

Lessons From FDR's Handling Of the Housing Crisis

by L. Wolfe

1. Introduction

Among the many lies told by the Cheney-Bush Administration is that the policies that have created the now-exploding housing bubble have created the largest spurt in home ownership in the nation's history. While it is true, that in absolute numbers, until this moment of collapse, there are more U.S. homeowners now than ever before, the greatest rate of growth in American homeownership occurred over an approximate 40-year period, ushered in by President Franklin Roosevelt's rescue of the dysfunctional and collapsing housing industry and homeowners under the threat of foreclosure during the 1930s, and ending in the early 1980s with Wall Street's looting and destruction of dedicated credit delivery system established for the housing sector (**Figure 1**).

As you read this, new waves of foreclosures are rippling through the housing sector, whose real product is not homes, but the mortgages for overpriced properties, and the financial paper that has been spun off them. Although these waves of foreclosures have not yet approached the proportions of the disaster faced by FDR—when more than half of all mortgages were in distress and a third in the foreclosure process—the incompetence of those dealing with the problem, including

many well-meaning Democrats, could rapidly push conditions to far worse than those of the 1930s. With this in mind, we explore FDR's approach to the problem, to point to the direction for a solution to our current housing crisis.

2. Facing a Disaster

Much like our recent past, the 1920s were a period of massive speculations of all types, in which such speculative activities masqueraded as "prosperity." During this same period, there was a modest, but important growth in home building and ownership, especially in areas outside cities that were made newly accessible to their urban cores by the automobile.

Home purchases were financed by mortgages issued with five- or ten-year maturities, at 8% interest or higher, depending upon the assessment of risk and asset strength, and requiring down payments of 35% of the purchase price, and a balloon payment at maturity. Then, as now with short-term mortgages or riskier adjustable rate mortgages (ARMs), the homeowner depended on ever-increasing valuations of his property and a stable income stream to secure refinancing.

Until 1927, all home mortgages were issued by non-commercial banks, mostly Savings & Loan associations, because commercial banks were prohibited from such activity. The S&Ls were, in reality, banking cooperatives, in which the depositors were the effective owners, and whose operation depended very much on the local bank officer and bank board, and their ability to make sound judgments.

At the insistence of Wall Street in 1927, the commercial banks, both Federally chartered and state-chartered, were allowed to jump into the lucrative housing market. With greater access to lending capital, such banks made loans at a feverish pace, pushing up the price of housing, especially in the suburban Northeast. In addition, the commercial banks, without roots in the communities, could afford to "cherry pick" mortgages, taking the best prospects away from the S&Ls, which were left with the riskier loans.

When the Coolidge-Hoover financial bubble burst in the 1929 Crash, the housing sector imploded, mostly on the S&Ls. Widespread unemployment left many homeowners unable to roll over their short-term mortgages when the balloons came due. Meanwhile, the

FIGURE 1
U.S. Home Ownership Rate, 1900-2006



Source: U.S. Census Bureau

deflation drove down property values to a fraction of the value of mortgages.

For a while, the S&Ls, especially in the rural areas and small towns, tried to postpone foreclosures; but, with their small asset-base, which was dependent on people's savings accounts, they were unable to absorb the losses, and the foreclosures began. At the same time, the larger commercial banks pulled back on their lending, and the housing industry collapsed in a heap, with foreclosures ultimately threatening *half* of all homeowners, and even more in rural areas hardest hit by deflation.

The S&L banker was caught in a self-destructive cycle: Strapped for operating capital, he was forced to turn on the only real source of his potential prosperity, his mortgagees: The more foreclosures, the lower property prices fell, and the more the banker lost against his loans; the more his mortgagees suffered, the worse the condition of the bank.

There were some 16,000 S&Ls serving an equal number of communities at the start of the Great Depression in 1929; by the end of 1932, more than 1,700 had closed their doors, with another 5,000 threatening to do the same. In many of those communities, all lending and credit issuance had ceased; economic activity was grinding to a halt.¹

Before the crash, more than 5,700 new mortgages were being issued by all lenders each year; by 1933, that number had fallen to less than 900.²

As foreclosures rose among homeowners, so did the number of evictions for urban tenants. Rental prices had been high throughout the 1920s; they did not drop appreciably with the onset of the Depression, even as the incomes of the tenants fell precipitously. And with the rise in evictions, came the rise in urban homelessness and the shanty towns of cardboard houses. It was estimated that by 1932, the number of those either ill-housed or homeless amounted to more than one-third of the nation—a figure that FDR would cite as a basis for his attack on poverty during his Administration. For the President knew, that no civilized nation could long survive with so many of its citizens suffering this way.

