive, risk of a massive crash in housing prices.¹²⁸ But the FHA's program was run, and continues to be run, as a profitable government enterprise. For over fifty years, the FHA made a profit every year on the insurance programs; in 2001, the insurance fund's net assets were valued at \$18 billion.¹²⁹ And the half-percent charge (on top of the usual interest payment that the bank received) initially set for FHA insurance was commensurate with what the market price had been for the failed private insurers of the 1920s.¹³⁰ Furthermore, the eventual development of a new private mortgage insurance market in the 1950s and 1960s, once safety-and-soundness regulations began to be relaxed, shows that the government subsidy, if there was one, was not large enough to keep the private sector out of the market.¹³¹

One might also think that the collapse of the private sector mortgage insurance market in the early 1930s made both investors and regulators wary of entering that market. But the fact that California authorized private mortgage insurance in 1935 seems to disprove that theory, at least from the regulatory perspective.¹³² One would think that if African-Americans and urban neighborhoods presented viable markets to enter, private insurers would have taken advantage of such authorizing legislation. Yet no firms entered the

128. *Reinvention of HUD and Redirection of Housing Policy: Hearing Before the Subcomm. on Hous. Opportunity and Cmty. Dev. and the Subcomm. on HUD Oversight and Structure of the S. Comm. on Banking, Hous., and Urban Affairs*, 104th Cong. 420-23 (1995) (statement of Stephen Moore, Director of Fiscal Policy Studies, Cato Institute).

129. BRUCE E. FOOTE, CONG. RESEARCH SERV., REPORT NO. RS20530, *FHA LOAN INSURANCE PROGRAM: AN OVERVIEW 4* (2003).

130. RAPKIN ET AL., *supra* note 34, at 25.

131. For a comprehensive overview of the private mortgage insurance market and its relation to FHA insurance, see Quintin Johnstone, *Private Mortgage Insurance*, 39 WAKE FOREST L. REV. 783 (2004). Today, private mortgage insurance generally costs less than FHA insurance, though perhaps part of that cost difference comes from the FHA insuring riskier buyers. *Id.* at 786.

132. See Insurance Code, div. 2, pt. 6, ch. 2, 1935 Cal. Stat. 496. Note that private mortgage insurers were, at least in some cases, subject to restrictions similar to the banking industry. The California insurance legislation allowed private mortgage insurers to insure only mortgages with up to a 60% LTVR. *Id.* at 747-78. In any event, such restrictions in private mortgage insurance regulations were unimportant. The regulatory restrictions imposed by banking regulators still would have stopped private insurers from guaranteeing high-LTVR, long-term loans, because no bank would have been able to originate such loans without FHA insurance.

market until the Mortgage Guaranty Insurance Corporation opened its doors in the late 1950s.¹³³

One explanation retains its strength: The private mortgage insurance market for low-down-payment, high-LTVR loans for blacks and in urban neighborhoods failed to develop because such loans were illegal unless insured by the FHA. In effect, Congress and state legislatures incorporated internal agency guidelines set by the FHA into statutes that shaped the entire mortgage market. Quite possibly, they did so without any intention of creating a massive system of discrimination that could not be broken up by outside competition. Rather than a comprehensive argument for transforming the mortgage market, the proposition to legislators was simply that banks' safety and soundness were not threatened by loans that the federal government would pay in case of default. Whether intentionally discriminatory or not, these legislative barriers provide a major reason to believe that government policies were responsible for a greater share of post-World War II racial segregation and disinvestment in urban areas than previously thought.

D. The Combined Effect of Section 203(b) Discrimination and Safety-and-Soundness Regulations: One City's Experience

My study of residential mortgages in New Haven, Connecticut illustrates how the combination of section 203(b) discrimination against urban neighborhoods and safety-and-soundness regulations transformed housing finance markets.