3. Developing an Approach

During his 1932 campaign, FDR repeated a pledge that, if elected, he would do something about the foreclosure and housing crisis. The foreclosures had to be stopped, he said, without tipping his hand on how he would accomplish this. Some time between the election and the March 1933 inauguration, a strategy emerged. As with many FDR "strategies," it was not focussed on one particular program or plan, but in multiple approaches that the President hoped were complementary and would be effective.

All the approaches were, however, unified around a set of



FDR Library

During his 1932 campaign, FDR pledged that, if elected, he would act to stop the mass foreclosures of homes and farms. By the time of his March 1933 inauguration, a strategy emerged. The President is shown here giving one of his famous Fireside Chats.

principles, which defined FDR's understanding of the relationship between housing and the economy:

1. What was important was the physical home and the homeowners—the families—who occupied dwellings, not the monetary values of either the property or financial paper that secured it. The financial paper and the speculation around it were crushing both the home and the homeowner; balance had to be restored, and the speculative, inflated values of mortgages written down.³

2. The government would not bail out the old mortgages, but would instead move to take pressure off the homeowner, by underwriting and insuring new mortgages issued at low rates appropriate to such Federally insured paper. This would take pressure off the banks and halt the foreclosures.⁴

3. Credit is what makes the housing sector go, and the community-based credit-issuance system of the S&Ls as dedicated lenders for home mortgages had been destroyed by allowing the predator commercial banks into the henhouse. The commercial banks had to be thrown out of the market and kept out, while a Federally regulated and insured S&L system had to be reborn and expanded.

4. This reform of housing credit had to be accomplished in the context of an overall government-directed reform and control of the credit markets and banking. Only the government could force this reorganization; to assume that the banks would, of their own free will, do it themselves, was ludicrous. In their world, the people with power and money, keep their money and steal from anyone they can; that is why they

1. Thomas Marvell, *The Federal Home Loan Bank Board* (New York: Praeger, 1969).

2. *Ibid.*

3. Gail Radford, "The Legacy of New Deal Housing Reform," Speech at Roosevelt University, Oct. 31, 1999.

4. *Ibid.*

would, sooner or later, once again destroy the thrifts, unless the government prevented it.

5. FDR was under pressure from his advisors to initiate a massive government-sponsored home-building program to create jobs and stimulate the economy. While Roosevelt supported such programs in cases where the private sector wouldn't do the job, he thought the private sector was perfectly capable of doing the job; it merely needed to be steered in the right direction: The key was the provision of credit, and the key to the provision of credit, was the S&Ls. As long as government regulators protected the S&L bankers, then FDR realized that the worst urges of the commercial banks could be, if not totally quelled, at least kept to manageable proportions.⁵

6. Despite the cries from many quarters for a foreclosure moratorium to be declared or enacted by the Federal government, FDR saw no real need for one. Provided the banks were placed under Federal supervision (as they were under the "Bank Holiday"), and provided steps were taken to rewrite mortgages for the long term (20-30 years) and have them Federally insured, the waves of foreclosure could be broken, without what he thought was legally dubious legislation.⁶

4. What FDR Did

A key component of what was to emerge as President Roosevelt's housing program was borrowed from a structure established towards the end of the Hoover Administration. With bipartisan backing, Hoover had pushed through Congress the Federal Home Bank Act of 1932, which created the Federal Home Loan Bank Board (FHLBB), to supervise and regulate the activities of the thrift sector. But Hoover seemed to be leaning toward using the structure to administer a Federal bailout of bad loans, which FDR would have none of. In his eyes, such an action would merely bail out the financial paper, while correcting none of the problems that created the crisis.

In his inaugural address, Roosevelt promised swift and bold action to halt the spreading foreclosures and to deal with the crisis in the banking sector, of which the S&L crisis was no small part. That action was to come immediately, with the

5. *Ibid.* While FDR held these views at the start of the New Deal, toward the end of World War II, he began to favor more aggressive government intervention, especially in blighted urban areas.

6. Randall R. Rucker and Lee J. Alston, "Farm Failures and Government Intervention: A Case Study of the 1930s," *American Economic Review*, Vol. 77 (1987). While our report focusses on non-farm housing, most of the impetus for foreclosure moratoria came from the farm sector. Although the actions we discuss halted most the foreclosures in that sector as well, the populist impulses sought greater safety and led to the passage, in more than 20 states, of anti-foreclosure legislation. The only Federal action, the initial 1935 passage of the Frazier-Lemke Farm Foreclosure Act, led to the courts overturning the legislation and it being more narrowly redrafted. Meanwhile, through the Agricultural Adjustment Administration, funding mechanisms were established to buy up, rewrite, and insure threatened mortgages.



Library of Congress

FDR vowed to address the needs of a nation he famously described in 1936 as "ill-clothed, ill-housed, and ill-fed. Too many Americans were living in substandard housing, such as this "Hooverville," in central Ohio (photo by Ben Shawn).

enactment of a bank holiday, under a Presidential declaration of emergency, later to be affirmed by the Congress. The entire banking system was essentially placed under Federal supervision, with the idea that it would be reorganized, with bad loans written off and certain harmful practices halted, one of which was foreclosures.

This prevented matters from getting worse for homeowners, but offered no long-term prospect of a solution. To accomplish the latter, FDR's people redefined the role of the FHLBB, and in June 1933, through the Home Owners' Loan Act, gave it a new agency to administer—the Home Owners Loan Corporation (HOLC).⁷ With most, if not all S&Ls, even those operating and open for business, still under Federal supervision, the HOLC was given the power to market more than \$2 billion in government bonds to purchase delinquent mortgages from the S&Ls before they went into default.⁸

If that was all it did, then the HOLC would have become the bailout agency for the banks that was desired and proposed by the Hoover people. But, under FDR's mandate, the new agency now turned around and offered direct aid to the beleaguered homeowners, whom the banking industry would have cut off from credit. The HOLC offered fully amortized mortgages, in 20- and 30-year terms, at a rate lower than their existing mortgages, with flexible initial payment terms. Beyond that, again under direct orders from Roosevelt's people, the HOLC loaned homeowners additional cash, also over the long term, at very favorable rates to meet crises, including the payment of local taxes.

Every loan situation was handled by the HOLC on an individual basis, with its agents making personal visits and

7. Kristin Crossney and David Bartelt, "The Legacy of the Home Owners Loan Corporation," in *Housing Policy Debate 16*, Fannie Mae Foundation, 2005.

8. *Ibid.*

helping clients organize their lives. Acting from the perspective that the only real basis for repayment came from the ability of the client and his family to survive and prosper, the agents used their wide discretionary powers to help clients find work, to collect insurance claims and pensions, to attract tenants for rentals, to qualify for public assistance, and even to locate foster children that could be taken in for a fee.

Most HOLC mortgages were offered at the then-unheard-of rate of 5% or less, up to 80% of the assessed value, which often meant rewriting loans for more than the original amount of the imperiled loans. They were directed mostly at single-family homes (although technically, its loans were available to units housing up to four families), with values under \$20,000.⁹

One year after it opened for business, the HOLC, which was allocated \$200 million by Congress as start-up capital, with the authority to issue \$2 billion in government-backed, tax-exempt bonds, received applications from 40% of all mortgage holders, and accepted half of them. As FDR had intended, the main beneficiaries of HOLC activity were people with incomes of between \$50 and \$150 per month—people who, had they been left to the private market, would have lost their homes. By establishing that government loan assistance must go to the people who needed it the most, and not to those deemed “good risks” by insurance companies and commercial bankers, the HOLC helped FDR re-establish the banking principles that he had seen the S&L community bankers practice to great effect.¹⁰

Despite being widely criticized by Wall Street, the HOLC remains a remarkable success story. Its loans, including mortgages which Wall Street bankers thought unwritable, had the same minimal failure rate as the “prime rate” loans issued by those banks to its best customers.