Before the Depression, New Haven banks made short-term, low-LTVR loans. Families made up the difference between these loans and the purchase price of their homes with savings and second mortgages from private lenders.¹³⁴ These patterns held across the city. Because lenders were only exposing themselves, in aggregate, to at most around two-thirds of the value of the house due to low LTVRs, they tended to issue standardized loan types regardless of neighborhood, based on family income. Even the city's largest, most prominent lending institutions were active in poor urban neighborhoods. For example, from 1912-1914, Connecticut Savings Bank made 7.7% of its transactions in Dixwell, a working-class urban neighborhood with a large black population;¹³⁵ New Haven Savings Bank made 5.2% of its transactions in

133. RAPKIN ET AL., *supra* note 34, at 38.

134. See Marshall, *supra* note 21, at 65. Marshall found that 46% of all mortgages made in New Haven in 1911 were second mortgages. *Id.*

135. ROBERT AUSTIN WARNER, *NEW HAVEN NEGROES: A SOCIAL HISTORY* 196 (Arno Press 1969) (1940).

Dixwell.¹³⁶ In 1936, as the FHA section 203(b) program was just starting, 5.6% of all loans made by Connecticut Savings Bank and 4.9% of those made by New Haven Savings Bank went to residential properties in Dixwell.¹³⁷

By 1954, the entire structure of the New Haven lending market had radically changed. Less than 1% of loans from Connecticut Savings Bank and New Haven Savings Bank went to residential properties in Dixwell.¹³⁸ The savings banks and competing prime-market institutions such as life insurance companies¹³⁹ had become highly specialized lending institutions, providing one product: fully amortized loans at 4% to 5%, with terms of up to twenty-five years. They originated mortgages primarily in certain neighborhoods that met FHA requirements, like the racially homogenous, single-family neighborhoods of Beaver Hills, Morris Cove, and Westville.¹⁴⁰

Meanwhile, other institutions stepped in to provide new, higher-cost loans for markets not served by the major savings banks. For example, Branford Federal Savings and Loan offered loans at a 6% interest rate for a fifteen-year term, generally with LTVRs of 60% to 70%. They made 7.1% of their loans in Dixwell in 1954. Most of their other loans were in older New Haven neighborhoods like the Hill and Fair Haven, which were not well served by the major savings banks.¹⁴¹

This system shows on the ground level how it was cheaper to buy a newer, more valuable home in an FHA-approved neighborhood than to buy an older home in a neighborhood like Dixwell. An example can be seen by comparing the following two mortgages, both made in June 1954, one by Connecticut Savings Bank with FHA insurance and one by Branford Federal Savings and Loan without FHA insurance.

136. Grantee Index to Land Records for 1912-1914 (on file with New Haven Hall of Records). See *supra* note 101 for an explanation of how I made these calculations.

137. Grantee Index to Land Records for 1936 (on file with New Haven Hall of Records).

138. Grantee Index to Land Records for 1954 (on file with New Haven Hall of Records).

139. For example, Prudential Insurance originated about thirty mortgages in 1954, all in the relatively upscale Westville, Whitney Avenue, and Foxon areas of the city. Grantee Index to Land Records for 1954 (on file with New Haven Hall of Records).

140. DOUGLAS W. RAE, CITY: URBANISM AND ITS END 267-68 (2003).

141. These neighborhoods were mainly graded "D" by the HOLC-derived rating system used by the FHA. *Id.* at 269-70.

Table 4.
SAMPLE FHA-INSURED AND CONVENTIONAL MORTGAGES IN NEW HAVEN, 1954¹⁴²

	NEW HAVEN SAVINGS BANK FHA-INSURED MORTGAGE, 147 POND LILY AVENUE	BRANFORD FEDERAL SAVINGS AND LOAN MORTGAGE, 138-40 LOMBARD STREET
Home Purchase Price	\$12500	\$11500
Down Payment	\$2800	\$4000
Loan Amount	\$9700	\$7500
Loan-to-Value Ratio	77.6%	65.2%
Interest Rate	4.5%	6%
Term	20 years	15 years
Monthly Payment	\$61.40	\$63.29

The home on Pond Lily Avenue (near the suburban border) cost more than the home on Lombard Street (in urban Fair Haven), but the buyer of the Pond Lily Avenue home put a lower down payment on the home and paid less per month for a mortgage, because of the lower interest rate and longer term.