By 1936, when, by order of Congress, it stopped new lending, the HOLC had written and held more than 1 million mortgages, valued at more than \$1 billion. The HOLC’s actions, which took troubled loans off the books of the S&Ls and rewrote them, laid the basis for the rebirth of a reinvigorated S&L system, with its mission redirected as a dedicated lender for new housing. Most of the HOLC lending had been directed at stabilizing the loan market and blocking foreclosures on existing loans; the S&Ls were charged with writing new loans for new housing to expand the homeownership rates, which had declined marginally from around 48% to

9. *Ibid.*

10. *Ibid.* Perhaps the best image of this “community banker” was to be found in the 1946 Frank Capra movie, “It’s a Wonderful Life,” in which the typical S&L banker is played by Jimmy Stewart. The story focusses on the banker, faced with the inability to pay his depositors and shareholders, who, despairing, considers taking his own life at Christmastime. He doesn’t, when an angel shows him what the world would have been like without him and his role as the community’s banker. As he comes to his senses, he and the bank are rescued by the goodwill and financial collections of his depositors.

43% between 1930 and 1934.¹¹

To set this process in motion, Congress passed the National Housing Act in 1934. The Act created the National (later Federal) Housing Authority, which had the power and authority to issue full insurance for home mortgages, and the Federal Savings and Loan Insurance Corporation (FSLIC), which through the issuance of Federally guaranteed bonded debt, would guarantee all deposits, then, up to \$5,000, in S&Ls. Roosevelt had championed the concept of deposit insurance as a means to restore confidence in the banking system and bring the money back from under people’s mattresses and back into banks, where it could be prudently loaned. Wall Street, for its own purposes, had backed FDR’s early creation of the Federal Deposit Insurance Corporation (FDIC), to insure the deposits of the banks in the Federal Reserve system; these same banks balked at supporting the same treatment for S&Ls, when it became clear that, thanks to FDR’s bank regulations, the big banks and commercial banks were going to be frozen out of the soon to be profitable again home lending business.

The reopened S&L industry took its mission to heart, writing new loans in the same way that the HOLC had handled the old debt, with concern for the individual and his family, and with renewed sense of community. What started emerging in 1936, was a fully Federalized S&L system, under the overall direction of the FHLBB, with branches of the Federal Home Loan Bank in regions across the country, owned by the S&Ls, that cleared the paper of these institutions, much as the Fed did for the commercial banks with its reserve banks.

The President and his Fed chief, Marriner Eccles, urged the creation of a private re-lending corporation, which would issue bonds and take in the now Federally insured mortgages, and thereby provide new capital for the S&Ls to re-lend. The creation of such an institution was authorized in the 1934 legislation that created the FHA, but the commercial banking interests made it clear that they weren’t interested in helping. By 1938, with the capital needs of the S&Ls growing, Roosevelt and Eccles could wait no longer, and they created the Federal National Mortgage Administration or as it is more commonly known, Fannie Mae. It is important to note that Fannie Mae was supposed to hold those mortgages, and collect on them as due; it was not supposed to market them to other banks, except under specific limited circumstances, and it was never supposed to be allowed to bundle them for resale or worse, to market the bundled mortgages as securities.¹²

With the government creation of Fannie Mae, FDR’s dedicated credit stream for the housing market was complete. As Figure 1 indicates, this credit system, anchored by the community bankers of the S&Ls, poured billions of dollars

11. *Ibid.*

12. “Government Sponsorship of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation,” (Washington, D.C.: U.S. Department of Treasury, 1996).

into the housing market, producing a spectacular, more than 30-year growth in homeownership, while keeping the housing market insulated from speculation, and prices relatively stable (absent inflation).

5. Destroying FDR's Dedicated Lending Program

Wall Street never accepted, nor could it ever accept the principle that the Federal government could create and supervise a dedicated housing lending system. However, with FDR's great popularity, while he was alive the bankers were reduced to carping on the sidelines, and criticism of the occasionally inefficient administration of what were generally popular programs.

It is clear from initiatives taken towards the end of World War II—such as the “Economic Bill of Rights,” which identified the right to decent, affordable housing as a basic human right, and the “GI Bill of Rights,” which authorized the provision of funds to make homeownership more accessible to returning servicemen and women by offering a VHA-administered program that would subsidize and reduce down payments on new home purchases—that Roosevelt remained committed to using government-directed credit to expand housing opportunity. However, while the VHA program went forward and programs for public housing committed to before FDR's death were fulfilled, no expansion took place.

FDR's legacy remained the dedicated credit mortgage system, anchored by the S&Ls; it was that system that Wall Street targeted, becoming ever more relentless as the time and emotional distance from the New Deal and the Great Depression grew. For example, there was widespread belief in the widely circulated charge, more recently thoroughly discredited, that the HOLC, and indirectly, the S&L mortgage system, were responsible for racially inspired lending that red-lined and destroyed America's inner cities.¹³

By the late 1960s, despite its great success, the final assault on the S&L system was launched, aimed at its destruction. The first, small but significant step, was taken when the Johnson Administration's Comptroller General required the Bureau of the Budget to count the scores of billions of dollars of mortgages held by Fannie Mae as a government expense and liability, rather than an asset; this, despite the fact that failure rates on these loans were minuscule. The action immediately ballooned the Federal budget deficit in the middle of

Johnson Administration's escalation of the Vietnam War. The President's advisors urged him to spin off Fannie Mae as a government-sponsored quasi-private entity, owned by shareholders, and with a small but symbolic line of credit direct from the U.S. Treasury. This set Fannie Mae, which could now lend to any mortgage lender/broker, effectively in competition with the S&Ls that it had been created to serve.

Under the Nixon Administration, this split-off of what had been a dedicated re-lending agency for the S&Ls, into a private competitor for the same market, was formalized, and in 1972, a Milton Friedman-inspired scheme created a new re-lending agency, the Federal Home Loan Mortgage Corporation, or as it is more commonly known, “Freddie Mac.” The Friedmanite new wrinkle to the process is that “Freddie” was allowed to purchase loans and resell them in the markets, thus opening the housing lending market to “securitization.”¹⁴

Fannie and Freddie soon supplanted the S&Ls as the principal mortgage lenders, as funding mortgages through loosely regulated mortgage brokers became the “quick and dirty” route to mortgage lending, rather than trying to mobilize deposits, as the highly regulated S&Ls did. Where the S&Ls long-term-fixed-rate, government-insured mortgages were once the “gold standard” of bank assets, the S&Ls soon found themselves in a deliberately set up competitive vice, in which their assets were declared by an insane market to be liabilities. When interest rates fell, borrowers refinanced their mortgages with the cutthroat low-rate lenders, taking assets away from the S&Ls; when interest rates rose, S&L depositors demanded higher rates or dividends on their money, threatening to take, and often taking their money elsewhere; to keep depositors, the S&Ls now paid more money out than they were taking in on their mortgages—a surefire ticket to banking oblivion.

Starting in the mid- to late-1970s, the cry came up for the total dismantling of the now “obsolete” S&L dedicated lending system, including in the Fred Hirsch book for the Council on Foreign Relations' “1980s Project,” which included the end of the S&L system as part of its proposed “controlled disintegration” of the financial system. The new Fed chairman Paul Volcker, implementing the Hirsch thesis, jacked up interest rates to stratospheric levels in excess of 20%, and the S&Ls now were induced to demand the end to the legislation that made them different from other banks, thus asking for their own ultimate extinction.¹⁵ With support from many S&Ls, the Congress passed the 1980 Depository Institutions Deregulation and Monetary Control Act, which laid out steps towards the total elimination controls on interest rates that banks and S&Ls could pay, and authorized S&Ls to take on checking accounts: FDR's dedicated lending system had been kicked to the side of the road, soon to become

13. Crossley, *Op cit.* This extensive study of HOLC records concludes that, while the risk assessment maps that marked in red (hence, red-lining) districts where loans were riskier, certainly existed, there is no evidence that the HOLC applied racial or other criteria in its lending, and that the maps were not circulated to other financial institutions. The restrictions in lending in those areas were a product of more generalized practices among lenders, which the HOLC did not correct. Perhaps an even more important, if in some quarters, unintended effect of policies stressing single-family homeownership, was that after the war, this lending helped bring about the growth of suburban sprawl.

14. *Op cit.* Fannie Mae Foundation.

15. Fred Hirsch, Michael W. Doyle, and Edward L. Morris, “Alternatives to Monetary Disorder,” Council on Foreign Relations, Project 1980s (New York: Magraw Hill, 1978).