The overlapping effect of having some neighborhoods with low-cost mortgages available only to whites (because the FHA would insure them on those terms) and other, FHA-redlined neighborhoods with high-cost mortgages encouraged racial segregation in New Haven, and perhaps many other cities. Buying homes in inner-city neighborhoods became irrational for buyers with access to FHA insurance. Meanwhile, blacks and those who wanted to keep living in older neighborhoods continued to struggle to save for large down payments, and to qualify for loans with shorter terms and thus higher monthly payments. Because most of these families could not afford the substantial down payments, exclusion from the section 203(b) program often meant elimination from the entire housing market.

142. Mortgage from Gilbert C. and Eleanor C. Earl to The New Haven Savings Bank (executed June 21, 1954) (on file with New Haven Hall of Records, Land Records, vol. 1814, p. 393); Mortgage from Benjamin and Kate Beck to Branford Federal Savings & Loan Association (executed June 23, 1954) (on file with New Haven Hall of Records, Land Records, vol. 1814, p. 511). Term, down payment, and LTVR are from my calculations using these records.

IV. ENDING FHA REDLINING: WHY THE REMEDY DID NOT MATCH THE HARM

A. Opening Up Section 203(b)

The FHA ended its racially discriminatory policies gradually. From 1948 to 1962, the FHA moved from active preference for racially homogenous neighborhoods and developments with racial covenants to a supposedly neutral policy of insuring homes whether or not they were open to purchase by blacks. In 1962, President Kennedy issued an Executive Order that took the next step, actively refusing FHA insurance to anyone who would not sell homes to blacks.

In 1948, the Supreme Court held in *Shelley v. Kraemer* that courts could not enforce racial covenants.¹⁴³ If courts could not enforce racial covenants, surely government agencies could not actively use racial covenants as a criterion for deciding where to insure mortgages. But it took the FHA a year to react to *Shelley*. When it did, it announced that its policy would not change until February 15, 1950, giving builders a sufficient amount of time to file covenants and secure FHA insurance for projects already planned.¹⁴⁴

Even after the FHA stopped using race as a direct criterion, it left developers to choose whether they wanted to impose racial restrictions on their own—a practice generally legal and frequently employed¹⁴⁵ until the passage of the Fair Housing Act of 1968.¹⁴⁶ The head of the FHA stated: “The role of the Federal Government in the housing programs is to assist, to stimulate, to lead, and sometimes to prod, but never to dictate or coerce, and never to stifle the proper exercise of private and local responsibility.”¹⁴⁷ In practice, leaving the choice to discriminate to developers produced the same results as explicitly including race as a criterion: Only 2.5% of FHA-insured loans reported in the 1960 census went to nonwhites.¹⁴⁸ And of new homes insured by the FHA

143. 334 U.S. 1 (1948).

144. JACKSON, *supra* note 25, at 208.

145. For example, as late as 1960, “[o]nly one tract of new private housing available for Negro ownership . . . [had] been built in the New Haven area in recent years. It consist[ed] of a few houses . . . in West Haven . . . offered at \$14,900 by a Negro builder.” CHESTER RAPKIN, *THE ECONOMIC FEASIBILITY OF URBAN RENEWAL IN THE DIXWELL AREA: A REPORT TO THE NEW HAVEN REDEVELOPMENT AGENCY* 119 (1960). Legendary builder William Levitt refused to sell to blacks as late as 1963 in his Belair development in Maryland. Geoffrey Mohan, *Levitt’s Defenses of Racist Policies*, NEWSDAY, Sept. 28, 1997, at H18.

146. Civil Rights Act of 1968, Pub. L. No. 90-284, tit. VIII (Fair Housing), §§ 801-819, 82 Stat. 73, 81-89 (codified as amended at 42 U.S.C. §§ 3601-3619 (2000)).

147. Letter from Albert Cole, Adm’r, Hous. & Home Fin. Agency, to Senator Prescott Bush, *in* 102 CONG. REC. 10,746 (1956).

148. CENSUS OF HOUSING: 1960, *supra* note 114, pt. 1, at 10.

from 1949 to 1959, less than 2% were available for sale to nonwhites—and even that paltry number came mainly from all-black developments.¹⁴⁹

One commentator explains the continuation of discriminatory results despite FHA “neutrality” by referring back to the “self-fulfilling prophecy” created by the adoption of Hoyt’s model of neighborhood change by the FHA and other market actors. The longstanding belief among developers, realtors, and homebuyers, backed by the FHA, that racial transition was a harbinger of neighborhood decline induced all these actors to try to keep neighborhoods white. In doing so, they made Hoyt’s false assumption increasingly true.¹⁵⁰ Drawing on Robert Ellickson’s work on the power of social norms, Carol Rose has argued that “[w]hen nudged along by judicial recognition, norms *become* law, in the formal as well as the informal sense.”¹⁵¹ After the FHA had helped establish a norm of racial segregation in housing in its early era of explicit discrimination, it continued to recognize discriminatory housing practices by developers through “neutrally” insuring homes with discrimination clauses, allowing the norm of segregation to continue as law.

President Kennedy finally truly ended redlining in the FHA’s core section 203(b) program by signing Executive Order 11,062 on November 20, 1962.¹⁵² The Executive Order recognized that “discriminatory policies and practices based upon race, color, creed, or national origin now operate to deny many Americans the benefits of housing financed through Federal assistance,”¹⁵³ and directed “all departments and agencies in the executive branch of the Federal Government, insofar as their functions relate to the provision, rehabilitation, or operation of housing and related facilities, to take all action necessary and appropriate to prevent discrimination because of race, color, creed, or national origin”¹⁵⁴ in a series of areas including “loans hereafter insured, guaranteed, or otherwise secured by the credit of the Federal Government.”¹⁵⁵ The action was the only one needed to make the FHA change its underwriting practices,

149. U.S. COMM. ON CIVIL RIGHTS, WITH LIBERTY AND JUSTICE FOR ALL 171 (abr. ed. 1959).

150. LAURENTI, *supra* note 110, at 25-26.

151. Carol Rose, *Property Stories: Shelley v. Kraemer*, in *PROPERTY STORIES* 169, 198 (Gerald Korngold & Andrew P. Morriss eds., 2004).

152. Exec. Order No. 11,063, 3 C.F.R. 652 (1959-1963), *reprinted as amended* in 42 U.S.C. § 1982 (2000) (amended version also includes sex, disability, and familial status as protected classes).

153. *Id.* at 652.

154. *Id.* § 101, at 653.

155. *Id.* § 101(a)(iii), at 653.

because its discrimination resulted from administrative policy, not legislative requirement.¹⁵⁶

Indeed, the FHA dramatically changed its practices, going from making 2.5% of its loans to nonwhites in 1960—far below the rate of the market as a whole—to 12.5% in 1970 and 19.8% in 1980, both far above the rate of the market as a whole.¹⁵⁷ One commentator notes that by 1969, “FHA’s standard mortgage program had become increasingly . . . an active tool of social policy by directing homeownership and affordable private-market rental opportunities to low-income households in inner-city neighborhoods.”¹⁵⁸

B. Why Ending Redlining Was Not Enough

Integrating the section 203(b) program had less impact on the overall housing market in 1969 than it might have had a decade or two earlier. By 1969, the FHA’s market share had fallen from a high of 45% of all new homes financed in the 1940s to just 14%.¹⁵⁹ The FHA’s falling market share reflected private market innovation, enabled by the gradual relaxation of safety-and-soundness requirements. In 1957, the Mortgage Guaranty Insurance Company became the first company to develop a modern system of private mortgage insurance.¹⁶⁰ By the late 1960s, some legislatures removed the statutory distinctions between FHA insurance and private mortgage insurance.¹⁶¹ But others did not, perhaps because these distinctions now mattered little: National and state lenders could make loans regardless of mortgage insurance at increasingly high LTVs and for long terms.¹⁶²

The integration of section 203(b) and the many reforms to the housing market that followed—from the Fair Housing Act of 1968¹⁶³ to the Community

156. The 1934 Housing Act delegated the details of the section 203(b) program to the FHA administrator, simply requiring a basic finding that mortgages were “economically sound.” National Housing Act, Pub. L. No. 73-479, § 203(c), 48 Stat. 1246, 1248-49 (1934).