National Archives



Stuart Lewis

As in the 1930s, today we are faced with new waves of foreclosures, which can only be stopped by placing the entire banking system under Federal supervision, for purposes of reorganization. But it will take the kind of leadership and political will that FDR exemplified for his time, and that Lyndon LaRouche can provide today.

banking “road kill.”

Deregulated, and now in competition with Wall Street’s banks and others, the S&Ls soon became insolvent. Wall Street moved in for the kill by kicking open the doors of the S&L industry to some of the more sleazy members of the banking profession, while stuffing down the throats of the desperate S&Ls, high-yield financial “toxic waste” such as junk bonds and speculative real estate developments. The FHLBB, now under the control of Heritage Foundation-type deregulators, sanctioned by the Garn-St. Germain Act, allowed for accounting shenanigans that avoided the recognition of losses, and allowed for the wild expansion of asset bases even as the S&Ls plunged deeper into insolvency. New sleaze-balls and outright crooks borrowed money to purchase bankrupt S&L charters, thinking that the Federal guarantees on what remained of their mortgage base and accounts meant, no matter what mess these crooks created, that the government would bail them out.

While the most noxious of these crooks were sent to jail, this amounted to a coverup of what had actually happened—a vendetta against President Roosevelt’s S&L home-lending system and its principle of regulated, dedicated lending, had destroyed a workable system. All that remained was for its carcass to be sold off, with taxpayer help, to the banks who had let loose this destruction. That was handled through the so-called Resolution Trust Corporation, following a script written for it in 1985 by the Heritage Foundation to put the obsolete S&Ls out of their misery.¹⁶

By 1987, with the S&Ls at death’s door, the way was cleared for the new Fed chairman, Ayn Rand cultist Alan Greenspan, to unleash the greatest debt-farming scheme in history, using mortgage-backed bundled securities to flood

the housing market with wave upon wave of speculative credit, jacking up the price of housing, and creating the housing bubble which is now collapsing. None of that would have been possible in the regulated climate for housing and the dedicated lending system created by FDR.¹⁷

6. What Needs To Be Done

Lyndon LaRouche has repeatedly argued that we must go back to things that worked in our former financial system, and one of those things was, most decidedly, the dedicated lending system that President Franklin D. Roosevelt created, anchored by the S&Ls.

We will need to reorganize the entire banking system, but when we do

that, we must remove all the flotsam and jetsam now known as “mortgage lenders” or “mortgage brokers,” and reestablish something resembling the dedicated and highly regulated lenders of FDR’s S&L system. We should, as Roosevelt did, keep Wall Street and its commercial banks out of the mortgage business. This means also restoring a community-based banking system, as the key decision-making mechanism on mortgage lending.¹⁸

Right now we are faced with waves of foreclosures, in part triggered by the unscrupulous lending practices of the post-S&L era. The foreclosures will be immediately stopped by placing the entire banking system under Federal supervision, for the purposes of reorganization. In that process, we will rewrite mortgages and establish benchmarks and fair prices for housing, based upon appropriate regional and other considerations, and pegging mortgages to this. There will be, as FDR demanded, no bailout of banks or bankers, but help will be given to homeowners to acquire fair, Federally insured mortgages, of a 30-year, fixed-rate type. All short-term lending, and variable-rate mortgages, will be eliminated by regulatory decree. A new HOLC, using government credit to provide capital for this vast underwriting task, would be helpful, as was the former version, in a similar, if less dire situation, some 60-odd years ago.

The time has come to fulfill Franklin Roosevelt’s promise that no one in this nation, no family or individual, should live in substandard housing, and no one should be forced to pay the banks or landlords their pound of flesh to do so.

17. See Richard Freeman, “U.S. Mortgage Crisis Can Trigger Collapse of the Global Casino,” *EIR*, March 23, 2007.

18. See the transcript of Lyndon LaRouche’s March 7 address to an international webcast, titled, “Implications of the Gore Hoax for International Policy,” *EIR*, March 16, 2007. The video and audio are available at www.larouchepac.com.

16. Bert Ely, “Confronting the Savings and Loan Industry Crisis,” paper drafted for the Heritage Foundation, Aug. 13, 1985.