157. CENSUS OF HOUSING: 1960, *supra* note 114, pt. 1, at 10; CENSUS OF HOUSING: 1970, *supra* note 114, at 77; 5 BUREAU OF THE CENSUS, U.S. DEP’T OF COMMERCE, CENSUS OF HOUSING: 1980, at 24 (1983). For 1970 and 1980, mortgages with no reported data on race are not included in calculations.

158. Kerry D. Vandell, *FHA Restructuring Proposals: Alternatives and Implications*, 6 HOUSING POL’Y DEBATE 299, 320 (1995).

159. *Id.* at 308-09 tbl.1.2.

160. *Id.* at 314 n.6.

161. See *supra* text accompanying note 85.

162. See *supra* Sections II.B-D.

163. 42 U.S.C. §§ 3601-3619 (2000).

Reinvestment Act of 1977¹⁶⁴—put blacks on nearly equal terms with whites in buying a home.¹⁶⁵ But was equal really enough? For three decades, FHA policies, combined with safety-and-soundness regulations, had given strong preference to whites over blacks in becoming homeowners and building assets. To simply level the playing field ignored that in the intervening decades whites had been able to gain wealth and opportunities through homeownership that gave them a distinct advantage over blacks. This advantage may have continued to transfer over time, considering that wealth from homeownership is often passed down from generation to generation,¹⁶⁶ and that homeownership confers strong human capital benefits on children, such as providing access to quality school systems.¹⁶⁷

In addition to the financial and human capital effects of the thirty-year head start that whites had on blacks in accumulating capital through homeownership, the FHA's policies reshaped how Americans conceived of residential segregation. The FHA's acceptance of the Hoyt model of neighborhood change made Americans think of residential segregation as the norm, even though in the early twentieth century that had not been the case.¹⁶⁸ It also made Americans conceive of racial change as leading to a decline in property values, thus inspiring the ubiquitous, panicked selling when blacks started to move into neighborhoods,¹⁶⁹ even though it was not necessarily the case that property values actually declined.¹⁷⁰ While the FHA could have actively challenged the rise of neighborhood segregation in the racial zoning ordinances of the 1910s and 1920s and the pseudoscience of economists like Hoyt, it instead helped institutionalize neighborhood segregation. The harms

164. 12 U.S.C. §§ 2901-2908 (2000).

165. However, serious questions exist about whether these laws as currently enforced sufficiently level the housing market. See, e.g., *WHY THE POOR PAY MORE: HOW TO STOP PREDATORY LENDING* (Gregory D. Squires ed., 2004); Susan Wachter, *Price Revelation and Efficient Mortgage Markets*, 82 *TEX. L. REV.* 413 (2003).

166. See Steven F. Venti & David A. Wise, *Aging and Housing Equity: Another Look* (Nat'l Bureau of Econ. Research, Working Paper No. 8608, 2001), available at <http://www.nber.org/papers/w8608>. Venti and Wise argue that wealth from homeownership is particularly susceptible to intergenerational transfers because elderly people are less likely to divest their housing before death than their more liquid assets. But see Michael D. Hurd, *Bequests: By Accident or by Design?*, in *DEATH AND DOLLARS: THE ROLE OF GIFTS AND BEQUESTS IN AMERICA* 93, 112-13 (Alicia H. Munnell & Annika Sundén eds., 2003) (suggesting that housing may be divested at a rate similar to that of other assets).

167. See, e.g., Nancy A. Denton, *Housing as a Means of Asset Accumulation: A Good Strategy for the Poor?*, in *ASSETS FOR THE POOR*, *supra* note 4, at 232, 234-35.

168. Sander, *supra* note 109, at 876-77.

169. See, e.g., W. EDWARD ORSER, *BLOCKBUSTING IN BALTIMORE: THE EDMONSON VILLAGE STORY* 102-17 (1994).

170. See *supra* text accompanying note 110.

of residential segregation have been well explained.¹⁷¹ Many of these harms can be attributed to the FHA's role in making residential segregation the norm in American culture.

C. Potential Remedies

Simply making FHA insurance available on an equal basis did not undo the past harms caused to blacks who missed out on a generation of wealth-building, nor did it address the ongoing harms caused by the FHA's institutionalization of neighborhood segregation. Several articles, books, statutes, and cases provide ideas for actions that could increase the opportunities available to blacks for access to wealth through homeownership, changes that could help desegregate neighborhoods. I do not claim to offer a full explanation or investigation of such actions, particularly with regard to the issues raised by constitutional limits on affirmative action programs. I simply wish to point out a few actions for which my findings on the combined effect of safety-and-soundness regulation and FHA discrimination may provide additional justification.

To ameliorate wealth disparities in the housing market, Richard Sander has suggested "mobility grants"—direct payments or mortgage subsidies to individual blacks. He suggests that such wealth-building actions could also be used to address neighborhood segregation by offering such grants on a preferential basis to African-Americans "willing to move into predominantly white neighborhoods."¹⁷² Sander mentions the FHA program as critical to making the case for the program's legality under affirmative action doctrine, seeing the grants as "very direct amends for the widespread exclusion of blacks from the federal mortgage subsidies."¹⁷³ My research provides additional justification for Sander's suggestions, as courts or legislators would likely want an explanation for why blacks were not able to access similar opportunities outside the FHA program in order to see that program as sufficient to justify affirmative action.

Payments of the type Sander proposes may be of particular interest to those who support providing reparations to African-Americans. As Keith Hylton has argued, significant barriers may exist to claims based on slavery and other historical injustices, notably the lack of surviving plaintiffs directly injured by

171. See, e.g., DAVID RUSK, *INSIDE GAME/OUTSIDE GAME: WINNING STRATEGIES FOR SAVING URBAN AMERICA* (1999); WILLIAM JULIUS WILSON, *WHEN WORK DISAPPEARS: THE WORLD OF THE NEW URBAN POOR* (1996); john a. powell, *Opportunity-Based Housing*, 12 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 188 (2003).

172. Sander, *supra* note 109, at 928.

173. *Id.* at 930.

the practice and the related difficulty of proving proximate cause in a tort suit.¹⁷⁴ In contrast, the relatively recent timeframe of the discrimination in the section 203(b) program means there are many living people who were directly harmed—indeed, many more people than, for example, in the current litigation over the Tulsa race riot of 1921.¹⁷⁵ My research might help explain (and, through the census data and land records research, quantify) the nature of that harm.

Anti-exclusionary zoning litigation and legislation may also find new support from my research. For three decades, activists and attorneys have attempted to use the courts and the political system to create further housing opportunities in communities with restrictive zoning. These initiatives at least have the potential to undo the pattern of racial residential segregation that the FHA helped create.¹⁷⁶ Notable decisions and actions have included the *Mount Laurel* series of cases mandating that each town in New Jersey provide some level of affordable housing;¹⁷⁷ a Pennsylvania case limiting the ability of towns to zone for large-lot homes;¹⁷⁸ state legislation in Massachusetts allowing developers to sue towns that do not set aside land for affordable housing construction;¹⁷⁹ and local legislation in places from Montgomery County, Maryland to Davis, California giving developers bonus density in exchange for building affordable housing.¹⁸⁰ Courts and legislatures may find additional justification for such actions if they understand that state action provided essential support for residential segregation. In adopting a view of inevitable neighborhood racial change and racial segregation as the norm, the FHA reversed a history of integrated neighborhoods with stable housing values, creating a different reality that continues to influence housing patterns today.

174. Keith N. Hylton, *A Framework for Reparations Claims*, 24 B.C. THIRD WORLD L.J. 31, 38 (2004).

175. This case was recently held to fall beyond the statute of limitations for bringing claims. *Alexander v. Oklahoma*, 382 F.3d 1206 (10th Cir. 2004).

176. *But see* Naomi Bailin Wish & Stephen Eisdorfer, *The Impact of Mount Laurel Initiatives: An Analysis of the Characteristics of Applicants and Occupants*, 27 SETON HALL L. REV. 1268, 1302-03 (1997) (showing that anti-exclusionary zoning programs may benefit poor and middle-class whites more than nonwhites).

177. *E.g.*, *S. Burlington County NAACP v. Twp. of Mount Laurel (Mount Laurel II)*, 456 A.2d 390, 451-52 (N.J. 1983).

178. *Nat'l Land & Inv. Co. v. Kohn*, 215 A.2d 597 (Pa. 1965) (invalidating zoning for minimum density of one house per four acres).

179. MASS. GEN. LAWS ANN. ch. 40B, § 22 (West 2004).

180. *See* RUSK, *supra* note 171, at 184.

CONCLUSION

When the FHA approached Congress and state legislatures in the mid-1930s, it succeeded in getting radical changes to banking safety-and-soundness laws because it had a simple, logical, and basically correct argument: If the FHA promised to make lenders whole in the case of default, it did not matter if the lenders made loans that otherwise would present too great a risk to their financial viability. This Note shows how quickly and how dramatically the FHA was able to get safety-and-soundness regulations changed.

Concurrently, the FHA wholeheartedly adopted a simple, logical, and utterly incorrect argument: Neighborhoods evolve on a predictable continuum from all-white to all-black, and as neighborhoods move along this continuum, home values decline. Even the economist credited with this theory, Homer Hoyt, cautioned that reality was far more complex. But the FHA preferred to see the world through this simple model, perhaps because it provided an apparently neutral justification for the goal of keeping the races segregated as millions of African-Americans left the rural South for Northern cities. This justification, unlike more brazen strokes like racial zoning and later racial covenants, would survive without effective legal change for three decades, until mounting political pressure from the civil rights movement led President Kennedy to reverse FHA policy.

When the FHA's simple and correct argument for safety-and-soundness exceptions was combined with its simple and incorrect argument for racial segregation, African-Americans were denied the opportunities to buy a home in developing suburban neighborhoods and to build the wealth that became the mainstay of the American white middle class. When African-Americans did buy homes, usually using conventional mortgages, they not only tended to pay more in down payments and roughly the same monthly payments when compared with whites using FHA-insured mortgages, but they also got much lower-quality homes. While private insurers might have arisen to offer African-Americans the opportunities denied to them by the FHA, this Note demonstrates that Congress and state legislatures amended safety-and-soundness regulations in a way that disallowed competition with the FHA.

For three decades, the combination of safety-and-soundness regulations and discrimination by the FHA created opportunities to build wealth for whites and not for African-Americans, and made a historically questionable view of racial segregation and neighborhood change the national norm. The changes to the FHA that sprung from Kennedy's Executive Order have failed to adequately address either the past disparity in wealth-building or the ongoing preferences from many market actors for segregated neighborhoods that the FHA helped create. While this Note does not suggest remedies, it does indicate that remedies proposed by others may gain further legal and political support

from understanding the history I describe. I hope that this Note will inspire others to further explore what kinds of actions might help to undo the ongoing harms caused by the combined effect of past safety-and-soundness regulations and FHA discrimination.

APPENDIX

Table 1.

STATE STATUTES WAIVING BANKING REGULATIONS FOR BANKS ORIGINATING FHA-INSURED MORTGAGES, 1935-1937

STATE	CITATION TO LEGISLATION	DATE APPROVED
Alabama	No. 10, § 3, 1935 Ala. Laws 11, 12	Jan. 31, 1935
Arizona	Ch. 19, § 1, 1935 Ariz. Sess. Laws 33; Ch. 21, 231, 1935 Ariz. Sess. Laws 36, 37	Feb. 27, 1935
Arkansas	Act 48, § 1, 1935 Ark. Acts 114, 115	Feb. 18, 1935
California	Ch. 6, § 5, 1935 Cal. Stat. 54, 55	Jan. 30, 1935
Colorado	Ch. 129, § 3, 1935 Colo. Sess. Laws 491, 492	Mar. 7, 1935
Connecticut	Ch. 137, § 1, 1935 Conn. Pub. Acts 350, 350	1935 (no date given)
Delaware	Ch. 150, 1935 Del. Laws 550	Apr. 18, 1935
Florida	Ch. 828, § 3, 1935 Fla. Laws 828, 829	Apr. 26, 1935
Georgia	No. 408, 1937 Ga. Laws 423	Mar. 31, 1937
Idaho	Ch. 127, § 3, 1935 Idaho Sess. Laws 299, 300	Jan. 28, 1935
Illinois	1937 Ill. Laws 426, 428	July 9, 1937
Indiana	Ch. 5, § 25(b)(3), 1935 Ind. Acts 7, 31	Mar. 19, 1935
Iowa	Ch. 98, § 4, 1935 Iowa Acts 130, 131	Apr. 17, 1935
Kansas	Ch. 77, § 3, 1935 Kan. Sess. Laws 121, 121	Mar. 2, 1935
Kentucky	Ch. 11, § 4, 1936 Ky. Acts 35, 37	Feb. 18, 1936
Louisiana	No. 232, § 6, 1936 La. Acts 624, 626	July 9, 1936
Maine	Ch. 2, § 1, 1935 Me. Laws 202, 203	Feb. 7, 1935
Maryland	Ch. 567, § 2, 1935 Md. Laws 1179, 1179	May 17, 1935
Massachusetts	Ch. 162, § 2, 1935 Mass. Acts 155, 155	Apr. 15, 1935
Michigan	No. 2, § 2, 1935 Mich. Pub. Acts 13, 14	Feb. 20, 1935

THE CREATION OF HOMEOWNERSHIP

STATE	CITATION TO LEGISLATION	DATE APPROVED
Minnesota	Ch. 49, § 2, 1935 Minn. Laws 55, 56	Mar. 15, 1935
Mississippi	Ch. 171, § 4, 1936 Miss. Laws 247, 248	Jan. 23, 1936
Missouri	§ 4, 1935 Mo. Laws 366, 377	June 5, 1935
Montana	Ch. 8, § 1, 1935 Mont. Laws 12, 12	Feb. 9, 1935
Nebraska	Ch. 17, § 1, 1935 Neb. Laws 92, 92	Apr. 1, 1935
Nevada	Ch. 58, § 2, 1935 Nev. Stat. 124, 125	Mar. 18, 1935
New Hampshire	Ch. 32, § 2, 1935 N.H. Laws 56, 57	Mar. 26, 1935
New Jersey	Ch. 21, § 3, 1935 N.J. Laws 45, 47	Feb. 5, 1935
New Mexico	Ch. 5, § 2, 1935 N.M. Laws 10, 11	Feb. 2, 1935
New York	Ch. 22, § 1(c), 1935 N.Y. Laws 51, 52	Feb. 8, 1935
North Carolina	Ch. 71, § 5, 1935 N.C. Sess. Laws 78, 79	Mar. 8, 1935
North Dakota	Ch. 94, § 2, 1935 N.D. Laws 101, 102	Mar. 2, 1935
Ohio	1937 Ohio Laws 416	May 12, 1937
Oklahoma	Ch. 46, § 3, 1935 Okla. Sess. Laws 201, 201	Jan. 25, 1935
Oregon	Ch. 150, § 3, 1935 Or. Laws 227, 227	Mar. 4, 1935
Pennsylvania	No. 310, 1935 Pa. Laws 963	July 12, 1935
Rhode Island	Ch. 2205, 1935 R.I. Pub. Laws 180	Jan. 18, 1935
South Carolina	No. 61, § 3, 1935 S.C. Acts 67, 68	Mar. 8, 1935

STATE	CITATION TO LEGISLATION	DATE APPROVED
South Dakota	Ch. 112, § 3, 1935 S.D. Sess. Laws 162, 162	Feb. 7, 1935
Tennessee	Ch. 137, 1935 Tenn. Pub Acts 266	Apr. 19, 1935
Texas	Ch. 9, 1935 Tex. Gen. Laws 26	Jan. 31, 1935
Utah	Ch. 13, 1937 Utah Laws 32	Mar. 11, 1937
Vermont	No. 170, § 1(b), 1935 Vt. Acts & Resolves 172, 172	Mar. 28, 1935
Virginia	Ch. 88, 1936 Va. Acts 134	Feb. 29, 1936
Washington	Ch. 9, § 56(a), 1935 Wash. Sess. Laws 22, 23	Feb. 18, 1935
West Virginia	Ch. 113, § 3, 1935 W. Va. Acts 481, 482	Feb. 25, 1935
Wisconsin	Ch. 45, § 219.03, 1935 Wis. Sess. Laws 73, 74	Apr. 27, 1935
Wyoming	Ch. 99, § 4, 1935 Wyo. Sess. Laws 132, 133	Apr. 27, 1935